

**Testimony Concerning
Resource Allocations and Strategic Planning**

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Management, Committee on Government Reform**

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

Thank you for the opportunity to testify on behalf of the Chairman of the Securities and Exchange Commission (SEC) regarding the SEC's allocation of recently received funding increases and strategic planning. The SEC has experienced unprecedented staffing and budgetary growth over the last three years, and we appreciate fully our responsibility to utilize these resources effectively and judiciously. In fiscal 2002, our budget was \$514.3 million; in 2003, it jumped to \$716.3 million; and by in 2004, it was \$811.5 million. The President's fiscal 2005 budget requests an additional \$101.5 million, for a total program level of \$913 million. This year's request is by far the largest ever proposed for the SEC and demonstrates a strong commitment to addressing the extraordinary challenges confronting the agency. The nation's investors and the industry we oversee need to be assured that we have a thorough, thoughtful plan to deploy these resources.

With this fundamental requirement in mind, I would like to update you on the strategic planning and operational initiatives that the SEC has made since Peter Derby, the SEC's Managing Executive for Operations, and I appeared before you last July. I also would respectfully request that in addition to my complete written statement, a copy

of Chairman Donaldson's recent Congressional testimony on the Commission's efforts to reform the mutual fund industry also be made part of the record.

Environment

The challenging environment in which the SEC operates has not abated since our hearing last summer. It has grown more complex. Last year, we faced accounting scandals, numerous earnings restatements, corporate and self-regulatory organization (SRO) governance issues, and analysts' conflicts of interest that severely shook investor confidence in the fairness of our markets. Prior to that, we faced the bursting of the dot-com bubble, a deluge of corporate malfeasance and fraud, and several years of constrained resource levels. More recently, the SEC has continued to uncover securities law violations in the mutual fund industry, such as those related to market timing and late trading.

The SEC's staff has been working hard to address all of these developments - from the global settlement on analysts' conflicts, to changes in SRO governance, and proposed rule changes to improve disclosures made to investors. On the enforcement side, our Division of Enforcement filed 679 enforcement actions in fiscal 2003 - more than in any previous year - and nearly 200 of these actions involved fraud or reporting violations. We have also made progress toward meeting the Sarbanes-Oxley Act requirement to review the filings of each publicly traded company once every three years.

With respect to our oversight of the mutual fund industry, we have taken a series of steps to improve our ability to identify and rectify problems early, before they can put large pools of investor savings at risk. We have increased the number of staff that inspect

investment funds and advisers by nearly 30 percent since fiscal 2002, to approximately 495 staff. With these new inspectors, the SEC has increased the frequency of examinations of funds and advisers posing the greatest compliance risks and has been able to conduct more examinations targeted to areas of emerging risk. Our inspection program also has been conducting more examination sweeps focused on issues of particular concern. Examples of some of the issues targeted include: payments by mutual funds for “shelf-space;” use of soft dollars by index funds; valuation and pricing of bond funds; fair value pricing; and practices of investment consultants. Although these areas are often highly technical, they are critical to determine whether a fund or adviser is truly operating in investors’ best interests.

These programmatic changes are vital to the restoration of the public’s confidence in the nation’s markets and the SEC. However, they do not present a complete picture of all the SEC has undertaken since Chairman Donaldson’s arrival. To fully appreciate the SEC’s efforts and the changes in how we are meeting our responsibilities, one must recognize the progress that we have made in improving agency operations.

Operational Progress

Since last February, we have spent considerable energy looking at our organizational structure and our workflow processes. Our goal is to become more proactive and to better anticipate risk. We conducted a comprehensive review of our activities to determine where we can be more efficient, where additional staff and resources can best be used, and what results we are achieving for our efforts.

This multi-faceted review is fundamentally designed to help us respond quickly to our changing environment by helping us to “see around corners and over hills.” Having this ability is vital to the success of the agency, and developing our capacity in this regard has been one of Chairman Donaldson’s highest priorities. Toward this end, we have:

- Drafted our 2004-2009 GPRA strategic plan, which we view not as a bureaucratic exercise, but as a roadmap that will chart the course for the agency for the next several years;
- Developed and are implementing a new agency-wide risk assessment function;
- Fully implemented and expanded the scope of our “performance dashboard” initiative;
- Undertaken systematic reviews of the organizational structure of the SEC’s primary operating divisions and offices;
- Hired about 770 new employees;
- Expanded our employee work-life and benefits program;
- Hired a new Chief Information Officer;
- Begun implementing our document management program; and
- Made substantial progress on the annual audit of our financial statements.

