



November 2022

SECURITIES AND EXCHANGE COMMISSION

Additional Guidance Needed for Assessing Staff Procedures

Accessible Version

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 at least every 3 years. GAO's last report was in 2019 (GAO-20-115).

This report examines SEC's processes for assessing (1) risks of staff not following procedures (such as program manuals), (2) the effectiveness of its internal supervisory controls, and (3) the effectiveness of its staff procedures.

GAO analyzed SEC's policies and guidance for assessing the effectiveness of its internal supervisory controls and staff procedures, reviewed records supporting SEC's fiscal year 2021 assessment processes, and interviewed SEC officials.

What GAO Recommends

GAO is making three recommendations to SEC about section 961 assessments. They are to direct that the Division of Enforcement documents work performed and results, develop guidance on using program data, and develop guidance for periodic reviews of program manuals. SEC agreed with the recommendations and plans to implement them.

View [GAO-23-105465](#). For more information, contact Michael Clements at (202) 512-8678 or ClementsM@gao.gov.

SECURITIES AND EXCHANGE COMMISSION

Additional Guidance Needed for Assessing Staff Procedures

What GAO Found

The Securities and Exchange Commission (SEC) is statutorily required to assess the effectiveness of its internal supervisory controls and staff procedures. An SEC working group issued a guide to establish a consistent approach to compliance with the requirement across the Divisions of Corporation Finance, Enforcement, and Examinations and Office of Credit Ratings. The guide defines internal supervisory controls as actions management establishes to monitor that staff follow and consistently perform procedures.

In fiscal year 2021, SEC generally followed its guidance for conducting risk assessments and establishing internal supervisory controls. For example, the divisions and office assessed and documented the risks of staff not following procedures for examinations, investigations, and filing reviews and established internal supervisory controls to mitigate the risks.

SEC's framework for assessing the effectiveness of internal supervisory controls generally was consistent with federal internal control standards. In turn, the divisions and office implemented processes consistent with SEC's framework to assess the effectiveness of their internal supervisory controls for fiscal year 2021. They generally documented the work performed, including evidence collected and analyzed, and supported the results of their assessments. The divisions and office determined that the design and operations of their internal supervisory controls were effective in fiscal year 2021.

Division and office plans to assess the effectiveness of staff procedures generally were consistent with internal control standards and were implemented accordingly. But the Division of Enforcement did not document its work performed and results in a memorandum used to inform the division director about the staff procedures assessment. SEC guidance specifies that the methodology and testing results should be documented. Including such information in the memorandum would help ensure that management receives the information needed to certify compliance with section 961. GAO also found the written plans did not include potentially useful steps for assessing staff procedures.

- **Use of program data.** The divisions and office collect data about their programs but do not consistently use the data to help assess the effectiveness of staff procedures. The development and monitoring of program metrics could enable the divisions and office to monitor trends and understand the extent to which such trends, including changes, positively or negatively relate to staff procedures.
- **Review of staff procedures.** The written plans lack steps to periodically and comprehensively review staff procedures. Including such a review in the plans would help ensure that all staff procedures receive regular scrutiny and program manuals are kept current.

This was the first year the divisions and office implemented written plans for assessing staff procedures. The plans and associated processes will continue to evolve, as the divisions and office gain experience.

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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
Examinations	Division of Examinations
FMFIA	Federal Managers' Financial Integrity Act of 1982
961 Working Group	Section 961 Working Group
NRSRO	nationally recognized statistical rating organization
OCR	Office of Credit Ratings
RCM	risk and control matrix
SEC	Securities and Exchange Commission

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November 18, 2022

The Honorable Sherrod Brown
Chairman
The Honorable Patrick J. 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 and Exchange Commission (SEC) views risk management and internal controls as integral to its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. 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.¹ The report must contain an assessment of the effectiveness of (1) SEC's internal supervisory controls and (2) staff procedures (that is, procedures applicable to SEC staff who perform reviews of corporate financial securities filings, enforcement

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

investigations, and examinations of registered entities).² The activities covered in section 961 fall within the purview of the Division of Corporation Finance (Corporation Finance), Division of Enforcement (Enforcement), Division of Examinations (Examinations), and Office of Credit Ratings (OCR)—to which we refer collectively as the divisions and office.³

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 2018, SEC's internal supervisory control framework reflected key components of federal internal control standards.⁴ The majority of controls we tested operated as intended. We also found the divisions and office had not developed written procedures to ensure that they systematically assess the effectiveness of procedures applicable to staff who perform examinations, enforcement investigations, and reviews of securities filings. Our recommendations included that the SEC Chair direct the division and office directors to develop such procedures, which they did in 2020 (as discussed in more detail later in this report).

In this report, we examine the extent to which the SEC divisions and office (1) identify and assess the risk of staff not following staff procedures and, if needed, develop internal supervisory controls to mitigate such risk; (2) assess the design and operating effectiveness of their internal supervisory controls; and (3) assess the effectiveness of their staff procedures in achieving their objectives.

²15 U.S.C. § 78d-6(b)(1). The report also must contain a certification on the adequacy of SEC's internal supervisory controls, signed by the directors of relevant divisions and offices. 15 U.S.C. §§ 78d-6(b)(2), 78d-6(c). Section 961 does not define internal supervisory control. SEC has defined it as the actions management establishes to monitor that staff procedures (day-to-day procedures employees are to follow in the applicable programs) are consistently performed according to policy and procedures, and also remain reasonable, adequate, and current.

³SEC determined that OCR is a successor of the Office of Compliance Inspections and Examinations, subject to the section 961 reporting and certification requirement. See 15 U.S.C. § 78d-6(c)(1). In December 2020, SEC renamed the Office of Compliance Inspections and Examinations as the Division of Examinations.

