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SECURITIES REGULATION

SEC Could Take Further Actions to Help Achieve Its FINRA Oversight Goals

Accessible Version

Contents

Letter	1
Background	5
FSIO Reviews of FINRA Included Statutorily Specified Areas and Typically Identified Deficiencies That Resulted in Proposed Corrective Actions	8
FSIO Performance Measures Do Not Reflect Leading Practices and It Lacks Certain Procedures for Using Information from Oversight Activities	11
Conclusions	18
Recommendations for Executive Action	19
Agency Comments and Our Evaluation	19
Appendix I: Objectives, Scope, and Methodology	21
Appendix II: Comments from the Securities and Exchange Commission	25
Text of Appendix II: Comments from the Securities and Exchange Commission	27
Appendix III: GAO Contact and Staff Acknowledgments	29

Tables

Table 1: FSIO Fiscal Year 2021 Strategic Goals	6
Table 2: FSIO Fiscal Year 2021 Objectives	6
Table 3: FSIO Oversight of FINRA by Areas Identified in Section 964 of the Dodd-Frank Act, Fiscal Years 2018–2020	9
Table 4: FSIO Performance Measures	13

Abbreviations

Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
Exchange Act	Securities Exchange Act of 1934
FINRA	Financial Industry Regulatory Authority, Inc.
FSIO	FINRA and Securities Industry Oversight
SEC	Securities and Exchange Commission

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December 15, 2021

The Honorable Sherrod Brown
Chairman
The Honorable Patrick Toomey
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 securities industry is generally regulated by direct Securities and Exchange Commission (SEC) regulation and industry self-regulation with SEC oversight. Self-regulatory organizations, such as national securities exchanges and associations, perform much of the day-to-day oversight of the securities markets. SEC oversees self-regulatory organizations to ensure they carry out their regulatory responsibilities—for example, by conducting examinations to improve compliance, prevent fraud, monitor risk, and inform policy.

The Financial Industry Regulatory Authority, Inc. (FINRA) is a self-regulatory organization registered with SEC as a national securities association. All securities broker-dealers doing business with the public in the United States—more than 3,400 firms with approximately 620,000 brokers—must be registered with FINRA.¹ FINRA writes rules to govern these firms and their representatives, and examines for and enforces broker-dealer compliance with FINRA rules and federal securities laws. FINRA conducts market surveillance on all U.S.-listed and over-the-counter equities as well as U.S.-listed options. FINRA also provides

¹The Securities Exchange Act of 1934 defines a broker as any person engaged in the business of effecting transactions in securities for the account of others, and a dealer as any person engaged in the business of buying and selling securities for his or her own account, through a broker or otherwise. 15 U.S.C. § 78c(a)(4)(A) and 15 U.S.C. § 78c(a)(5)(A). A broker or dealer doing business with the public must be registered with a national securities association. As FINRA is the only national securities association for the securities industry, all brokers or dealers doing a public business must be a FINRA member.

regulatory services such as market surveillance, compliance examinations, and enforcement to securities exchanges. Given the scope of FINRA's regulatory responsibilities, ensuring that it carries out these responsibilities is critical to SEC's mission to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Section 964 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) includes a provision for us to evaluate SEC's oversight of national securities associations registered under Section 15A of the Securities Exchange Act of 1934 (Exchange Act), a provision that currently applies to FINRA.² Specifically, Section 964 identifies 10 aspects of SEC's oversight of FINRA for our review:³

1. Governance of FINRA, including the identification and management of conflicts of interest.
2. Examinations performed by FINRA, including the expertise of examiners.
3. Executive compensation practices of FINRA.
4. Arbitration services provided by FINRA.
5. Reviews performed by FINRA of advertising by its members.
6. Cooperation with and assistance to state securities regulators by FINRA.
7. Use of funding to support FINRA's mission, including the methods and sufficiency of funding, how FINRA invests funds pending use, and the impact of these aspects on FINRA's regulatory enforcement.
8. Policies on the employment of former employees of FINRA by regulated entities.

²Pub. L. No. 111-203, § 964(a), 124 Stat. 1376, 1910 (2010) (codified at 15 U.S.C. § 78d-9(a)). The National Futures Association is also registered as a national securities association, as specified in Section 15A(k) of the Exchange Act, but only for the purpose of regulating activities of National Futures Association members registered as brokers or dealers in security futures products under Section 15(b)(11) of the Exchange Act. Because the Commodity Futures Trading Commission is the association's primary regulator (SEC has limited direct oversight of the association), we do not consider the association to fall under the Section 964 provision to evaluate SEC oversight of national securities associations.

³Section 964 also states we may include any other issues that have an impact, as determined by the Comptroller General, on the effectiveness of such national securities associations in performing their mission and in dealing fairly with investors and members.

9. Effectiveness of FINRA rules.

10. Transparency of FINRA governance and activities.

Section 964 also specified that we were to conduct an initial review no later than 2 years after the enactment of the Dodd-Frank Act and every 3 years thereafter. We issued reports in 2012, 2015, and 2018.⁴ The first report examined how SEC conducted oversight of FINRA and planned to enhance such oversight, the second report included an examination of SEC's implementation of a risk-based framework for overseeing FINRA, and the third reviewed SEC guidance for examining FINRA and evaluated SEC inspections of FINRA's governance.

This report generally focuses on SEC's use of inspections and examinations to oversee FINRA. Specifically, this report (1) determines the extent to which SEC oversight of FINRA operations and programs since fiscal year 2018 included the 10 areas specified in Section 964 of the Dodd-Frank Act, and (2) assesses SEC's use of inspection and examination findings to help achieve its FINRA oversight goals.