Each of these topics was raised by GAO at our last hearing as an area with room for improvement. I would now like to highlight our efforts in each of these areas for you. Admittedly, work remains to be done, but we believe we have made substantial and tangible progress.

Organizational Reviews

Soon after the Chairman joined the SEC and the agency received significant budget increases, the Commission began a comprehensive planning initiative to

determine how to best allocate these funds. Throughout the planning process, the primary concern of the Chairman and the senior leadership was that resources be deployed as effectively and efficiently as possible, maximizing the value for taxpayers and investors alike.

To achieve this objective, the Chairman held a series of meetings with the heads of the divisions and major offices to review their mission, environment, goals, and strategies. These sessions delved in detail into the offices' current operations, their requests for new staff, and their justifications for those requests. The Chairman's Office then initiated top-to-bottom reviews of the new organizational structures proposed by the divisions and offices to incorporate their new staff. These reviews have examined whether positions are being deployed effectively, are fully supported by program workload consistent with agency priorities, and whether they are accompanied by the appropriate level of supervision. This initial round of reviews is complete, and we intend to use the process as the model for analyzing future division and office reorganizations.

Risk Assessment

Just as our strategic plan, which I will discuss in a moment, should inform every aspect of our operations, so too should our risk assessment initiative. Fundamentally, this initiative is about instilling a new spirit into our everyday activities, so that we are constantly searching for new and emerging risks to investors and U.S. financial markets.

As we highlighted last July, after conducting a thorough internal review of how the agency deals with risk, we initiated a new risk management program and laid the groundwork for the Office of Risk Assessment and Strategic Planning, the first of its kind

at the Commission. The first phase of this new effort has been to organize internal risk teams made up of representatives from each major program area. The new office, working in coordination with the internal risk teams, then will push the agency to proactively identify new or resurgent forms of fraudulent, illegal, or questionable activities. In addition to fostering better communication and coordination between divisions and offices within the Commission, this initiative will help senior managers make better-informed decisions and proactively adjust operations and resources to meet new challenges. In addition, the Office of Risk Assessment and Strategic Planning will play a key role in the agency's strategic planning, ensuring that our plan remains current and directly linked to our ongoing performance dashboard initiative.

Performance Dashboards

As discussed in last year's testimony, performance dashboards are management reports designed to present regular snapshots of the divisions' and offices' progress in meeting budget, staffing, and performance objectives. We have been generating dashboards for roughly the last seven months, and they continue to evolve as divisions and offices refine their performance measures. Dashboards are becoming an increasingly important tool for the executives managing our divisions and offices, providing a more complete picture of their activities and helping to illustrate areas in need of continued improvement. Rather than motivating staff to simply "hit the numbers," our dashboards are designed to identify emerging problems, promote the discussion of solutions, and reinforce each executive's accountability for staff, performance and key initiatives. In

conjunction with our other efforts, the dashboards will help the agency proactively adjust operations and resources as environmental changes require.

Strategic Planning

The Chairman feels strongly that completing our five-year strategic plan is critical not just because it is required by law, but also because it embodies our comprehensive strategy for the next several years. Although the plan is being completed later than we originally anticipated, we have taken the time necessary to make sure it is a useful tool for the agency at a critical time in its history. In particular, the strategic plan has been substantially enhanced due to the critical work I've just outlined in the areas of organizational reviews, risk assessment, and performance dashboards. GAO has stressed the importance of having a strategic plan upon which to base agency-wide resource decisions, and we strongly concur with this view. While we would have preferred to have a mature strategic plan prior to deploying our additional resources and staff, the environment in which we were operating did not permit us that luxury. As you can see from my testimony, we have had to undertake multiple efforts concurrently. However, its vision, mission, and values have guided our activities for quite some time.