⁴See GAO, *Securities and Exchange Commission: Systematically Assessing Staff Procedures and Enhancing Control Design Would Strengthen Internal Oversight*, [GAO-20-115](#) (Washington, D.C.: Dec. 19, 2019). The key components are control environment, risk assessment, control activities, information and communication, and monitoring. See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

For our first objective, we reviewed the divisions' and office's processes for conducting annual risk assessments to evaluate whether they were consistent with applicable SEC guidance and the risk assessment component of federal internal control standards. We reviewed risk-assessment records to evaluate the extent to which the divisions and office followed SEC guidance in conducting and documenting their fiscal year 2021 risk assessments. In addition, we reviewed program manuals and related material to identify key activities for examinations, filing reviews, and investigations and, in turn, evaluate whether the divisions and office had internal supervisory controls covering the activities.

For our second objective, we reviewed SEC's section 961 policies and procedures and other guidance to evaluate the extent to which SEC's framework for assessing the effectiveness of internal supervisory controls was consistent with the monitoring component of federal internal controls. We also reviewed assessment records to evaluate the extent to which each division and office assessed the design and operation of its internal supervisory controls for fiscal year 2021, documented the assessment results, and collected evidence to support the conclusions.

For our third objective, we evaluated the extent to which the divisions' and office's written plans for assessing the effectiveness of staff procedures were consistent with applicable SEC guidance and the monitoring component of internal control standards. We reviewed program manuals, annual reports, and other program-related materials to evaluate the plans' approaches for assessing staff procedures. We reviewed assessment records to evaluate the extent to which the divisions and office followed their plans to assess staff procedures for fiscal year 2021, documented their assessments, and supported their conclusions.

For all three objectives, we interviewed SEC staff from the divisions and offices as well as the Section 961 Working Group (961 Working Group)—which is responsible for establishing a consistent approach for and guidance on section 961 compliance—about their processes for conducting annual risk assessments, assessing the design and operation of their internal supervisory controls, and assessing the effectiveness of staff procedures. For more information about our scope and methodology, see appendix I.

We conducted this performance audit from October 2021 to November 2022 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.

Background

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 six divisions and 25 offices. SEC's approximately 4,800 staff are located in Washington, D.C., and in 11 regional offices.

Section 961 of the Dodd-Frank Act

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. 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 through internal supervisory controls.⁵ SEC has submitted 11 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.

As discussed previously, three divisions and one office are subject to section 961 of the Dodd-Frank Act (see table 1). These divisions share information and coordinate their section 961 compliance processes through the 961 Working Group, a staff-level group comprising one or more representatives from each of the three divisions and office, and the Office of the Chief Risk Officer. The Working Group is responsible for establishing a common understanding and consistent approach to

⁵See S. Rep. No. 111-176, at 137 (2010).

compliance and developing and updating guidance related to implementing section 961.

Table 1: Roles and Responsibilities of SEC Divisions and Office 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 disclosure 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 advisers) 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.
Division of 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 advisers) 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-23-105465

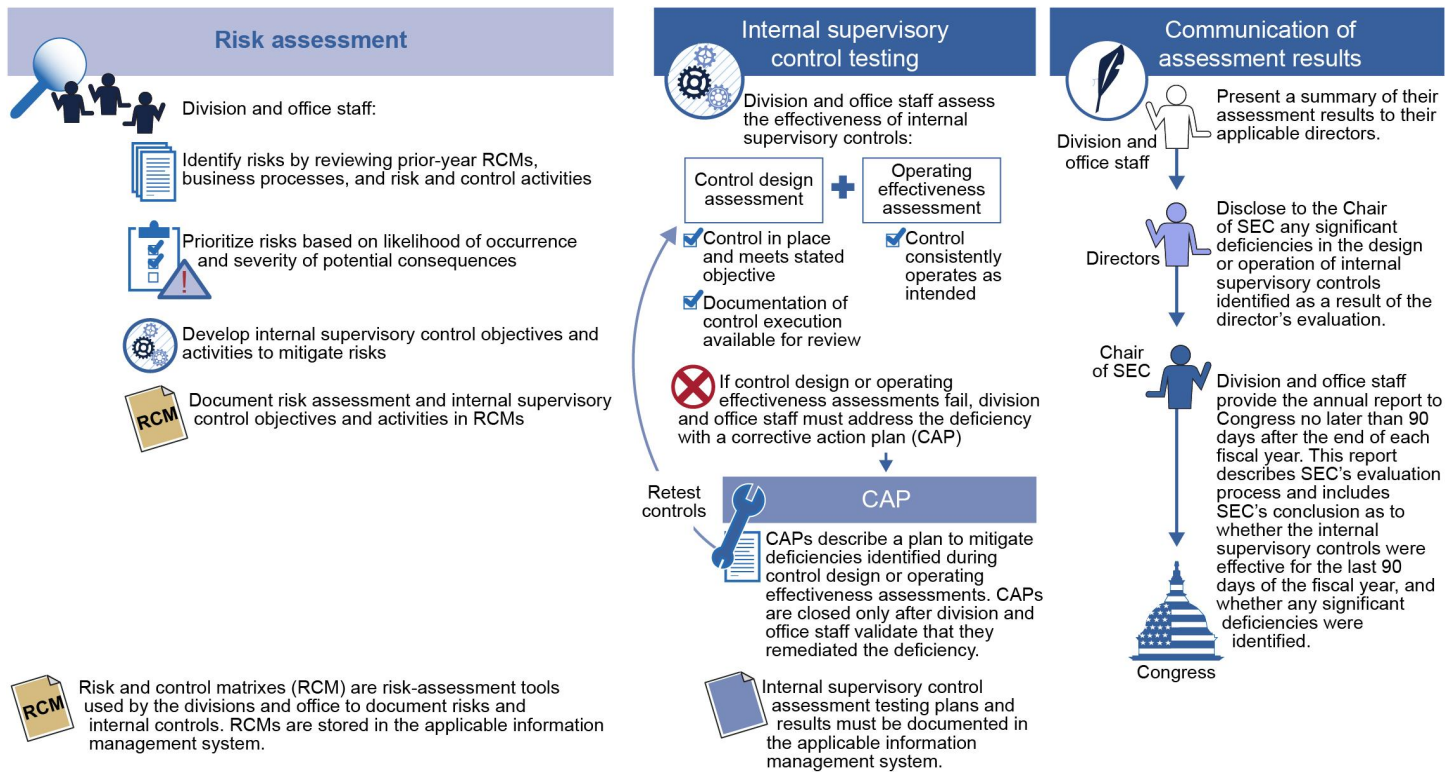
In response to section 961 of the Dodd-Frank Act, the 961 Working Group put in place a framework that provides guidance for staff responsible for assessing the effectiveness of internal supervisory controls. The framework draws on both external sources, such as federal internal control standards, and internal documents. These include the 961 Working Group’s *Reference Guide for Compliance with Section 961 of the Dodd-Frank Act* and charter and the Office of the Chief Operating Officer’s *Risk Management and Internal Control Review Reference Guide*. Our previous reviews in 2013, 2016, and 2019 found SEC’s framework for assessing the effectiveness of internal supervisory controls reflected internal control standards.⁶

