Testimony Concerning Strategic Planning and Operational Effectiveness

Peter Derby
Managing Executive for Operations, U.S. Securities and Exchange Commission

(Accompanied by James M. McConnell
Executive Director, U.S. Securities and Exchange Commission)

Before the Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
United States House of Representatives

July 23, 2003

Chairman Platts, Ranking Member Towns, and Members of the Subcommittee:

Thank you for the opportunity to testify today on behalf of the Chairman of the Securities and Exchange Commission about our exciting initiatives related to strategic planning and operational effectiveness. The Commission takes seriously its need to fulfill its investor protection mission and to utilize taxpayer resources efficiently and effectively. After a short statement, Executive Director Jim McConnell and I look forward to addressing any questions that you may have.

At the outset, I would like to thank on behalf of the Chairman, the members of this subcommittee and all other members of Congress for supporting the "Accountant, Compliance, and Enforcement Staffing Act of 2003" that recently was passed unanimously and signed into law by the President. Without this vital legislation, many of the strategic planning, personnel, and operational initiatives that I will address today would be in jeopardy due to our difficulties hiring additional professional staff in a timely manner.

Environment

When Chairman Donaldson took the helm five months ago, the SEC had reached a critical juncture. Recent accounting scandals, earnings restatements, and bankruptcies have damaged our economy and severely shaken investor faith in the fairness of our markets. These events come on the heels of tremendous industry growth, innovation, and change. Today, over half of all U.S. households are invested in our capital markets. Twenty years ago, that rate was less than 20 percent. In addition, mutual fund investments now exceed the amount on deposit at commercial banks by more than $2 trillion and are equal to the approximately $7 trillion in total financial assets currently in the commercial banking system.

With these changes, the workload of the Commission has increased significantly over time. However, until recently, our staffing and budgetary resources did not keep pace with the growth of that workload. For example, the number of open enforcement investigations increased 81 percent over the last ten years, whereas our enforcement staff grew only 21 percent. While the total number of companies filing annual reports increased 73 percent over the last 20 years, the total number of staff in our Division of Corporation Finance rose only 29 percent. As a result, in 2002, we were only able to review about 23 percent of issuers, well below the 33 percent required under the Sarbanes-Oxley Act. During the IPO boom years, the average time in which we issued initial comments on small business filings was significantly longer than the time in which we issued initial comments on all other filings. Although in the last three years we have generally been able to issue initial comments on transactional filings, including small business filings, quickly enough to meet our objectives, a return to the volume of the IPO boom years would severely tax our ability to continue meeting these timeframes and to review as many reporting companies as we would like. With the increased financial resources the agency received a few months ago, we believe we will be in a much better position as we move forward to meet the demands of our mission and the new congressional mandates.

Fiscal 2003 Resource Levels

Staffing

On February 20, 2003, the President signed into law the Consolidated Appropriations Resolution, providing the Commission with a fiscal year 2003 appropriation of $716 million, which is $278 million more than our fiscal 2002 appropriation. A portion of these funds will be used to hire 842 new staff. These new positions have been allocated as follows:

Division/Office	**# of new positions**
Office of Compliance Inspections and Examinations:	308
Division of Enforcement:	209
Division of Corporation Finance:	176
Division of Market Regulation:	35
Office of Information Technology:	30
Office of the Chief Accountant:	20
Division of Investment Management:	16
Other:	48

These staffing allocations were determined through an exhaustive analysis beginning with the findings of the draft study on operations and resources and culminating in multiple meetings with each division director and program manager. During these meetings, each manager presented detailed justifications for the slots including their impact on the mission of the agency.

These new positions will allow us to: 1) implement the Sarbanes-Oxley Act, including the review of each registrant's financial statements every three years; 2) enhance our enforcement program so we can bring more investigations and complete them sooner; 3) review investment advisers and investment companies more frequently, based on risk criteria; and 4) conduct more broker-dealer branch-office examinations; among other activities.

Information Technology

In addition to providing a much-needed staffing increase, our fiscal 2003 appropriation roughly doubled to $100 million the amount available for information technology. In recent years, the Commission received only enough funds to maintain a "lights-on" operations level and to undertake a few small-scale projects. As a result, the SEC entered fiscal 2003 with a substantial backlog of information technology needs.

For the last four years, we have based our acquisitions of new information systems on the recommendations of our information technology capital planning committee. This rigorous process, which is consistent with the requirements of the Clinger-Cohen Act and OMB guidance, has strengthened the Commission's decision-making processes by requiring that all requests for new information systems be reviewed by a diverse group of senior SEC program staff. In particular, it has proven effective in getting divisions to see beyond their own information technology "stovepipes" and to prioritize the needs of the agency as a whole. As a result, we are very well situated to responsibly deploy our fiscal 2003 funding increase for IT.