This report is a public version of a sensitive report we issued on July 29, 2021.⁵ The sensitive report's first objective included information on the results of SEC's FINRA oversight activities. SEC determined that some of this information was confidential supervisory information. Thus, this public report omits certain information related to the (1) subjects of SEC's inspections and examinations of FINRA, (2) findings of these reviews, and (3) corrective actions proposed by FINRA in response to these findings. SEC also determined that certain information in our second objective on how SEC uses inspection and examination findings was sensitive because it was confidential supervisory information. Thus, this report omits certain information on SEC's use of inspection and examination findings to inform future reviews and assess FINRA's corrective actions and omits certain references to SEC policies and procedures. We also removed one appendix with information on the subjects of SEC's inspections and examinations of FINRA in fiscal years

⁴GAO, *Securities Regulation: Opportunities Exist to Improve SEC's Oversight of the Financial Industry Regulatory Authority*, [GAO-12-625](#) (Washington, D.C.: May 30, 2012); *Securities Regulation: SEC Can Further Enhance Its Oversight of FINRA*, [GAO-15-376](#) (Washington, D.C.: Apr. 30, 2015); and *Securities Regulation: SEC Inspections of Financial Industry Regulatory Authority's Governance Were Consistent with Internal Guidance*, [GAO-18-522](#) (Washington, D.C.: July 18, 2018).

⁵GAO, *Securities Regulation: SEC Could Take Further Actions to Help Achieve Its FINRA Oversight Goals*, [GAO-21-576SU](#) (Washington, D.C.: July 29, 2021).

2018–2020. Although the information provided in this report is more limited, it generally addresses the same objectives and uses the same methodology as the sensitive report.

For the first objective, we requested and reviewed inspection and examination case file materials for the 69 reviews of FINRA (13 program inspections, 11 thematic oversight examinations, and 45 single oversight examinations) that SEC completed from fiscal year 2018 through 2020. These materials included documents such as the scoping memorandum, exit outline, closing letter to FINRA, FINRA response to the closing letter, the closing memorandum, and documentation of SEC follow-up on review findings. To determine the extent to which these reviews reflected Section 964 areas, we reviewed SEC documentation associated with a program inspection. We compared our results to SEC’s own coding of these reviews and requested additional documentation to resolve any differences.

To describe SEC findings from its FINRA oversight activities and associated FINRA responses and corrective actions, we created a data collection instrument to review each examination and inspection case file. This data collection instrument captured information on findings and associated corrective actions.

For the second objective, we reviewed agency documentation, policies and procedures, and examination guidance; and interviewed agency officials. To determine how SEC evaluated the outcomes of its reviews of FINRA, we analyzed performance measures and determined the extent to which they reflected leading practices identified or established in previous GAO work.⁶ To determine the extent to which SEC tracked review findings and corrective actions, we reviewed the agency’s tracking documentation and associated policies and procedures. To determine how review findings were communicated within SEC and to FINRA, we reviewed policies and procedures and assessed the extent to which SEC used all its available reporting tools in its oversight of FINRA. For more information on our scope and methodology, see appendix I.

⁶See GAO, *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: June 1, 1996); *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, [GAO-03-143](#) (Washington, D.C.: Nov. 22, 2002); and *Defense Logistics: Improved Performance Measures and Information Needed for Assessing Asset Visibility Initiatives*, [GAO-17-183](#) (Washington, D.C.: Mar. 16, 2017).

We conducted this performance audit from June 2020 to July 2021 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. We subsequently worked from August 2021 to November 2021 to prepare this public version of the original sensitive report. This public version also was prepared in accordance with those standards.

Background

Framework for Oversight of FINRA

SEC oversees FINRA through its Division of Trading and Markets and its Division of Examinations. The Division of Trading and Markets oversees FINRA's rulemaking process and reviews and approves FINRA's rules. The Division of Examinations administers SEC's nationwide examination and inspection program for registered self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. The Division of Examinations' mission is to protect investors; ensure market integrity; and support responsible capital formation through risk-focused strategies that (1) improve compliance, (2) prevent fraud, (3) monitor risk, and (4) inform policy. SEC uses the results of the division's oversight activities to inform rule-making initiatives, identify and monitor risks, improve industry practices, and pursue misconduct.

Individual groups in the Division of Examinations have oversight responsibility for the various registered entities. The FINRA and Securities Industry Oversight (FSIO) Program within the division performs reviews of FINRA and the Municipal Securities Rulemaking Board, a self-regulatory organization for the municipal securities market. FSIO and the division's mission is to improve compliance, prevent fraud, inform policy, and monitor risk.

FSIO has developed strategic goals and objectives relating to its mission (see tables 1 and 2), and reviews them annually. The strategic goals describe types of program activities.

Table 1: FSIO Fiscal Year 2021 Strategic Goals

Develop risk-based priorities to use FSIO's limited resources effectively
Conduct integrated and risk-based oversight examinations and programmatic inspections
Review FINRA- and MSRB-related tips, complaints, and referrals
Monitor and surveil FINRA and MSRB
Maintain national staff proficiency across all aspects of FINRA and MSRB oversight
Effectively inform stakeholders of regulatory issues, trends, and developments

Legend: FINRA = Financial Industry Regulatory Authority, Inc.; FSIO = FINRA and Securities Industry Oversight; MSRB = Municipal Securities Rulemaking Board

Source: Securities and Exchange Commission. | GAO-22-105367

FSIO's objectives for implementing the strategic goals focus on completing activities in furtherance of its mission, such as inspecting or examining significant functional areas at FINRA, executing an annual examination plan, and conducting monitoring meetings.