SEC’s framework for assessing the effectiveness of internal supervisory controls consists of three phases—risk assessment, internal supervisory control testing, and communication of results. Division and office staff

⁶GAO, *Securities and Exchange Commission: Continued Management Attention Would Strengthen Internal Supervisory Controls*, [GAO-13-314](#) (Washington, D.C.: Apr. 18, 2013); *Securities and Exchange Commission: Management Has Enhanced Supervisory Controls and Could Further Improve Efficiency*, [GAO-17-16](#) (Washington, D.C.: Oct. 6, 2016); and [GAO-20-115](#).

conduct activities to systematically assess and report on the effectiveness of their internal supervisory controls (see fig. 1 for examples).

Figure 1: Overview of SEC’s Internal Supervisory Control Assessment



Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

Text of Figure 1: Overview of SEC’s Internal Supervisory Control Assessment

- **Division and office staff:**
 - Identify risks by reviewing prior-year RCMs, business processes, and risk and control activities
 - Develop internal supervisory control objectives and activities to mitigate risks
 - Prioritize risks based on likelihood of occurrence and severity of potential consequences
 - Document risk assessment and internal supervisory control objectives and activities in RCMs

- Risk and control matrixes (RCM) are risk-assessment tools used by the divisions and office to document risks and internal controls. RCMs are stored in the applicable information management system.
- **Internal supervisory control testing**
 - Division and office staff assess the effectiveness of internal supervisory controls:
 - Control design assessment and
 - Operating effectiveness assessment
 - Control in place and meets stated objective
 - Documentation of control execution available for review
 - Control consistently operates as intended
 - If control design or operating effectiveness assessments fail, division and office staff must address the deficiency with a corrective action plan (CAP)
 - CAP
 - CAPs describe a plan to mitigate deficiencies identified during control design or operating effectiveness assessments. CAPs are closed only after division and office staff validate that they remediated the deficiency.
 - Internal supervisory control assessment testing plans and results must be documented in the applicable information management system.
- **Communication of assessment results**
 - Division and Office staff - Present a summary of their assessment results to their applicable directors.
 - Directors - Disclose to the Chair of SEC any significant deficiencies in the design or operation of internal supervisory controls identified as a result of the director's evaluation.
 - Chair of SEC - Division and office staff provide the annual report to Congress no later than 90 days after the end of each fiscal year. This report describes SEC's evaluation process and includes SEC's conclusion as to whether the internal supervisory controls were effective for the last 90 days of the fiscal year, and whether any significant deficiencies were identified.

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

Federal Internal Control and Financial Management Standards

Standards for Internal Control in the Federal Government provides the overall framework for establishing and maintaining internal control in federal agencies.⁷ Agency management is responsible for adapting the framework for an agency. An agency may use the framework to organize its development and implementation of internal 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: (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring. 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 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.

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).⁸ 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. FMFIA also requires agencies to provide an assurance statement regarding the effectiveness of the agency's internal controls.⁹ SEC's internal controls for financial management systems are not included in this report because they are reported in our

⁷[GAO-14-704G](#).

⁸See 31 U.S.C. § 3512.

⁹See 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).

annual financial audit of SEC. All of SEC's internal controls—including those that constitute internal supervisory controls—are in scope for FMFIA.

Fiscal Year 2021 Risk Assessments Generally Were Consistent with SEC Guidance

SEC Conducted Risk Assessments and Prepared Risk and Control Matrixes That Included Internal Supervisory Controls

The divisions and office generally followed SEC's risk-management guidance in conducting their fiscal year 2021 risk assessments and preparing their risk and control matrixes (RCM), which included the internal supervisory controls.¹⁰ Through their annual risk-assessment process, the SEC divisions and office identify and analyze risks to achieving their objectives and determine whether internal supervisory controls are needed to mitigate those risks. This process includes the following steps:

- Understanding and identifying division or office objectives and related processes
- Identifying, analyzing, and responding to change that could significantly affect the internal control system
- Identifying and documenting risks within division or office processes, including fraud risks
- Prioritizing risks based on significance (likelihood and impact)
- Identifying and documenting internal controls to meet the control objective and mitigate the risks

The divisions and office record the results of their risk assessments in an RCM that shows the relationship among division or office objectives, processes, risks, and internal controls. According to the Office of the

¹⁰The divisions' and office's risk assessments support multiple requirements, including enterprise risk management requirements under Office of Management and Budget Circular A-123 and management assurance requirements under FMFIA. Division and office RCMs include controls that are relevant to other requirements but are not internal supervisory controls for the purpose of section 961. In reviewing RCMs, we considered only controls the divisions and office designated as relevant to section 961.

Chief Operating Officer's *Risk Management and Internal Control Review Reference Guide*, descriptions of internal control activities in RCMs should "contain all essential attributes (who, what, when, why and how) to adequately mitigate risks." The descriptions also should identify evidence that can be used to test whether the control is operating, such as a signature or approval.

We found the risk-assessment process for each division and office addressed the key steps, such as defining objectives, gathering updated information about business processes, identifying changes that could affect internal supervisory controls, consulting process and control owners, and documenting risks and controls. In addition, Corporation Finance's, Examinations', and OCR's descriptions of the internal supervisory control activities in their fiscal year 2021 RCMs met all guidelines in the risk management guide.