We started developing the agency's 2004-2009 strategic plan by convening a team of senior managers and staff upon Chairman Donaldson's arrival at the Commission last spring. The team, comprised of representatives from sixteen of the SEC's divisions and offices, possesses extensive knowledge of the SEC's programs and major initiatives. In developing the strategic plan, the team considered and discussed the condition of domestic and international securities markets, recent changes in the marketplace,

legislative developments, and issues affecting investors and the general public.

Organizational considerations such as human capital, diversity, financial resources, and technology also were evaluated.

The team crafted a new strategic vision, mission, core values, and goals that better reflect the challenges and opportunities the Commission now faces, and identified the initiatives we would undertake to achieve these goals. Throughout development of the plan, the team actively conferred with their office or division leadership and interacted with external stakeholders. Simultaneously, senior agency leadership held a continuing dialogue, including an offsite retreat, to discuss and evaluate the Commission's new strategic priorities.

A draft of the SEC's strategic plan is currently being reviewed by the Chairman's Office and will soon be voted upon by the Commission. I will provide you a copy of our strategic plan as soon as it is approved and look forward to your feedback.

New Hires, Training, and Workforce Planning

Thanks to significant budgetary help from the President and Congress, the agency received appropriations in February 2003 for resources needed to hire 842 new employees. Also, in July 2003, President Bush signed the "Accountant, Compliance, and Enforcement Staffing Act of 2003," that provided the SEC with the same expedited hiring authority for accountants, economists and securities compliance examiners as it has for lawyers. This authority, which would not have become law without the instrumental support of this Subcommittee, was especially important because it allowed

us to use our additional resources to put critical staff in place much more quickly than would otherwise have been possible.

Since December 2002, we have hired about 770 new staff – 39 percent as attorneys, 23 percent as accountants, 23 percent as examiners, and the remaining 15 percent to fill other positions. Approximately 107 new staff members will begin working at the SEC by the end of June – roughly 38 percent of them as accountants and another 36 percent as attorneys.

Hiring must be viewed in connection with the agency's ability to retain staff. The SEC traditionally has operated with a vacancy rate of approximately 5 percent or higher. The Commission's turnover rate in fiscal year 2001 was approximately 8 percent, but had previously risen as high as 13.8 percent. Pay parity has proved to be an important tool for reducing staff turnover, as GAO has acknowledged. Since it was approved, the turnover rates dropped to 1.2 percent in fiscal year 2002 and 1.5 percent in fiscal year 2003.

Our ability to hire staff more expeditiously and to pay them at more competitive levels have been very beneficial to the agency. However, as GAO has previously pointed out, we would be better served by not just focusing on pay and hiring, but by also creating a comprehensive workforce planning effort to ensure that we reach our human capital goals and objectives. We have begun to make progress in this area. On top of our comprehensive plan to deploy and reorganize staff, we have also focused our energies on enhanced training and benefits. For example, the SEC has launched SEC University – an initiative that offers online and in person courses for managers and line staff to help them perform their responsibilities better and keep abreast of industry changes and trends. We

also have significantly enhanced our recruitment and orientation programs, to continue to attract high-quality applicants and to ensure that they start their jobs at the SEC firmly grounded in the agency's culture, mission, and values.

As part of the continuing development of our pay parity program, we have signed a contract to provide all employees, their spouses and dependents with enhanced vision and dental services. This benefit, which we negotiated with our employee union, is in addition to the increased percentage of healthcare premiums that the SEC now covers, our tuition repayment program, and emergency childcare benefits. We have also begun to review the Commission's succession planning needs, which have preliminarily shown that we are unlikely to face a significant wave of upcoming retirements, as is projected to occur throughout the rest of the federal government.

We have likewise fully implemented the Commission's new pay-for-performance system, which is designed to reward job performance based on employee contribution to the Commission's overall mission. This program is helping to ensure that the SEC's talented pool of experienced, dedicated, high-quality staff remains strong. These changes help to ensure an exciting and dynamic workplace that rewards leadership, commitment, dedication, and contributions.

Notwithstanding improvements in retention, we continue to have vacancies. After the 107 new staff members join us through June, we will have 403 (or 11 percent) vacancies remaining, of which about 150 may be considered due to normal attrition levels. Of the 403 vacancies, approximately 150 (or 38 percent) are attorney positions; approximately 110 (or 28 percent) are accountant positions; approximately 50 (or 13 percent) are examiner positions, and about 90 (or 23 percent) represent other positions.