Table 2: FSIO Fiscal Year 2021 Objectives

Conduct periodic monitoring meetings with FINRA and MSRB
Inspect or examine significant functional areas of FINRA and MSRB using a risk-based approach
Execute FSIO's annual, risk-based inspection and examination plan
Maintain examiner proficiency and expertise in all areas of FSIO's oversight function

Legend: FINRA = Financial Industry Regulatory Authority, Inc.; FSIO = FINRA and Securities Industry Oversight; MSRB = Municipal Securities Rulemaking Board

Source: Securities and Exchange Commission. | GAO-22-105367

According to FSIO officials, the office annually develops its FINRA oversight priorities using a risk-based planning approach, which involves consulting with relevant stakeholders and FSIO staff, and considering resource constraints, ongoing activities, and the findings of previous examinations. As part of its planning process, FSIO considers the 10 areas identified in Section 964 of the Dodd-Frank Act. This process results in an annual inspection and oversight examination plan that describes FSIO's oversight activities.

FSIO performs five main categories of oversight activities:

- **Program inspections** review FINRA operations and program areas. For example, fiscal year 2020 inspection topics included areas identified in Section 964 such as FINRA governance and former FINRA employees.

- **Thematic oversight examinations** review particular regulatory areas across a number of FINRA member firm examinations.
- **Single oversight examinations** review specific examinations that FINRA conducted of member firms. FSIO typically initiates an oversight examination based on a referral from the Division of Examinations' Broker-Dealer and Exchange Examination Program, other offices in SEC, or the Tips, Complaints, and Referrals system (outside sources). Referrals from the Broker-Dealer and Exchange Examination Program constitute the basis for the majority of FSIO's single oversight examinations. For example, referrals result when an examination of a broker-dealer uncovers deficiencies that FINRA potentially should have identified during one of its examinations.
- **Tips, complaints, and referrals** are allegations or statements of concern about possible violations of securities laws or risky conduct received by SEC. FSIO reviews FINRA-related tips, complaints, and referrals by evaluating facts and circumstances, conducting research, and assessing the underlying issue. The reviews may result in FINRA inspections or examinations or be used for inspection planning purposes.
- **Monitoring meetings** are held periodically with departments and program offices in FINRA. FSIO identifies specific topics for the meetings based on key risk areas.

Leading Practices for Successful Performance Measures

In prior work, we identified several leading practices for successful performance measures, including that performance measures should be limited to the vital few, demonstrate results, cover multiple priorities, and provide useful information for decision-making.⁷ We also have developed overarching attributes that are key to successful performance measures, including that they align with goals and be clear, measurable, objective, and reliable, and that they focus on core program activities and government-wide priorities.⁸ Finally, the leading practices suggest that a

⁷Performance measurement focuses on whether a program has achieved its objectives, expressed as measurable performance standards. See GAO, *Performance Measurement and Evaluation: Definitions and Relationships*, [GAO-11-646SP](#) (Washington, D.C.: May 2, 2011). For examples of our prior work on successful performance measures, see [GAO/GGD-96-118](#); and *The Results Act: An Evaluator's Guide to Assessing Agency Annual Performance Plans*, [GAO/GGD-10.1.20](#) (Washington, D.C.: Apr. 1 1998).

⁸For a description of how we developed the attributes of effective performance goals and measures, see [GAO-03-143](#): 45.

suite of performance measures should be balanced to include all program priorities.

FSIO Reviews of FINRA Included Statutorily Specified Areas and Typically Identified Deficiencies That Resulted in Proposed Corrective Actions

FSIO's Oversight Activities Covered Areas Specified in the Dodd-Frank Act

We reviewed all of FSIO's reviews of FINRA completed in fiscal years 2018–2020 and determined that FSIO had completed an inspection or examination that addressed all but one of 10 Section 964 areas (see table 3). In fiscal year 2021, FSIO completed a program inspection that addressed the remaining Section 964 area (review of member advertising). In total, our review of inspection and examination documents indicated that FSIO completed 69 reviews of FINRA (13 program inspections, 11 thematic oversight examinations, and 45 single oversight examinations) in the period we evaluated.

Table 3: FSIO Oversight of FINRA by Areas Identified in Section 964 of the Dodd-Frank Act, Fiscal Years 2018–2020

	Program inspections ^a		Thematic oversight examinations ^b		
	Open	Closed	Open	Closed	Total
Total^c	9	13	5	11	38
By Section 964 area					
Governance	4	3	—	—	7
Examinations performed by FINRA	4	4	5	11	24
Executive compensation	—	1	—	—	1
Arbitration services	1	1	—	—	2
Review of member advertising	1	—	—	—	1
Cooperation with state securities regulators	—	2	—	—	2
Funding	3	2	—	—	5
Policies on former employees	1	1	—	—	2
Effectiveness of FINRA's rules	2	2	1	—	5
Transparency of governance and activities	3	2	—	—	5
Other ^d	3	9	—	—	12

Legend: Dodd-Frank Act = Dodd-Frank Wall Street Reform and Consumer Protection Act; FINRA = Financial Industry Regulatory Authority, Inc.; FSIO = FINRA and Securities Industry Oversight

Source: Securities and Exchange Commission documentation. | GAO-22-105367

Note: Each of FSIO's 45 single oversight examinations during the period covered the Section 964 area of examinations and were not included in this table.

^aProgram inspections are reviews of FINRA programs and operations.

^bThematic oversight examinations evaluate FINRA's review of a particular regulatory area across a number of its member firms.

^cThis row represents the total number of discrete program inspections and thematic oversight examinations. Some inspections and examinations covered multiple Section 964 areas. As a result, column totals for the Section 964 areas do not sum to the total.

^dThese reviews assessed FINRA programs and operations in areas other than those specified in Section 964 of the Dodd-Frank Act.