For Enforcement, 23 of its 26 internal supervisory control activity descriptions fully met the risk management guidelines. For three controls, one or more essential attributes were not documented in the RCM. For example, one description did not identify the person responsible for implementing the control. However, these documentation issues did not affect Enforcement's ability to assess the effectiveness of its internal supervisory controls (as discussed below). During the course of our review, Enforcement updated the three control activity descriptions to include all essential attributes.

Internal Supervisory Controls Address Key Operational Procedures and Have Been Updated Recently

According to our review of staff procedures, RCMs, and related information, each division and office incorporated internal supervisory controls in its RCM that covered key stages of its operations. Table 2 below provides examples of such controls.

Table 2: Examples of Internal Supervisory Controls SEC’s Divisions and Office Used for Key Operational Stages

SEC division or office	Examples of internal supervisory controls for key operational stages
Division of Examinations	<ul style="list-style-type: none"> • Planning examinations: Examination managers or assistant directors approve examination scoping and staffing. • Developing findings: Assistant directors review the examination workbook.
Office of Credit Ratings	<ul style="list-style-type: none"> • Planning examinations: Assistant director approves examination planning and scoping documentation. • Developing findings: The branch chief or assistant director approves the final examination worksheets.
Division of Enforcement	<ul style="list-style-type: none"> • Opening investigations: Investigative senior officers approve the opening of an investigation. • Recommending enforcement actions: Investigative senior officers approve the decision to recommend enforcement action.
Division of Corporation Finance	<ul style="list-style-type: none"> • Screening filings: Managers or approved staff members approve initial screening recommendations for filing reviews. • Examining filings: A staff member reviews filings that require a second-level review.

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

Each division and office produced a new version of its RCM in fiscal years 2019, 2020, and 2021. SEC officials told us they reviewed RCMs annually and made updates based on feedback from senior management and control owners, operational changes that affected internal supervisory controls, and recommendations from GAO and SEC’s Office of Inspector General, as illustrated by the examples below.¹¹

- Corporation Finance removed an internal supervisory control from its RCM in fiscal year 2019 because it made a policy change that reduced the risk the control was designed to mitigate.
- Examinations undertook a reassessment of its internal control design in fiscal year 2021 that included a comprehensive RCM review, according to Examinations officials. As a result, Examinations created four new internal supervisory controls, eliminated two, and reclassified four others as not covered by section 961.
- OCR removed two internal supervisory controls in fiscal year 2020 because it determined that their content could be consolidated under

¹¹Most recently, the SEC Office of Inspector General reviewed Examinations’ planning of registered investment adviser examinations and made three recommendations, including that the division develop controls to help ensure timely supervisory approval of an examination’s pre-fieldwork phase. Examinations management agreed with all the recommendations. Securities and Exchange Commission, Office of Inspector General, *Registered Investment Adviser Examinations: EXAMS Has Made Progress To Assess Risk and Optimize Limited Resources, But Could Further Improve Controls Over Some Processes*, report no. 571 (Washington, D.C.: Jan. 25, 2022).

other controls and added one internal supervisory control in response to a GAO recommendation.¹²

- Enforcement increased the number of internal supervisory controls by one in 2019 when it reclassified an existing control as relevant to section 961. Enforcement also made changes to internal supervisory control descriptions in its RCM in response to suggestions from risk and control owners.

Processes to Assess Internal Supervisory Controls Generally Were Consistent with SEC Framework

SEC's framework for assessing the effectiveness of internal supervisory controls—which includes the section 961 reference and risk management guides—generally was consistent with the monitoring component of federal internal controls and the underlying principles that management should perform monitoring activities and evaluate issues and remediate deficiencies. For example, the framework included guidance on documenting internal control responsibilities, establishing a baseline to monitor controls, reporting issues, evaluating and documenting the results of evaluations, and completing and documenting corrective actions to remediate internal control deficiencies.

The divisions and office developed and implemented processes generally consistent with SEC's framework to assess the design and operating effectiveness of their internal supervisory controls for fiscal year 2021. Specifically, our review of the testing records found that the divisions and office tested all controls not under a corrective action plan.¹³ They generally documented the work performed, including evidence collected and analyzed, and supported their findings and conclusions. As shown in

¹²Our 2019 review of SEC's internal supervisory controls recommended that the divisions and office should develop written policies and processes to systematically assess the effectiveness of staff procedures. SEC fully implemented this recommendation in September 2021, and OCR added an internal supervisory control for conducting the staff procedure assessment. See [GAO-20-115](#).

¹³When a division or office finds the design or operation of an internal control to be deficient, it creates a corrective action plan for correcting or eliminating the deficiency. The corrective action plan helps ensure a deficiency is prioritized and remediated.

table 3, they determined that the design and operations of their internal supervisory controls were effective in fiscal year 2021.

Table 3: Number of Internal Supervisory Controls for Which Design and Operating Effectiveness Were Tested in Fiscal Year 2021 and the Results

SEC division or office	Number of internal supervisory controls	Number of internal supervisory controls tested for effectiveness	Number of internal supervisory controls found to be effective
Division of Corporation Finance	6	6	6
Division of Enforcement	26	26	26
Division of Examinations	14	12 ^a	12
Office of Credit Ratings	13	13	13

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

^aTwo of the internal supervisory controls were under corrective action plans; thus, their operating effectiveness was not tested.

SEC Plans to Assess Staff Procedures Generally Were Consistent with Applicable Standards, but Lack Key Assessment Steps

SEC Developed and Implemented Plans to Assess the Effectiveness of Staff Procedures

In response to our 2019 recommendation, SEC divisions and office developed and implemented written plans to assess the effectiveness of the procedures their staff use to perform reviews of examinations, investigations, and securities filings.¹⁴ In 2020, the 961 Working Group revised its reference guide to require the divisions and office to develop these plans. The guide specifies steps to be included in the plans, such as time frames for conducting the assessments and requirements for

¹⁴In our 2019 review, we found that SEC's assessments of internal supervisory controls did not directly assess the effectiveness of staff procedures and that the activities the divisions and office referenced as such assessments did not represent systematic assessments for the purposes of section 961. Those activities varied among the divisions and office, were implemented on an irregular basis, and were not established through written policies or procedures. We recommended the SEC Chair direct the divisions and office to develop written policies and processes to systematically assess the effectiveness of staff procedures. We also noted examples of elements SEC could include (such as process steps and time frames, responsibilities, documentation requirements, and steps for mitigating and reporting identified deficiencies). See [GAO-20-115](#).

documenting the assessments and mitigating and reporting deficiencies identified through the assessments. The guide also states the plans should demonstrate how the assessments directly address whether the procedures are reasonable, adequate, current, and designed to achieve their stated objectives.