The Commission's fiscal 2003 appropriation provides funding for three major, multi-year information technology initiatives: development of a robust document management system for our enforcement and inspections programs, enhancements to our information technology security architecture, and a review of the Commission's disclosure business processes.

- Document Management: For each of our biggest enforcement investigations, the SEC receives hundreds of boxes of documents. Not only are these documents difficult to store, but SEC staff can spend countless hours searching for particular pieces of data. This illustrates why we are investing in a new document management system. The new system will allow attorneys and examiners to receive, store, and search non-evidentiary materials in electronic form, thereby saving staff time and storage space, providing backups in case of disaster, and improving the effectiveness of our enforcement and examination efforts.

- Security: Our second major information technology initiative is to enhance our disaster recovery program. The SEC learned first-hand from the loss of our New York Regional Office on September 11th the importance of keeping our data even more secure than it already is. In addition, we need the capacity to store and move large amounts of data from one regional or district office to another without first going through Washington. We need to move to a true "point to point" information technology system that allows us to mitigate the loss of data and to recover quickly in the event of a disaster. When this project is complete, the agency's critical files and information systems will be backed up daily and in multiple locations.

- Disclosure Review: When our current electronic disclosure system, EDGAR, was developed in the early 1980s, it was hailed as a major technological breakthrough for the agency. Now we are taking the next step. As part of a comprehensive review of our disclosure operations, we are modifying our review processes to make them more intensive, robust, and effective. We are also considering how to alter EDGAR accordingly to better support our mission. Finally, we have embarked on a process that seeks to convert financial statements into a new format that will allow investors and SEC staff to more easily view, analyze, and manipulate the data included in companies' SEC filings.

Fiscal 2004 Request

Budget Formulation

At the time the Commission began preparing its fiscal 2004 OMB budget, the agency had yet to receive its fiscal 2003 appropriation. The Commission used this situation as an opportunity to broadly assess our resource needs, instead of just building upon the prior year's funding level.

The SEC built its fiscal 2004 request on the preliminary results of a draft study on agency operations and resources. The study, which was conducted by senior SEC career staff with the support of outside consultants, was based on extensive interviews with current and former SEC staff and knowledgeable stakeholders outside the agency, as well as a comprehensive analysis of the data on each division's operations. The study had three primary goals: to explore ways to improve the quality and efficiency of agency operations; to recommend the level of resources needed to successfully perform each of our statutory duties; and to explore how the agency can regularly identify trends and risks in our external environment so that we can adjust our operations accordingly. We then used the draft study's preliminary findings to construct the 2004 budget proposal for each division and office from the ground up.

Pay Parity and Excepted Service Authority

Pay Parity

The Investor and Capital Markets Fee Relief Act, which was signed into law in January 2002, greatly enhanced the Commission's ability to attract and retain staff. This legislation allows the Commission to set pay and benefits comparable to those offered at other federal financial regulatory agencies, such as the Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency. This authority is helping us to attract highly qualified personnel and stem the long-term drain of our most talented and experienced staff members. "Pay parity" authority is a critical building block in our effort to meet our challenges and fulfill our responsibilities.

Excepted Service

A second, and equally significant, building block that will help shape the Commission's future is the recently enacted "Accountant, Compliance, and Enforcement Staffing Act of 2003." This law is a direct result of the support that the SEC has received from the Government Reform and Financial Services Committees, and is a tremendous victory for the investing public. It frees the Commission to quickly hire the new staff Congress provided for in the Commission's appropriations increase. Specifically, its provisions allow the Commission to hire accountants, examiners, and economists in the same manner that we currently hire attorneys. We will no longer lose high-quality job applicants because of a lengthy hiring process. At the same time, as a result of discussions with our union, the National Treasury Employees Union, this statute also preserves all the civil service protections that our employees previously had under the competitive service.

Strengthening SEC Operations, Accountability, and Effectiveness

While adequate staff and better information technology systems, a salary structure that reduces turnover, and expedited hiring authority all are essential to our ability to fulfill our mission, there is more that we must do. To be effective and efficient, the Commission must take additional steps to strengthen its internal operations, including its strategic planning and its accountability to stakeholders and the public. As an illustration of the seriousness with which Chairman Donaldson views this part of his responsibilities, he reorganized the Office of the Chairman to include three managing executives, one of which is a Managing Executive for Operations that works full-time on the SEC's efficiency and operational effectiveness. In addition, the Chairman is undertaking several other initiatives that should assist greatly in this regard.