Recruiting and hiring the most qualified individuals takes time but is critical to the Commission's success. We have refused to hire employees simply to fill chairs, but rather are focused on hiring the best and most appropriate people to fill these important positions, and are keenly focused on where each staff person can do the most good. By the end of the year, we fully expect that our hiring efforts will achieve targeted staffing levels.

Information Technology

Investments in the SEC's information technology are critical to help us delve deeper in our investigations and inspections, improve investors' access to company disclosures, and otherwise support the Commission's efforts to protect investors. The Commission has made progress on a variety of fronts, including on many issues that GAO has raised previously. Early this year, we hired a new Chief Information Officer (CIO) to guide the agency's information technology program. In the short time since his arrival, our CIO has begun adding staff with the skills necessary to manage a broad range of IT projects and has started to reshape the activities of our Information Officers' Council and our IT Capital Planning Committee. Through these initiatives, the SEC will be better positioned to develop and maintain a state-of-the-art information technology program, based on a solid IT strategic plan that everyone understands, embraces, and supports. This comprehensive, multi-year strategic program, when completed, will help the Commission to more effectively support the enforcement, inspection, and other programmatic and regulatory functions.

We are moving forward on several critical technology projects that are fundamental to the agency's IT programs. **Electronic document management** will provide agency-wide systems and processes for electronically capturing, searching, and retrieving investigative and examination materials and integrating them into the workflow of our staff. As a result, enforcement and examination staff will no longer need to spend countless hours poring through millions of pages of documents, as is often the case now. The system also will be critical to maintain these files in case of a major disaster. The initial phase of the system should be fully operational in fiscal year 2005, and will continue to be integrated with data-mining, case tracking and correspondence systems.

We also have continued to focus on streamlining our **enterprise architecture** and our business processes. Our IT and program staff are working to restructure Commission filings and forms to eliminate redundant data, particularly within the EDGAR filing system. We are actively pursuing a strategy for improving the filing and disclosure process, making it possible for investors and SEC staff to more easily analyze company data by using structured filings and "tagged data" through tools such as XBRL.

Finally, we are making substantial investments in state-of-the-art **information security**. Our upgraded "point-to-point" network will be operational later this year, allowing continued communications between remaining SEC sites in the event that a disaster forces headquarters or the off-site operations center to close. At the end of this calendar year, we also should complete the construction of the Commission's alternate data center, which will help prevent any future disruption. In addition, the Commission is currently undergoing a complete security certification and accreditation for current and future information and financial systems.

Audited Financial Statements

The recently enacted “Accountability of Taxpayer Dollars Act” requires the SEC to meet all Federal accounting guidelines and to be audited annually. The SEC recognizes the importance of leading by example. With a vision of being the standard against which Federal agencies are measured, we have developed an aggressive plan to allow for an audit of our financial statements this year, far earlier than the five years large federal agencies were given to produce their first audited financial statements.

One aspect of this plan includes the resolution of several complicated accounting issues. For example, one challenge 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, while another priority is the improvement of our financial management systems and internal controls.

An external assessment of the Commission’s financial management systems in 2002 did not find any systematic problems, but did identify areas with room for improvement. To address these areas, we formed internal task forces, hired additional staff, and enlisted contractor support. With much work already concluded, we are confident we have taken the necessary steps to resolve any issues of internal control that may have been revealed by the audit.

Conclusion

Over the last two years, this subcommittee and GAO have raised valid concerns regarding the SEC’s lack of an updated strategic plan and need to develop a

comprehensive workforce planning effort. We agree that it is imperative that the SEC position itself appropriately so that we can respond quickly to changes in our environment and deploy resources efficiently and effectively. By closing in on the ability to “see around corners and look over hills” we have been addressing GAO’s concerns. We have a strategic plan, soon to be approved, that will guide our activities for the next several years; a workforce plan for filling the remaining vacancies and training staff; and performance measurement and risk assessment functions that will help ensure that we remain on track and are better able to foresee developing trends. These efforts give us confidence that we are proceeding down the correct path.

I would once again like to thank the Subcommittee for inviting me to testify before you today. I look forward to addressing any questions that you may have.