The divisions and office developed their plans in 2020 and implemented them in 2021.¹⁵ Division and office officials told us the plans formalized existing processes to monitor staff procedures. As shown in table 4, the divisions and office engage in a number of activities to assess their staff procedures.

Table 4: Assessment Activities Included in SEC’s 2021 Written Plans to Assess Staff Procedures

Division or office	Assessment activity
Division of Examinations	<ul style="list-style-type: none"> • Examine the work of internal committees to monitor examination program operations and review and assess staff procedures • Conduct assessments of specific controls that relate to monitoring staff procedures • Conduct other inquiries, such as reviewing audit findings from GAO and Office of the Inspector General reports and examining performance metrics to consider whether any failure to meet strategic plan goals was the result of ineffective staff procedures
Division of Enforcement	<ul style="list-style-type: none"> • Conduct internal supervisory control testing^a • Review and update EnforceNet, a central repository for staff guidance and information • Discuss proceeding cases during quarterly case reviews between staff and management • Publish an annual report, which includes metrics related to the work of the division
Division of Corporation Finance	<ul style="list-style-type: none"> • Conduct quarterly testing of four staff procedures • Conduct ad hoc assessments relevant to evaluating the effectiveness of the disclosure review program • Review external commentary about disclosure program effectiveness, such as accounting and law firm publications, academic papers, and news articles and blogs
Office of Credit Ratings	<ul style="list-style-type: none"> • Review program manual periodically • Conduct an after-action review following the completion of the annual examination cycle to analyze input received from internal sources (staff feedback) and external sources (credit rating agencies)

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

^aAlthough the Division of Enforcement includes internal control testing as an activity to assess staff procedures, in 2019 we found that SEC’s assessments of internal supervisory controls did not directly assess the effectiveness of staff procedures. We recommended the SEC Chair direct the divisions and office to develop written policies and processes to systematically assess the effectiveness of staff procedures. We considered our recommendation to be fully implemented in 2021 after the Section

¹⁵We considered our recommendation to be fully implemented in 2021 after the 961 Working Group revised its reference guide to require the divisions and office to develop written plans to assess staff procedures and the divisions and office developed such plans.

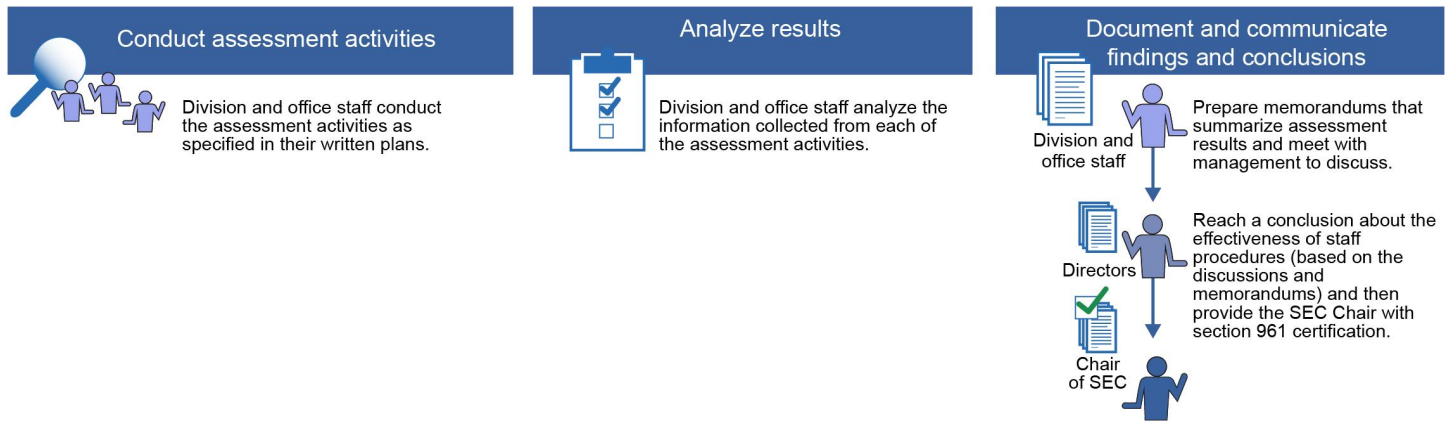
961 Working Group revised its reference guide to require the divisions and office to develop written plans to assess staff procedures and the divisions and office developed such plans. See [GAO-20-115](#).

Plans Generally Were Consistent with Applicable Guidance and Implemented Accordingly

We found that the divisions' and office's written plans generally were consistent with applicable SEC guidance and federal internal control standards. Consistent with the 961 Working Group's guidance, the divisions' and office's plans identified relevant procedures applicable to staff as those documented in their program manuals and in related guidance. The plans documented steps to conduct the assessments, specified the assessment activities that would be conducted to collect information about the effectiveness of staff procedures, and described how the assessments would be documented. The plans also were consistent with the monitoring component of federal internal controls and the underlying principle that management should perform monitoring activities and evaluate issues. Specifically, the plans generally specified activities to monitor and assess the procedures—including establishment of a baseline for monitoring—and steps to evaluate and document results of the assessments.

According to our review of the assessment records, the divisions and office generally conducted their fiscal year 2021 assessments of staff procedures in accordance with their plans. Specifically, the divisions and office conducted the assessment activities in their plans (see table 4), analyzed the results of the activities, and documented the conclusions about the effectiveness of their staff procedures (see fig. 2).