Most program inspections (eight of 13) addressed multiple Section 964 areas. For example, one program inspection considered four Section 964 areas: the effectiveness of examiners, effectiveness of rules, funding, and transparency. Some (five of 13) program inspections focused on a single Section 964 area. The "Other" category in table 3 refers to reviews that evaluated aspects of FINRA's programs and operations not specifically identified in Section 964.

FSIO's thematic oversight and single oversight examinations typically focused on the Section 964 area relating to expertise of examiners. But FSIO stated that it has an ongoing thematic oversight examination that

will focus on the Section 964 area relating to the effectiveness of FINRA's rules.

Inspections and Examinations of FINRA Frequently Identified Deficiencies and Typically Resulted in Proposed Corrective Actions

Areas of Focus

Our review of FSIO program inspections, thematic oversight examinations, and single oversight examinations completed in fiscal years 2018–2020 found that these reviews typically focused on FINRA's policies and procedures, including execution of such procedures.⁹ Program inspections generally were focused on FINRA's programmatic policies and procedures (including execution of such procedures), while thematic oversight and single oversight examinations tended to focus on FINRA's execution of examination procedures and associated policies. Program inspections and thematic oversight examinations also evaluated areas such as the timeliness of FINRA's operations, staffing levels, and sufficiency of training and program risk management.

The reviews covered a number of issue areas. For example, the 13 program inspections looked at the implementation of certain rules, the effectiveness of FINRA programs, and other efforts. The 10 thematic oversight examinations reviewed how FINRA examiners implemented examination procedures on a cross section of subject firms. Each of the 45 single oversight examinations reviewed FINRA examinations of individual broker-dealers.

Both program inspections and thematic oversight examinations commonly reviewed FINRA documentation and conducted interviews with FINRA staff. Thematic oversight examinations were more likely to review information in FINRA's examination case files, although some program inspections also reviewed those documents. In designing both program inspections and thematic oversight examinations, FSIO staff nearly

⁹SEC had completed 11 thematic oversight examinations at the time of our analysis, but had not completed the closing memorandum for one examination. Our analysis of thematic oversight examinations is based on the 10 complete case files. In addition, we excluded one of the 45 single oversight examinations from our analysis because it contained information collected under SEC's whistleblower program (under which SEC receives tips about possible violations of federal securities laws). Our analysis is based on the 44 other single oversight examinations.

always coordinated with internal stakeholders to help determine the scope of examination objectives, most commonly with SEC's Division of Trading and Markets, but also with groups such as the Division of Examinations' Office of Risk Analysis and Surveillance.

Findings Identified and FINRA Responses

FSIO reviews often identified findings, some of which indicated areas of concern with FINRA programs or examinations, and many of these findings had multiple components.¹⁰ Program inspections were more likely than thematic and single oversight examinations to characterize findings as areas for potential improvement, although each type of review characterized the majority of findings as deficiencies. FINRA provided formal responses to FSIO's findings and typically proposed corrective actions to address these findings.¹¹

FSIO Performance Measures Do Not Reflect Leading Practices and It Lacks Certain Procedures for Using Information from Oversight Activities

FSIO Uses Review Findings to Inform Risk-Based Monitoring of FINRA

FSIO uses review findings from program inspections, thematic oversight examinations, and single oversight examinations of FINRA to inform its risk-based monitoring of FINRA, set oversight priorities, and identify areas to review in future inspections and examinations. FSIO officials stated they make risk-based decisions about what issues to discuss with FINRA in regularly scheduled monitoring meetings and which to review in an inspection or examination. For example, a program or operation associated with previous findings might be deemed higher-risk and

¹⁰We did not validate FSIO's findings.

¹¹Our sensitive report provided information on the number and type of findings for program inspections, thematic examinations, and single oversight examinations closed in fiscal years 2018–2020. The sensitive report also summarized the extent to which FINRA agreed with FSIO's findings and the nature of FINRA's responses, and provided information on the number and type of corrective actions proposed by FINRA. We omitted such information from this report because SEC determined it to be confidential supervisory information.

receive an inspection, while other issues might be discussed in a monitoring meeting.

FSIO also uses previous inspection or examination findings to inform decisions about the scope of review for future inspections and examinations. In addition, FSIO uses information identified in other parts of SEC, including referrals from the Broker-Dealer and Exchange Examination Program, to help select FINRA inspection and examination topics.

Furthermore, FSIO may use inspections or examinations to review newly identified risks, such as those uncovered during other inspections or examinations. FSIO also may use reviews to assess FINRA corrective actions taken in response to prior inspections or examinations.

FSIO Performance Measures for FINRA Oversight Do Not Reflect Leading Practices

FSIO has indicators that its officials said it uses to measure performance in overseeing FINRA, but they do not reflect the characteristics of successful performance measures that we identified in prior work.¹² More specifically, FSIO's performance metrics do not measure progress in achieving a mission, set targets against which actual performance can be measured, incorporate key elements of its oversight activities, or provide outcome information that would allow FSIO to assess its performance in overseeing FINRA. Instead, FSIO's 10 performance measures focus on the completion of internal program activities (see table 4).

¹²Performance measurement focuses on whether a program has achieved its objectives, expressed as measurable performance standards. See [GAO-11-646SP](#). For examples of our prior work on key attributes for successful performance measures, see [GAO/GGD-96-118](#); [GAO-03-143](#); and [GAO-17-183](#).