Strategic Planning, Risk Assessment, and Management Accountability

The Commission is moving on several fronts to improve our strategic planning and management accountability activities. We are scheduled to issue our updated 2004-2009 GPRA Strategic Plan this fall. Since earlier this year, a cross-section of senior managers and staff has been meeting regularly to identify, discuss, and prioritize draft goals and objectives.

In addition, the draft study on operations and resources, mentioned earlier, represented a comprehensive strategic assessment and planning exercise that offered us a view of how best to align our staff and resources against the challenges we face. At the direction of Chairman Donaldson, the SEC is now implementing several key portions of the draft special study, including proposals to create a new Office of Risk Assessment and develop regularly-produced management reports, called "dashboards," that can provide ongoing snapshots of the agency's progress in meeting annual performance objectives.

The Office of Risk Assessment, as currently proposed, will support the SEC's divisions and offices by identifying risks that may affect the SEC's ability to fulfill its mission. By creating a risk assessment function, the Chairman and the agency will be able to determine more quickly whether new business trends and industry practices warrant further SEC attention and to proactively adjust operations and resources to address these new challenges.

Another of the Chairman's aggressive new initiatives is a systematic approach to program management, through the use of "dashboards," that will allow each program director on a regular basis to determine the progress made towards budget, staffing, and performance objectives. This approach will provide a more detailed picture of the Commission's operations and effectiveness than we've ever had before. At quarterly meetings, the Chairman and the division directors will review operations and performance to identify emerging problems, discuss possible solutions, and hold managers accountable for their staff and activities.

Audited Financial Statements

The Commission is preparing audited financial statements for the first time in our history. Under the recently enacted "Accountability of Taxpayer Dollars Act," the Commission is required by statute to meet all federal accounting guidelines and to be audited annually. While it makes sense that the SEC should do no less than we require of those we regulate, in order to have audited financial statements the Commission not only has to improve our management systems but also needs to resolve several complicated accounting issues. For example, one of our questions is how best to classify certain fines and penalties that are levied by the Commission but collected and disbursed by non-SEC receivers and trustees.

Even before the enactment of the "Accountability of Taxpayer Dollars Act" last fall, the Commission was working to enhance our internal controls and meet applicable reporting requirements. In early 2002 our Inspector General contracted with Cotton & Company, a small accounting firm, to conduct an assessment of the Commission's financial management systems controls. This assessment did not find any systematic problems that would indicate the Commission is misusing taxpayer dollars or lacks the ability to account for any funds.

However, it did identify several issues that we are now working to address by forming internal task forces, hiring additional staff, and enlisting additional contractor support. Two of our task forces are close to completing their work. For example, next month the Commission will consider a new policy developed by the registration fee task force that governs payments held in filers' deposit accounts. In addition, our property task force has bolstered the SEC's property accountability procedures and policies, which will soon be reviewed by our auditors. These efforts will help to resolve internal control issues that, if not improved, could be highlighted in our audit. We reached agreement with the General Accounting Office to perform our first audit, since we cannot hire a public accounting firm because of the SEC's regulatory role.

Although private companies going public generally take three years to move to audited financial statements and large federal agencies were given five years to do so, we have developed a plan that we expect will attain a clean opinion in 18 months.

Orientation/Training

As the Commission begins to hire more than 840 new employees, we have taken this opportunity to redesign and expand our orientation and training programs. We are developing a comprehensive orientation program that will welcome all our new employees with a solid foundation in the SEC's mission, culture, and values. Our new "SEC University" will ensure not only that our new employees learn their new responsibilities, but that all our staff continue to build their knowledge of rapidly evolving markets. Through this initiative, we will expand the in-house training activities of each division and office, launch new e-learning programs for both managers and employees, and develop new ways to keep staff abreast of industry practices. These steps are critical to maximize the effectiveness of our staff. But they also serve as an effective retention tool, exposing staff to hot issues facing other SEC divisions and new career opportunities within the Commission.

Conclusion

The Commission's most fundamental responsibility is to maintain investor confidence in the integrity of our securities markets. In addition, we must ensure that America's public companies provide accurate disclosures that truly reflect their activities and financial condition. The Commission's resource allocations, information technology investments, and strategic planning initiatives are essential components of these efforts. With new resources and staff, greater hiring flexibility, and a renewed concentration on the SEC's internal operations, we are making great strides forward. We look forward to sharing with you the results of these labors.

Thank you again for the opportunity to testify today.