Figure 2: Overview of SEC’s Section 961 Assessment of Staff Procedures



Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

Text of Figure 2: Overview of SEC’s Section 961 Assessment of Staff Procedures

- **Conduct assessment activities**
 - Division and office staff conduct the assessment activities as specified in their written plans.
- **Analyze results**
 - Division and office staff analyze the information collected from each of the assessment activities.
- **Document and communicate findings and conclusions**
 - Division and office staff: Prepare memorandums that summarize assessment results and meet with management to discuss.
 - Directors: Reach a conclusion about the effectiveness of staff procedures (based on the discussions and memorandums) and then provide the SEC Chair with section 961 certification.

Source: GAO analysis of Securities and Exchange Commission (SEC) information. | GAO-23-105465

Enforcement’s Director Memorandum Did Not Document All Elements

To inform and support their directors’ fiscal year 2021 certification of compliance with section 961 requirements, division and office staff

prepared memorandums for their directors.¹⁶ But unlike the other divisions and office, Enforcement's memorandum did not include a summary of the work performed for or the results of the assessment of staff procedures. Instead, the memorandum largely summarized the work performed for and results of its assessment of internal supervisory controls. Regarding the assessment of staff procedures, the memorandum stated only that the assessment had been done and no deficiencies had been found.

According to the 961 Working Group's reference guide, each division or office should document the methodology and results of its testing procedures to support its assessments, and the documentation should link the results of its assessments to the conclusions in SEC's annual reports to Congress under section 961. Additionally, the reference guide states that the written plans should demonstrate how the assessments directly address whether staff procedures are reasonable, adequate, current, and designed to achieve their stated objectives. The working group's chair told us that, as envisioned by the reference guide, the divisions and office make this demonstration through their section 961 memorandums to their directors.

In comparing Enforcement's fiscal year 2021 and 2020 memorandums, we found the two memorandums were nearly identical, except for the dates covered in the review and findings related to internal control testing. This suggests that staff largely used the fiscal year 2020 memorandum as a template for the fiscal year 2021 memorandum, but the 2020 assessment did not include the newly adopted written plan for assessing the effectiveness of staff procedures. According to an Enforcement official, the section 961 memorandum is the only document summarizing the work performed and conclusions reached for the fiscal year 2021 assessment of staff procedures. Because Enforcement's memorandum did not summarize the work performed for and results of its assessment of the effectiveness of staff procedures, the Enforcement director faced the risk of not having the information needed to make a fully informed decision about the section 961 certification.

¹⁶Under section 961, each division and office director must certify that the individual (1) is directly responsible for establishing and maintaining the internal supervisory controls of his or her office; (2) is knowledgeable about the internal supervisory controls of his or her office; (3) has evaluated the effectiveness of the internal supervisory controls during the 90-day period ending on the final day of the fiscal year; and (4) has disclosed to the commission any significant deficiencies in the design or operation of internal supervisory controls that could adversely affect the ability of his or her office to consistently conduct examinations, investigations, or reviews with professional competence and integrity.

Plans Do Not Call for Using Program Data or Periodically Reviewing Staff Procedures

Use of Program Data in Assessment of Staff Procedures

Division and office written plans for assessing staff procedures generally did not include a step for using program data to assess the effectiveness of the procedures. Examinations and Enforcement plans considered whether changes in their performance metrics are related to staff procedures. For example, one performance metric Examinations uses is the percentage of investment advisers examined in a year. According to Examinations officials, if the division were to fail to achieve its investment adviser coverage goals, it then would assess whether this failure was the result of ineffective staff procedures. In our view, the metrics generally reflect the ability of staff procedures to achieve program efficiency rather than overall program effectiveness.

OCR's and Corporation Finance's plans do not include steps for using program data to assess staff procedures. Corporation Finance's plan notes there are no quantitative metrics available that indicate the effectiveness of efforts to monitor and enhance compliance with disclosure and accounting requirements. OCR officials told us they consider only qualitative metrics, such as overlooking or missing issues during an examination of a nationally recognized statistical rating organization (NRSRO) or being unprepared for any NRSRO-specific events.

Based on our review of program manuals and other information, we found that the divisions and office collect data about their examinations, investigations, and filing reviews. For example, they collect data on the number of (1) examinations with deficiencies, (2) investigations that result in an enforcement action, and (3) annual report filing reviews that have staff comments.¹⁷ This gives the divisions and office an opportunity to use

¹⁷If an examination reveals deficiencies, Examinations issues a deficiency letter to help ensure the entity is aware of deficiencies observed during the examination and puts the entity on notice that corrective action is recommended. Deficiencies may include violations, or apparent violations, of a law, rule, or regulation; or significant weaknesses in the entity's controls, even where there are no violations of a law, rule, or regulation. Enforcement files enforcement actions in response to violations of federal securities laws detected during investigations. In filing reviews, Corporation Finance communicates its questions, concerns, and suggestions for disclosure improvements to companies with comments, as well as through speeches and other disclosure guidance.

program data to develop program metrics, such as percentage of examinations, investigations, or reviews that result in a specified outcome. In turn, as an additional activity in the written plans, SEC could use such metrics to monitor and investigate trends to determine whether changes were related to the effectiveness of staff procedures.

In a January 2022 staff report, OCR presented information on changes in the number of essential findings in the eight review areas covered in 2016–2021 NRSRO examinations.¹⁸ OCR noted that the number of essential findings from the 2016 examination cycle was higher in several review areas, which likely was related to the new and amended rules that became effective in 2015. OCR observed that the decrease in essential findings over subsequent examination cycles likely indicated NRSRO's greater awareness of applicable laws and obligations as regulated entities. Although SEC officials noted that a myriad of factors contribute to the number of findings in NRSRO examinations, changes in finding trends could prompt OCR to investigate the extent to which, if any, such changes are related to staff procedures.

According to the 961 Working Group's reference guide, the divisions' and office's policies and processes should demonstrate how the assessments directly address whether the procedures applicable to the staff are reasonable, adequate, current, and designed to achieve their stated objectives. According to federal internal control standards, agencies should use quality information to achieve objectives, which includes processing obtained data into quality information. Fiscal year 2021 was the first year that the divisions and office implemented their written plans for assessing staff procedures. The plans and assessments likely will continue to evolve, as the divisions and office gain experience.