Table 4: FSIO Performance Measures

Create annual inspection and examination oversight plan
Monitor progress and complete inspection and examination plan
Process tips, complaints, and referrals
Conduct periodic meetings with FINRA
Document examination plan update meetings
Review recurring information from FINRA
Conduct internal meetings with FSIO staff and provide training
Meet with other SEC departments periodically to identify risks and priorities
Inform Division of Examinations leadership weekly about oversight of FINRA
Conduct meetings of FSIO senior staff to discuss FSIO risk-mitigation efforts

Legend: FINRA = Financial Industry Regulatory Authority, Inc.; FSIO = FINRA and Securities Industry Oversight; SEC = Securities and Exchange Commission

Source: SEC. | GAO-22-105367

FSIO's performance measures focus on tracking completion of particular tasks, but they do not establish a measurable goal for program performance that relates to FSIO's mission, or define any metrics that could be used to assess performance. For instance, FSIO has several performance measures related to holding meetings with relevant stakeholders. FSIO officials stated that the periodic meetings with FINRA were useful and served as an important component of its FINRA oversight by providing FSIO with valuable information to supplement the information it obtained through inspections and examinations. However, these measures only assess whether a meeting has occurred; they do not assess the outcomes of the meetings or demonstrate how they contribute to FSIO's program goals. Similarly, the measures also are not useful in assessing progress in meeting goals or improving performance.

FSIO's performance measures do not provide managers or stakeholders with useful information for measuring performance in achieving program goals. For instance, while FSIO's measures related to processing of tips, complaints, and referrals and implementation of the annual oversight plan track completion of important oversight activities, they do not provide information on how well FSIO performed those activities. Decision makers would be unable to use the existing measures to assess whether FSIO oversight activities achieved satisfactory results in terms of accomplishing mission goals or objectives, and what changes would be necessary to improve performance.

FSIO officials stated that their current performance measures do not measure the outcomes of FSIO's oversight activities on FINRA's

programs. According to the officials, there are few specific rules in the federal securities laws prescribing how FINRA must oversee broker-dealers. The officials explained that, as a result, FSIO's inspections and examinations generally do not identify SEC rule violations by FINRA. Rather, the officials said that FSIO's reviews are intended to assess whether FINRA has been enforcing its broker-dealer members' compliance with SEC and FINRA rules and are designed to improve FINRA's processes or procedures.

Furthermore, the officials said that FSIO findings exist on a spectrum from noteworthy findings to minor observations and that one challenge with developing outcome-oriented measures is the difficulty in assessing the relative significance of observations that typically do not involve rule violations. The officials stated it may be difficult to assess the overall importance of the number of findings or observations. For instance, the existence of a large number of findings or observations in a particular inspection or thematic oversight examination provides FSIO statistical information. But the number of findings, by itself, does not provide any information on the quality of those findings or observations, whether they were technical or ministerial in nature, or whether they had a material or significant effect on the area being inspected or examined. Officials said FSIO's current performance measures were developed with those challenges in mind and designed to help ensure FSIO completes oversight activities on schedule, communicates findings to FSIO and Division of Examinations leadership, provides staff with appropriate training, and appropriately documents meetings with FINRA.

While we acknowledge that developing outcome-oriented measures can be challenging, it is important that agencies strive to establish performance measures consistent with leading practices so that agency management can track progress toward achieving its mission. Although some outcome-oriented performance measures may have known limitations, they also may provide more useful information than measures that do not reflect leading practices and therefore may be ineffective at monitoring performance.

Furthermore, FSIO may have additional opportunities to develop outcome-based measures relating to findings. For example, officials explained that FSIO's review findings exist on a spectrum with some findings leading to relatively more significant changes to FINRA's operations than others. Incorporating information reflecting the relative significance of its findings may be one way for FSIO to address potential limitations with a metric based on the number of findings. Additionally, to

help interpret the results of performance measures, we have emphasized in our past work the importance of including adequate contextual information, such as factors inside or outside the agency's control that might affect performance.¹³ Developing outcome-oriented performance measures consistent with leading practices would allow FSIO to better evaluate the effectiveness of its program, and identify its impact on FINRA's oversight of the broker-dealer industry.

FSIO Lacks Policies and Procedures on Which Deficiencies and Corrective Actions to Track

FSIO Review of Proposed Corrective Actions

FSIO officials told us that when FINRA proposes a corrective action in response to a deficiency letter, FSIO inspection or examination staff will review FINRA's response and any proposed action and determine if it is appropriate.

FSIO officials noted that FINRA is generally not required to implement corrective actions to address FSIO's findings and observations because they generally do not involve rule violations. According to FSIO officials, SEC has a mechanism to enforce compliance by making referrals to the agency's Division of Enforcement, but it only can be used in cases of a rule violation by FINRA or the failure of FINRA to carry out its responsibilities as a national securities association as set forth in Section 15A of the Exchange Act. According to officials, because there are few specific rules in federal securities laws prescribing how FINRA must oversee broker-dealers, FSIO is unlikely to encounter a rule violation by FINRA in its inspections or examinations. Instead, FSIO's reviews and inspections are more likely to identify areas for FINRA to improve its operations. The officials stated that if FSIO encountered a rule violation by FINRA, staff could refer it to the Division of Enforcement.¹⁴

Our review of FSIO documentation found that FSIO review teams often determined to review FINRA's implementation of some proposed corrective actions in the future by discussing them in monitoring meetings or by requesting documentation. According to agency officials, FSIO also may follow up on previously identified findings and associated corrective

¹³GAO, *Federal Prison System: Justice Could Better Measure Progress Addressing Incarceration Challenges*, [GAO-15-454](#) (Washington, D.C.: June 19, 2015).

¹⁴SEC officials stated that SEC last took an enforcement action against FINRA in 2011.

actions during the course of subsequent reviews or as part of a corrective action review process.

