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United States Government Accountability Office  
Washington, DC 20548

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October 20, 2005

The Honorable Frank R. Wolf  
Chairman  
Subcommittee on Science, the Departments of State,  
Justice, and Commerce, and Related Agencies  
Committee on Appropriations  
House of Representatives

Subject: *U.S. Securities and Exchange Commission: Building Project Management and Related Budget Planning*

Dear Mr. Wolf:

You asked us to provide a briefing on the facilities management and budgeting issues of the U.S. Securities and Exchange Commission (SEC) that SEC disclosed to your subcommittee in May 2005, which resulted in SEC's requesting a reprogramming of approximately \$48 million of 2005 and 2006 funds. The reprogramming was requested to cover unbudgeted costs related to the construction of new facilities in Washington, D.C., and the improvement of new leased facilities in New York City and Boston. Specifically, our objectives were to provide information on (1) the amount of funding for these projects that was not planned; (2) the reasons for the change in budgeted amounts; (3) the related actions taken by SEC since this budgeting issue was uncovered; and (4) any corrective actions to prevent this issue from recurring.

In order to meet these objectives, we interviewed SEC personnel and reviewed supporting documents. We conducted our work from July through August 2005 in accordance with U.S. generally accepted government auditing standards. We requested comments from the SEC Chairman or his designee. On August 30, 2005, we briefed the staff of your subcommittee on the preliminary results of our review. The briefing slides discussed at that meeting are included as enclosure I and written comments from SEC's Chairman have been reprinted as enclosure II.

### **Results in Brief**

In May 2005, the SEC disclosed to your subcommittee that it had identified unbudgeted costs of approximately \$48 million attributable to misestimates and omissions of budget costs associated with the construction of its new facilities in Washington, D.C. and improvements in its new leased facilities New York City and Boston. SEC estimates that the impact on its 2005 and 2006 budgets for construction costs is \$20.2 million and \$28.5 million, respectively, for a total of \$48.7 million. On

June 7, 2005, SEC requested a reprogramming of 2005 funds among object classes to address construction-related needs associated with these offices.

Our work identified the following as the primary causes of the misestimates and omissions of amounts in SEC's budget submission: (1) ineffective management controls over budget formulation and review for these projects; (2) an inadequate administrative infrastructure; and (3) the nature of these facilities projects.

SEC has taken several actions, as detailed in the enclosed briefing slides, to address its facilities project management and budget problems. In addition, we are recommending that the Chairman of the SEC direct the Executive Director to take the following additional actions:

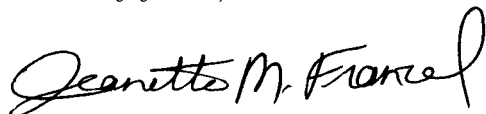
- ◆ establish accountability at both the staff and management levels for the reasonableness of budget estimates submitted during the budget formulation process;
- ◆ establish regular reporting and review procedures related to the three construction projects, and any future projects, to ensure that management is promptly informed when changes or problems occur with estimates;
- ◆ improve communication and consultation with operating units and staff regarding space and property needs;
- ◆ evaluate options for budget and facilities management activities in terms of number of staff and expertise needed; and
- ◆ complete hiring for new positions in the Office of Administrative Services and Office of Financial Management.

In commenting on a draft of this report, the SEC Chairman agreed with the conclusions and recommendations in the draft report and included information on actions taken and planned in this area. The complete text of SEC's response is included in enclosure II.

We are sending copies of this report to the Ranking Minority Member of your subcommittee. We are also sending copies to the Senate Committee on Appropriations, Subcommittee on Commerce, Justice, and Science, and other interested congressional committees.

This letter will also be available on GAO's home page at <http://www.gao.gov>. If you have any questions, please contact me at (202) 512-9471 or by e-mail at [franzelj@gao.gov](mailto:franzelj@gao.gov). Key contributors to this letter were Cheryl Clark, Kimberley McGatlin, and Maxine Hattery.

Sincerely yours,



Jeanette M. Franzel  
Director  
Financial Management and Assurance

Enclosures



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## **SEC Facilities Project Management and Related Budget Planning**

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Briefing for the staff of the Subcommittee on Science, the  
Departments of State, Justice, and Commerce, and  
Related Agencies, House Committee on Appropriations

August 30, 2005

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## **Background**

In May 2005, the Securities and Exchange Commission (SEC) informed Congress that it had identified unbudgeted costs of approximately \$48 million related to construction of its two new building facilities in Washington, D.C. (Station Place One and Station Place Two), and improvements in its new leased offices in New York City and Boston.

On June 7, 2005, SEC requested a reprogramming of funds among object classes to address construction-related needs associated with Station Place One and Two and certain costs associated with improvements in the new leased offices in Boston and New York City.



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## **Objective, Scope, and Methodology**

- ◆ Our objectives were to determine
  1. the amount of funding for these projects that was not initially planned;
  2. the reasons for the change in budgeted amounts;
  3. the related actions taken by SEC since this budgeting problem was uncovered; and
  4. any corrective actions to prevent this problem from recurring.
  