By incorporating the analysis of program data in their staff procedures assessment, the divisions and office could complement their current qualitative approaches with data-driven insights to assess the effectiveness of staff procedures. The development and monitoring of

¹⁸See Securities and Exchange Commission, Office of Credit Ratings, *Staff Report on Nationally Recognized Statistical Rating Organizations: As Required by Section 6 of the Credit Rating Agency Reform Act of 2006 and Section 15E(p)(3)(C) of the Securities Exchange Act of 1934* (Washington, D.C.: January 2022). An essential finding is any instance of apparent noncompliance by an NRSRO with the federal securities laws or related SEC rules applicable to NRSROs, except those instances attributable to a nonrecurring and nonsignificant clerical or ministerial error or omission. Areas covered included adherence, internal supervisory controls, conflicts of interest, ethics policies, governance, and complaints.

program metrics could enable the divisions and office to monitor trends and understand the extent to which such trends, including changes, are positively or negatively related to staff procedures. Such a data-driven approach could better position them to respond more quickly to changes in trends and adjust staff procedures as needed.

Review of Staff Procedures on a Periodic and Comprehensive Basis

SEC divisions have not incorporated into their written plans a step to periodically and comprehensively review their staff procedures. In their plans, the divisions and office state their staff procedures are reflected primarily in their respective program manuals. However, except for OCR, the divisions do not include in their plans a step for periodically reviewing their program manuals on a comprehensive basis.

In its plan, OCR notes program manual reviews will be conducted annually by senior management and reviewed periodically by staff as needed to determine whether any revisions or additions are needed. The policy for this process is included in OCR's program manual. OCR's manual was last updated in April 2021.

In its plan, Enforcement cites the review and update process of EnforceNet, its central repository for staff guidance and primary means of communicating procedures to staff, as a monitoring activity. The division's policy is to review Topic Pages—pages of EnforceNet that cover a particular aspect of the program—about every 2 years following initial publication of each topic narrative. Enforcement's manual, a public reference document that describes certain policies and procedures for the division's investigative processes, was last updated in November 2017. According to Enforcement officials, the division plans to review and, as needed, update the manual.

Examinations also reviews and updates its program manual, but this process is not included in its plan. An Examinations official told us the division has a number of activities with objectives similar to program manual reviews. These include the Exam Process Advisory Committee's biweekly meetings to review and assess policies and procedures, which are included in the plan. The division's program manual also includes a section on the periodic review of its manual. According to Examination officials, they typically update their manual several times a year.

Like Examinations, Corporation Finance reviews and updates its program manual, but this process is not included in its plan. A Corporation Finance official told us the division considers potential updates to the program manual as it conducts its quarterly analysis of feedback collected through its staff procedure assessment activities, but the division currently has no written policy to update its program manual. Corporation Finance's manual was updated in October 2020 and, according to Corporation Finance officials, has been regularly assessed thereafter, with updated temporary guidance released in June 2021.

The 961 Working Group's guidance states that the divisions' and office's plans should demonstrate how the assessments directly address whether the procedures applicable to the staff are reasonable, adequate, current, and designed to achieve their stated objectives. According to federal internal control standards, agencies should establish and operate monitoring activities to monitor the internal control system and evaluate the results. Ongoing monitoring is built into agency management's operations, performed continually, and responsive to change. As mentioned earlier, fiscal year 2021 was the first year that the divisions and office implemented their plans for assessing staff procedures. The plans and associated processes likely will continue to evolve, as the divisions and office gain experience.

By incorporating in their plans a step to periodically review their program manuals on a comprehensive basis, the divisions would help ensure that all procedures are assessed regularly, including lower-risk procedures that may not be raised during committee meetings or through staff feedback. Linking the review to the plans for assessing staff procedures under section 961 also would formalize the process and help ensure that program manuals are kept up-to-date.

Conclusions

SEC's well-established framework and processes for section 961 assessments of risks and of internal supervisory controls generally are consistent with applicable standards. The reference guide developed by SEC's 961 Working Group has helped further the efficiency and effectiveness of SEC's processes related to section 961 compliance. However, some gaps exist in the guidance for new processes to assess the effectiveness of staff procedures, and application of the guidance among the divisions and office varies.

We note the following opportunities for improvement that could be undertaken at both the individual division and office level and through the 961 Working Group:

- Division and office staff used memorandums to provide their directors with support for section 961 certification, but Enforcement's memorandum did not summarize the work performed for and results of its fiscal year 2021 assessment of staff procedures. Including a summary of the work and results in the memorandum would give the division director the support needed to make a fully informed decision about section 961 certification.
- Although the divisions and office collect data about their programs, they generally do not include a step in their written plans to use such data to help assess the effectiveness of staff procedures. Revising the 961 Working Group's reference guide to include guidance on developing and monitoring program metrics as an additional step could improve the effectiveness and consistency of the assessments.
- The divisions' and office's program manuals are their primary staff procedures. While the divisions and office periodically update their manuals, only OCR's plan for assessing staff procedures includes a review of the program manual. Revising the reference guide to require that written plans include a periodic and comprehensive review of program manuals would promote greater consistency and help ensure that all procedures remain effective and relevant.

Recommendations for Executive Action

We are making the following three recommendations to SEC.

The Director of the Division of Enforcement should ensure that the division's memorandum regarding certification under section 961 of the Dodd-Frank Act include a summary of the work performed for and results of the assessment of the effectiveness of staff procedures. (Recommendation 1)

The 961 Working Group should revise its *Reference Guide for Compliance with Section 961 of the Dodd-Frank Act* to include guidance on using program data to help assess the effectiveness of staff procedures. (Recommendation 2)

The 961 Working Group should revise its *Reference Guide for Compliance with Section 961 of the Dodd-Frank Act* to require the relevant divisions and office to include in their written plans for assessing the effectiveness of staff procedures a requirement that they review their program manuals on a periodic and comprehensive basis. (Recommendation 3)

Agency Comments

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

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. 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 focuses on activities that the Securities and Exchange Commission's (SEC) Division of Corporation Finance, Division of Enforcement, Division of Examinations, and Office of Credit Ratings undertook in fiscal year 2021 relating to requirements under section 961 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).¹ We examined the extent to which the SEC divisions and office (1) identify and assess the risk of staff not following staff procedures and, if needed, develop internal supervisory controls to mitigate such risk; (2) assess the effectiveness of their internal supervisory controls, and (3) assess the effectiveness of their staff procedures in achieving their objectives.