FSIO Lacks Policies and Procedures for Tracking Deficiencies and Corrective Actions

FSIO does not have policies and procedures for monitoring review findings or corrective actions beyond those in the Division of Examinations' manual, which calls for examiners to document certain findings in SEC's examination tracking system. Officials stated that FSIO follows all the division's procedures for documenting inspection and examination findings. However, these procedures do not address how the information might be used for ongoing monitoring (such as identifying and tracking trends and patterns) or tracking corrective actions proposed or implemented by FINRA. Furthermore, FSIO officials stated that SEC's system was not designed to track the types of findings FSIO typically identifies in its FINRA reviews.

To supplement the information in SEC's examination tracking system, FSIO staff created a spreadsheet to monitor some identified deficiencies and corrective actions proposed by FINRA. However, officials stated that FSIO does not have documented policies or procedures for determining which findings or proposed corrective actions to track (for example, all identified deficiencies or only those with proposed corrective actions) or how, or how often, the deficiencies and status of any corrective actions should be tracked. Instead, the officials described relying on meetings to discuss findings and proposed corrective actions that may warrant monitoring.

In furtherance of its mission (improving compliance, preventing fraud, informing policy, and monitoring risk), FSIO developed a strategic goal to monitor FINRA. We previously identified six essential elements of enterprise risk management, including monitoring how risks change and if responses are successful, to assist federal agencies.¹⁵ We also reported that the absence of any one of the elements likely would result in an agency incompletely identifying and managing enterprise risk. According to agency officials and FSIO's risk-focused oversight framework, FSIO

¹⁵GAO, *Enterprise Risk Management: Selected Agencies' Experiences Illustrate Good Practices in Managing Risk*, [GAO-17-63](#) (Washington, D.C.: Dec. 1, 2016). The six principles are to (1) align the enterprise risk-management process to goals and objectives, (2) identify risks, (3) assess risks, (4) select risk response, (5) monitor risks, and (6) communicate and report on risks.

uses its inspection and examination process as a mechanism to monitor risks it has determined to be of greatest consequence and thus warranting an inspection or examination, as opposed to some other monitoring activity. Therefore, the findings from these reviews and any associated corrective actions represent important information about the status of identified risks and any mitigation efforts.

By developing and implementing documented policies and procedures for monitoring identified findings and associated corrective actions, FSIO would be better positioned to have key information about the state of risk in its oversight of FINRA and the extent to which identified risks have been appropriately mitigated.

FSIO Has Not Identified or Communicated the Significance of Deficiency Findings and Lacks Policies and Procedures to Do So

FSIO lacks documented policies and procedures to identify and communicate the significance of its findings both internally and externally. Although FSIO has a strategic goal to effectively inform stakeholders of regulatory issues, trends, and developments, FSIO maintains an informal process for assessing the importance of review findings and communicating those findings within SEC and to FINRA, when necessary.

The Division of Examinations' guidance states that it is important to identify and monitor significant findings to assist in evaluating the effectiveness of SEC's examination program and plan future examinations. The guidance provides a mechanism to identify significant findings for certain entities. According to officials, FSIO has not applied this guidance for its reviews of FINRA because the criteria in the guidance generally do not apply to the types of findings FSIO has on FINRA. The officials stated that, as such, guidance does not require FSIO staff to identify significant findings when conducting examinations of FINRA. As a result, FSIO does not formally categorize findings in the context of its reviews of FINRA, or otherwise formally differentiate findings based on potential risk. According to FSIO officials, when review teams identify findings in their inspections and examinations of FINRA, the teams apply professional judgment to determine the relative importance of the findings.

Without documented policies and procedures, FSIO lacks reasonable assurance that it has correctly and consistently identified and communicated its most important findings internally and to FINRA. Instead, FSIO's informal process operates on an ad hoc basis that relies largely on verbal discussion at meetings. More systematically identifying significant findings would (1) provide FSIO with relevant information for its prioritization and planning of future oversight activities, as specified in the SEC examination manual; (2) help FSIO clearly communicate its concerns to FINRA, instead of relying on FINRA's interpretation of the relative significance of findings in deficiency letters; (3) provide potentially useful information for FSIO's implementation of outcome-based performance measures and tracking of deficiencies and corrective actions; and (4) help provide assurance FSIO is achieving its strategic goal of effectively informing stakeholders of key regulatory information.

Conclusions

Ensuring that FINRA is properly carrying out its wide-ranging regulatory responsibilities is critical to SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. FSIO inspections and examinations of FINRA are conducted in furtherance of SEC's mission and have included areas specified in Section 964 of the Dodd-Frank Act.

However, FSIO lacks some tools that could help it leverage inspection or examination information to help it achieve its oversight goals and objectives for FINRA. Those tools are successful performance measures, policies and procedures for tracking inspection or examination findings and associated corrective actions, and policies and procedures for assessing and communicating the significance of its findings.

Developing performance measures that reflect leading practices (such as being outcome-oriented and measurable), as well as policies and procedures for the areas discussed above, would allow FSIO to improve and better assess its oversight of FINRA. Specifically, FSIO could monitor and assess the effect of its oversight on FINRA, better track its review findings and FINRA responses (including implementation of corrective actions), generate information on the significance of its findings, and more clearly communicate that information internally and to FINRA. In turn, SEC would have greater assurance that FINRA was carrying out its regulatory responsibilities and that SEC was meeting its mission, including to protect investors and maintain efficient markets.