- ◆ We obtained information to address these objectives primarily through interviews with SEC personnel, and through review of corroborating documents.



## Condition

- ◆ Budget amounts
  - did not include improvement costs for its newly leased office space in New York City for budget years 2005 and 2006; and
  - included unrealistically low costs for improvements in the new Boston office and construction costs for Station Place Two.
    - Estimates for Boston were based on a rule-of-thumb amount that had not been updated annually and was not adjusted for current labor and materials costs.
    - Estimates for Station Place Two had not been updated in 18 months and therefore did not reflect increased costs for construction materials, security, and technology.



- ◆ SEC estimates that the impact on the 2005 and 2006 budgets for construction and lease improvement costs is \$20.2 million and \$28.5 million, respectively, for a total of \$48.7 million.



### Budget: Construction and Lease Improvement Costs

(Dollars in millions)

	<b>FY 2005 operating budget ( as of December 2004)</b>	<b>Updated 2005 budget (June 2005)</b>	<b>2005 difference</b>	<b>President's Proposed FY 2006 operating budget (as of February 2005)</b>	<b>Updated 2006 budget (June 2005)</b>	<b>2006 difference</b>
<b>Station Place One</b>	\$6.00	\$6.80	(\$0.80)	\$1	\$1	\$0
<b>Station Place Two</b>	8.60	14.60	(6.00)	3	15.50	(12.50)
<b>Total Station Place One and Two</b>	<b>\$14.60</b>	<b>\$21.40</b>	<b>(\$6.80)</b>	<b>\$4</b>	<b>\$16.50</b>	<b>(\$12.50)</b>
<b>New York City</b>	5.00	17.00	(12.00)	0	16.00	(16.00)
<b>Boston</b>	2.60	4.00	(1.40)	0	0	0.00
<b>Total</b>	<b>\$22.20</b>	<b>\$42.40</b>	<b>(\$20.20)</b>	<b>\$4</b>	<b>\$32.50</b>	<b>(\$28.50)</b>

Note: \$5 million in New York City original 2005 operating budget is for the buyout of the previous New York lease.





## **Causes of Facilities and Budget Problems**

- ◆ Ineffective management controls
- ◆ Inadequate administrative infrastructure
- ◆ Nature of the facilities projects



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## **Ineffective Management Controls**

- ◆ Lack of oversight and quality assurance over project management and budget planning for these projects
- ◆ Lack of internal controls, including reporting and accountability mechanisms, over budget estimates
  - Reliance on amounts in budget requests without proper review and analysis
  - Project managers not held accountable for providing accurate and complete estimates



**Ineffective Management Control (continued)**

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- ◆ Personnel problems and staff vacancies were not addressed timely.
- ◆ Inadequate consultation with key divisions and commissioners regarding space needs and accommodations resulted in change orders and additional costs.



## **Inadequate Administrative Infrastructure**

- ◆ Insufficient institutional expertise and resources in facilities project management
  - Construction of building is not a typical SEC operating activity.
    - Leases and improved lease-held space were more typical for SEC.
    - Concurrent lease expirations overtaxed facilities management staff.



## Inadequate Administrative Infrastructure (continued)

- ◆ Key management positions over the construction projects and related budget process were restructured and positions left vacant.
  - Human Resources (HR) and Office of Administrative Services (OAS) had been one combined office but was split into two separate offices.
  - The executive heading the combined office was reassigned to another position.
    - As a result, there was a five month vacancy of an executive position in OAS during the budget formulation process.



## Inadequate Administrative Infrastructure (continued)

- ◆ OFM did not have sufficient staff to perform budget analysis,
  - placed too much reliance on OAS for budget estimates, and
  - focused heavily on financial statement audit.
- ◆ Construction project managers were overwhelmed by
  - heavy workload and insufficient SEC infrastructure for handling construction projects of this size.



## Inadequate Administrative Infrastructure (continued)

- ◆ Growth in financial, budget, and administrative demands of SEC overall was not met with commensurate changes in the administrative infrastructure.
  - SEC grew from 2,936 staff in 2001 to 3,871 staff in 2005.
  - SEC's appropriations went from \$413 million in 2001 to \$888 million in 2005.
    - During the period of rapid SEC growth, OAS and OHR staff decreased from 146 staff in 2001 to 143 staff in 2005.