For our first objective, we reviewed the divisions' and office's processes for conducting annual risk assessments to evaluate the extent to which they were consistent with applicable SEC guidance, including the Office of the Chief Operating Officer's *Risk Management and Internal Control Review Reference Guide*. We also evaluated these processes against federal internal control standards—specifically the risk assessment component and the underlying principles that management should define objectives clearly; identify, analyze, and respond to risks related to achieving the defined objectives; and identify, analyze, and respond to significant changes that could impact the internal control system.²

We obtained the divisions' and office's risk and control matrixes (RCM), examples of their correspondence with risk or process owners, and other records that the divisions and office used to document and support their

¹Section 961 of the Dodd-Frank Act directs SEC to provide Congress with an annual report on the conduct of SEC's examinations, investigations, and securities filing reviews. 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). Pub. L. No. 111-203, § 961(a), 124 Stat. 1376, 1907 (2010) (codified at 15 U.S.C. § 78d-6(a)).

²See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

fiscal year 2021 risk assessments.³ We then used the records to evaluate the extent to which divisions and office followed SEC guidance in conducting and documenting their fiscal year 2021 risk assessments. In addition, we reviewed the divisions' and office's program manuals, including internal controls, RCMs, and other records to identify the key activities of examinations, filing reviews, and investigations and, in turn, evaluate whether the divisions and offices had internal supervisory controls covering the activities. To evaluate changes that the divisions and office made to their internal supervisory controls and the rationale for the changes, we obtained and reviewed the divisions' and office's RCMs (which document internal supervisory controls) for fiscal years 2019–2021 and corresponding records used to document and explain changes to RCMs.

For our second objective, we reviewed the divisions' and office's section 961 reports to Congress for fiscal years 2019–2021 and internal memorandums supporting the reports to evaluate whether they met the section 961 reporting requirements under the Dodd-Frank Act. We also evaluated whether SEC's framework for assessing the effectiveness of internal supervisory controls—which includes the 961 Working Group's *Reference Guide for Compliance with Section 961 of the Dodd-Frank Act* and the Office of the Chief Operating Officer's guide—was consistent with the monitoring component of federal internal controls and the underlying principles that management should perform monitoring activities and elevate issues and remediate deficiencies.⁴

For each division and office, we obtained internal memorandums, testing sheets, and other records documenting the scope of its internal supervisory control assessment, work performed to assess the design or operation of the controls, and conclusions reached about the effectiveness of the controls. We then used the records to evaluate the extent to which each division and office assessed the design and

³RCMs are risk-assessment tools the divisions and office use to document risks and internal controls, including internal supervisory controls.

⁴The Section 961 Working Group is a staff-level group established in 2010 and chartered in 2016 to enhance the efficiency and effectiveness of SEC processes associated with complying with section 961 of the Dodd-Frank Act and to enhance coordination and information sharing among the section 961 divisions and office. The purpose of its reference guide is to establish a common understanding of and consistent approach to compliance with section 961 of the Dodd-Frank Act. Federal internal controls standards provide the overall framework for establishing and maintaining an effective internal control system. See GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

operation of all controls, documented the assessment results, and collected evidence to support the conclusions.

For our third objective, we evaluated the extent to which the divisions' and office's plans for assessing the effectiveness of staff procedures were consistent with applicable SEC guidance, including the Section 961 Working Group's reference guide. We also evaluated these plans against the monitoring component and underlying principle of federal internal control standards that management should perform monitoring activities and evaluate issues. We reviewed the divisions' and office's program manuals, annual reports, performance metrics, and other program-related materials to evaluate the plans' approaches for assessing staff procedures. To evaluate the extent to which the divisions and office followed their written plans, documented their assessments, and supported their conclusions, we obtained and reviewed internal memorandums regarding the section 961 assessments, ad hoc or targeted assessments, and other records that the divisions and office used to document and support their fiscal year 2021 assessment of the effectiveness of staff procedures.

For all three objectives, we interviewed SEC staff from the divisions and office about their processes for conducting annual risk assessments, assessing the design and operation of their internal supervisory controls, and assessing the effectiveness of staff procedures. We also interviewed the chairperson and other members of SEC's Section 916 Working Group about its reference guide and related issues.

We conducted this performance audit from October 2021 to November 2022 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.

Appendix II: Comments from the Securities and Exchange Commission



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

October 28, 2022

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: Additional Guidance Needed For Assessing Staff Procedures* (GAO-23-105465). We appreciate GAO's insights and recommendations related to the Securities and Exchange Commission's (SEC) efforts under Section 961 of the Dodd-Frank Act of 2010 to maintain effective internal supervisory controls over examinations of registered entities, enforcement investigations, and reviews of corporate disclosure filings.

We are pleased GAO found that the SEC conducts risk assessments and establishes internal supervisory controls in accordance with established guidance, and that the agency's framework for assessing those controls reflects federal standards. The GAO's report contains three recommendations for the SEC to enhance its guidance for assessing staff procedures and improve documentation of these assessments. We concur with the recommendations and will take appropriate management action to implement them in a timely manner.

Thank you for the consideration you and your staff have shown our agency during this engagement. If you have any questions, please do not hesitate to contact me at (202) 551-4306.

Sincerely,

Kenneth A. Johnson
Chief Operating Officer

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

October 28, 2022

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,

Kenneth A. Johnson Chief Operating Officer

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

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

Staff Acknowledgments

In addition to the contact named above, Richard Tshara (Assistant Director), Tarik Carter (Analyst in Charge), Margaret Devlin, Loren Lipsey, Alicia Martinez-Melton, Scott McNulty, Marc Molino, William Reinsberg, Barbara Roesmann, Grant Simmons, and Farrah Stone made key contributions to this report.

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