Recommendations for Executive Action

We are making the following three recommendations to SEC:

The Director of the Division of Examinations should develop FSIO performance measures that reflect leading practices, including measuring progress in achieving FSIO's mission, setting targets against which actual performance can be measured, incorporating key elements of FSIO's oversight activities, and providing information on the outcomes of FSIO program activities related to its stated mission goals and objectives. (Recommendation 1)

The Director of the Division of Examinations should develop and implement FSIO policies and procedures for tracking identified deficiencies and associated FINRA corrective actions, including establishing when and how to monitor findings and FINRA's implementation of corrective measures. (Recommendation 2)

The Director of the Division of Examinations should develop and implement FSIO procedures to identify and communicate the significance of its inspection and examination findings. (Recommendation 3)

Agency Comments and Our Evaluation

We provided a draft of this report to SEC for review and comment. In its written comments, reproduced in appendix II, SEC generally agreed with our recommendations and described actions it would take to address them.

In response to the first recommendation, SEC acknowledged that enhancements to its performance measures could allow SEC to better measure program performance, and stated that it will review FSIO's existing performance measures and develop additional measures, as necessary, that reflect leading practices. We believe this would be a positive step and note that these performance measures should measure progress in achieving a mission, set targets against which actual performance can be measured, incorporate key elements of oversight activities, and provide information on the outcomes of program activities related to mission goals and objectives.

In response to the second recommendation, SEC stated it would develop policies and procedures to formalize the process of tracking deficiencies and corrective actions proposed by FINRA. As stated in our recommendation, we believe SEC should include in these policies and procedures when and how to monitor findings and FINRA's implementation of corrective measures.

For the third recommendation, SEC noted that the agency maintains an informal process for assessing the importance of and communicating findings and stated it would enhance the current process and adopt formalized written procedures.

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

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or 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 III.



Michael E. Clements
Director, Financial Markets and Community Investment

Appendix I: Objectives, Scope, and Methodology

This report, which generally focuses on the Securities and Exchange Commission's (SEC) use of inspections and examinations to oversee the Financial Industry Regulatory Authority, Inc. (FINRA), is a public version of a sensitive report we issued on July 29, 2021.¹ Specifically, this report (1) determines the extent to which SEC oversight of FINRA operations and programs since fiscal year 2018 included the 10 areas specified in Section 964 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and (2) assesses SEC's use of inspection and examination findings to help achieve its FINRA oversight goals.²

The sensitive report's first objective included information on the results of SEC's FINRA oversight activities, some of which SEC determined to be sensitive because it was confidential supervisory information. Thus, this public report omits certain information related to the (1) subjects of SEC's inspections and examinations of FINRA, (2) findings of these reviews, and (3) corrective actions proposed by FINRA in response to these findings. SEC also determined that certain information in our second objective on how SEC uses inspection and examination findings was sensitive because it was confidential supervisory information. As a result, this report omits certain information on SEC use of inspection and examination findings to inform future reviews and assess FINRA's corrective actions as well as certain references to SEC policies and procedures. We also removed one appendix that provided information on the subjects of SEC's inspections and examinations of FINRA in fiscal years 2018–2020. Although the information provided in this report is more limited, it generally addresses the same objectives and uses the same methodology as the sensitive report.

To assess SEC oversight of FINRA as it relates to Section 964 areas and associated findings, we requested and reviewed examination case file

¹GAO, *Securities Regulation: SEC Could Take Further Actions to Help Achieve Its FINRA Oversight Goals*, GAO-21-576SU (Washington, D.C.: July 29, 2021).

²Pub. L. No. 111-203, § 964(a), 124 Stat. 1376, 1910 (2010). The 10 areas are (1) governance, (2) examinations, (3) executive compensation, (4) arbitration services, (5) member advertising oversight, (6) coordination with state securities regulators, (7) funding, (8) policies regarding employment of former employees, (9) effectiveness of rules, and (10) transparency of governance.

materials for the 69 reviews of FINRA (13 program inspections, 11 thematic oversight examinations, and 45 single oversight examinations) that SEC completed from fiscal year 2018 through 2020. These materials included documents such as the scope or referral memorandum, exit outline, closing letter to FINRA, FINRA response to the closing letter, the closing memorandum, and documentation of SEC follow-up on review findings.

To determine the extent to which these reviews reflected Section 964 areas, we used an independent review method to assess each scope memorandum associated with a program inspection. In this approach, two team members independently reviewed the scope memorandum for each program inspection and coded which of the Section 964 areas each memorandum identified. The coders then compared their results and met to resolve any differences. We compared our results to SEC's own coding of these reviews and requested additional documentation to resolve any differences. We also reviewed case file documentation for thematic oversight examinations and single oversight examinations to determine the extent to which they covered Section 964 areas.

To describe SEC findings from its program inspections and oversight examinations of FINRA as well as associated corrective actions, we created a data collection instrument to review each case file. This data collection instrument was designed using an iterative approach to capture key review characteristics across the case file documentation associated with each review. These included review findings and FINRA's response to findings (including level of agreement and any proposed corrective actions). Two coders independently reviewed and coded each case file for the information the data collection instrument was designed to collect. The coders then compared their results and met to resolve any differences. We then summarized SEC's findings and FINRA's responses.

To determine how SEC used review findings in its oversight of FINRA, we reviewed agency documentation, policies and procedures, and examination guidance; and interviewed agency officials. Specifically, we reviewed SEC case files as discussed above to determine the extent to which oversight activities were informed by previous findings. We reviewed internal guidance and planning documents, including FINRA and Security Industry Oversight's (FSIO) annual inspection and examination plans for fiscal years 2018–2021 to understand the methodology for FSIO's risk-based determination on which oversight activities it plans to conduct annually, and the degree to which review

findings were incorporated in that process. We reviewed FSIO's risk-management framework and associated risk inventory to understand the role findings play in informing FSIO's risk-management processes and procedures.