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## Nature of Facilities Projects

- ◆ For construction and lease improvements in general, building and lease improvement costs are estimates until construction and improvements are complete.
    - In our experience of reviewing construction projects, we have found that original estimates are necessarily based on incomplete information and need to be continually updated.
      - SEC's 2005 and 2006 original budget figures did not include
        - changes in building codes (Station Place One);
        - environmental factors (New York);
        - increase in construction and improvement materials (Boston and Station Place Two);
        - additional security needs after 9/11/2001 (Station Place One and Two);
        - "lessons learned" from building Station Place One (Station Place Two); and
        - aesthetics similar to Station Place One (Station Place Two).
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## Nature of Facilities Projects (continued)

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- ◆ A high level of experience and expertise is needed to handle the complexity and unpredictability of construction and to produce reliable estimates based on the best information available at the time of the estimate



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## **Actions Taken by SEC to Address Facilities Management and Budget Problems**

- ◆ New head of OAS has budgeting and construction experience
- ◆ Improved communication between OFM and OAS regarding budget formulation
- ◆ Increased staffing of day-to-day management of construction projects
- ◆ Created several new budgeting and project oversight positions in OAS
- ◆ Instituted a budget analysis branch



**Actions Taken by SEC to Address Project Management and Budget Problems (continued)**

- ◆ New automated budget system was approved and is in planning: SEC expects the new system to
  - free-up staff for analysis and
  - detect abnormalities.
- ◆ Program areas have been asked to provide more support for their budget estimates and their estimates are to receive closer scrutiny by OFM.
- ◆ Three staff members previously involved in managing and overseeing the construction and lease improvement projects have been replaced.



## **Actions Taken by SEC to Address Project Management and Budget Problems (continued)**

- ◆ Commitment from Chairman
  - August 10, 2005, message to all SEC staff cited the budget issue as one of SEC's top priorities.
- ◆ Cost estimates for all three projects have been updated based on recent information and included in SEC's budget.
- ◆ Project management for the three projects has been restructured and is receiving increased SEC management oversight.



## **Additional Actions Needed**

We recommend that the Chairman of SEC direct the Executive Director to:

- ◆ Establish accountability at both the staff and management levels for the reasonableness of budget estimates submitted during the budget formulation process.
- ◆ Establish regular reporting and review procedures related to the three construction and lease improvement projects, and any future projects, to ensure that management is promptly informed when changes or problems occur with estimates.



**Additional Actions Needed** (continued)

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- ◆ Improve communication and consultation with operating units and staff regarding space and property needs.
- ◆ Evaluate options for budget and facilities management activities in terms of numbers of staff and expertise needed.
- ◆ Complete hiring of new positions in OAS and OFM.



## Timeline of Events

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### 2004 – Calendar Year

March	Boston: new lease signed
Summer/Fall	New York: decision to leave Woolworth Building/negotiations begin on 3 World Financial Center
Midyear	Budget: regular financial review
August	Head of Office of Administrative and Personnel Management (OAPM) removed from position
November	Budget: memo from SEC Executive Director begins 2005 operating budget cycle
December	Budget: FY 2005 requests due back to Office of Financial Management (OFM) SEC FY 2005 appropriations enacted
	Budget staff analyze Office of Administrative Services (OAS) 2005 rent numbers

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### 2005 – Calendar Year

January	Heads of OAS and Office of Human Resources hired to fill vacancy created by removal of OAPM head in August 2004
February-March	Facilities budget problems surface in preparation for mid-year comparison of actual to budget costs, magnitude unknown Several meetings of directors and staff held to study the facilities budget problems
March	New York: lease signed for 3 World Financial Center
May	"How did this happen" meeting of Managing Executive Officer (MEO), Executive Director (ED), and staff from OAS and OFM  2005 & 2006 Budget Impact meeting: MEO, ED, and staff from OFM discuss the overall picture and proposals for addressing the shortfalls Conference call by MEO and ED with appropriations subcommittee staff Reprogramming: draft of request sent to appropriations subcommittee  The SEC budget issue was reported in press
June	Reprogramming: Final request letter sent to appropriations subcommittee

(194559)



THE CHAIRMAN

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

October 7, 2005

Ms. Jeanette M. Franzel  
Director, Financial Management and Assurance  
Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Ms. Franzel:

In response to your recent letter, thank you for the opportunity to review and comment on the Government Accountability Office's (GAO) draft report regarding the SEC's building project management and related budget planning. I fully support the conclusions of the report and appreciate your assistance in helping strengthen the SEC's project planning and budgetary activities.

The SEC has an obligation to ensure that taxpayer resources are used wisely and efficiently. For this reason, I have devoted significant staff resources to completing these projects in a timely manner and funding them appropriately. In this regard, I continue to meet regularly with the managers involved. I am determined to put these budgeting errors and omissions behind us.

In particular, the SEC has made changes to these projects in order to reduce their cost. As a result, we expect to realize approximately \$4 million in cost savings associated with the completion of our Northeast Regional Office. We also continue to seek opportunities to achieve additional build-out savings where possible. In addition, I am working to completely pay for these projects in fiscal 2006, so that no amount will be required to be amortized in the agency's future lease payments.

Separately, I agree with all of the additional recommendations included in the report. I will ensure that they are implemented as we complete our real estate projects, and that, more broadly, the entire agency fully appreciates the communications, accountability, and budgetary lessons of this avoidable experience.

If you would like to discuss any of our building efforts further, please call me directly at 202-551-2100.

Sincerely,

A handwritten signature in cursive script that reads "Chris Cox".

Christopher Cox



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