We also reviewed SEC's overarching guidance for Division of Examinations programs to understand how that guidance instructs examination programs to handle review findings and the extent to which findings should inform FSIO's monitoring of FINRA. We discussed this information with FSIO staff to understand how they integrated various guidance on the use of findings and any additional related activities.

To determine how SEC evaluates the performance of FSIO's program and the extent to which FSIO assessed the impact on FINRA's oversight of broker-dealers, we analyzed FSIO performance measures and determined whether they reflected leading practices identified and established in previous GAO work.³ We also used practices on which we reported in response to the Government Performance and Results Act as criteria to assess the extent to which FSIO's performance measures incorporated key elements established in that previous work.⁴ We also met with FSIO staff to understand the processes they used to develop their performance measures and the areas on which they decided to focus.

To determine the extent to which SEC tracked review findings and corrective actions, we reviewed the agency's tracking documentation and associated policies and procedures. We also interviewed agency, including FSIO, officials to gain additional perspectives on how they

³See *Executive Guide: Effectively Implementing the Government Performance and Results Act*, [GAO/GGD-96-118](#) (Washington, D.C.: June 1996). In that report, we reviewed the experiences of leading public-sector organizations; reviewed literature on management reform, strategic planning, and performance measurement; and obtained input from a wide range of experts and federal managers. Also see GAO, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, [GAO-03-143](#) (Washington, D.C.: Nov. 22, 2002). To develop the criteria for that report, we developed nine key attributes for successful performance measures based on analyses of prior criteria, key pieces of legislation, and a review of relevant literature. For *Defense Logistics: Improved Performance Measures and Information Needed for Assessing Asset Visibility Initiatives*, [GAO-17-183](#) (Washington, D.C.: Mar. 16, 2017), we applied our previously developed attributes for successful performance measures to assess selected Department of Defense performance measures.

⁴[GAO/GGD-96-118](#).

tracked findings and corrective actions and any challenges associated with SEC's tracking systems.

To determine the extent to which review findings were categorized and communicated within SEC and to FINRA, we reviewed FSIO examination case files and policies and procedures and assessed the extent to which SEC used its available reporting tools in its oversight of FINRA. We reviewed SEC's Division of Examinations guidance regarding the classification of findings and interviewed FSIO staff to understand the extent to which that guidance applied to their work, and what similar processes they incorporated. We also reviewed FSIO's goals, objectives, and milestones to gain insight into channels of communication in SEC that FSIO might use to communicate about review findings, and discussed those activities with SEC staff.

We conducted this performance audit from June 2020 to July 2021 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. We subsequently worked from August 2021 to November 2021 to prepare this version of the original sensitive report for public release. This public version also was prepared in accordance with those standards.

Appendix II: Comments from the Securities and Exchange Commission



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

November 30, 2021

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 the opportunity to review the U.S. Government Accountability Office's (GAO) draft report concerning the SEC's Oversight of the Financial Industry Regulatory Authority (FINRA).

The GAO prepared the draft report in response to Section 964 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires the GAO to review the SEC's oversight of FINRA in a number of substantive areas. Given the scope of FINRA's regulatory responsibilities, the SEC conducts robust oversight of FINRA to help ensure that FINRA carries out its regulatory responsibilities. As noted in the draft report, the SEC's oversight of FINRA is primarily conducted through the review of FINRA's rules, which is coordinated by the staff of the Division of Trading and Markets, and examinations led by the staff of the FINRA and Securities Industry Oversight program (FSIO) within the Division of Examinations (EXAMS).

The GAO makes three recommendations regarding the SEC's oversight of FINRA in the draft report. First, the GAO recommends that FSIO develop performance measures that reflect leading practices. FSIO appreciates the GAO's recognition of its current performance measures and acknowledges that enhancements could allow the program to better measure program performance that relates to FSIO's programmatic goals. As such, FSIO will review its existing performance measures and develop additional ones, as necessary, that reflect leading practices.

Second, the GAO recommends that EXAMS should develop and implement FSIO policies and procedures for tracking identified deficiencies and associated FINRA corrective actions, including establishing when and how to monitor findings and FINRA's implementation of corrective measures. FSIO follows EXAMS-wide guidance and utilizes the SEC's examination tracking system to document examination findings. Additionally, as noted in the draft report, FSIO has a detailed spreadsheet to monitor identified deficiencies and corrective actions proposed by FINRA. FSIO will develop policies and procedures to formalize this process.

**Appendix II: Comments from the Securities
and Exchange Commission**

Michael E. Clements
Page 2

Third, the GAO recommends developing and implementing FSIO procedures to identify and communicate the significance of its examination findings. As noted in the draft report, FSIO has an informal process for assessing the importance of and communicating findings and has several avenues for communicating the significance of findings both internally and externally. Based on the GAO's recommendation, FSIO will enhance its current process and adopt formalized written procedures.

I appreciate the GAO's attention to these important issues and would like to thank you and your staff for the opportunity to review the GAO's draft report. If you have any other questions, please do not hesitate to contact me at (202) 551-6730.

Sincerely,



Daniel Kahl
Acting Director
Division of Examinations

Text of Appendix II: Comments from the Securities and Exchange Commission

November 30, 2021

Michael E. Clements Director

Financial Markets and Community Investment

U.S. Government Accountability Office 441 G Street, NW

Washington, DC 20548

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Sincerely,

Daniel Kahl Acting Director

Division of Examinations

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Michael E. Clements at (202) 512-8678 or clementsm@gao.gov

Staff Acknowledgments

In addition to the contact named above, Kevin Averyt (Assistant Director), Robert Lowthian (Analyst in Charge), Marc Molino, Evan Nemoff, Barbara Roesmann, Jessica Sandler, and Farrah Stone made key contributions to this report.

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