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SEC STRATEGIC PLANNING—WILL ADDITIONAL RESOURCES HELP THE SEC FULFILL ITS MISSION?

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

JULY 23, 2003

Serial No. 108–81

Printed for the use of the Committee on Government Reform

Available via the World Wide Web: http://www.gpo.gov/congress/house
http://www.house.gov/reform

U.S. GOVERNMENT PRINTING OFFICE

90–815 PDF WASHINGTON : 2003

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SEC STRATEGIC PLANNING—WILL ADDITIONAL RESOURCES HELP THE SEC FULFILL ITS MISSION?

WEDNESDAY, JULY 23, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND
FINANCIAL MANAGEMENT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 3:25 p.m., in room 2247, Rayburn House Office Building, Hon. Todd Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Blackburn and Towns.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady and Kara Galles, professional staff members; Amy Laudeman, clerk; Mark Stephenson, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. PLATTS. We will bring this hearing of the Subcommittee on Government Efficiency and Financial Management to order. Our ranking member, Mr. Towns, will be joining us shortly, as well as our vice chair, the gentlelady from Tennessee, Ms. Blackburn.

I am going to dispense with the reading of my more extensive opening statement and submit it for the record, and I will ask the other Members to do so also.

[The prepared statement of Hon. Todd Russell Platts follows:]

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Opening Statement
Congressman Todd R. Platts
July 23, 2003

In March 2002, the General Accounting Office released a report on the Securities and Exchange Commission (SEC) which identified a number of challenges facing the Commission, including a workload that has grown exponentially over the past decade and newly imposed requirements resulting from enactment of the Sarbanes-Oxley legislation in the 107th Congress. The GAO report entitled *"SEC Operations: Increased Workload Creates Challenges"*, stressed that the SEC had not undertaken comprehensive strategic planning to assess the gaps that exist between the way the SEC currently operates and the way the SEC should operate to execute its mission properly.

Since that report was issued, there have been broad changes at the SEC, including the appointment of a new Chairman, a substantial budget increase, increased regulatory responsibilities, and the requirement for a full audit of the SEC's financial statements. All of these factors, along with the requirement under Sarbanes-Oxley to hire over 800 new staff, pose a major challenge for any agency. For the SEC, the challenge is even more overwhelming because of the intense scrutiny the Agency is under due to corporate abuses during the past few years.

Under the Government Performance and Results Act (GPRA), the SEC is required to create a five-year strategic plan, an annual performance plan, and a year-end performance report. The SEC's strategic plan includes four broad goals: "protect investors; maintain fair, honest and efficient markets; facilitate capital formation; and sustain and improve organizational excellence". Unfortunately, the performance measures for achieving these goals have traditionally focused on outputs not outcomes. As a result, the SEC cannot gauge whether the actions taken result in greater protection for investors or the smooth functioning of markets. In short, strategic planning at the SEC has been inadequate for an agency of this level of importance.

Congress has granted the Commission two important human capital management tools – pay parity, which brought the SEC pay scale more in line with other federal

financial regulators and enabled the Commission to compete for talent with private industry; and expedited hiring procedures to allow the SEC to recruit top-notch accountants, economists and examiners. In addition, Congress has provided an increase of more than 60% to the SEC's budget between FY 2002 and FY 2004. Our hearing today will focus on how the SEC intends to utilize this substantial budget increase and the newly provided management tools.

A well-run SEC is important to the overall health of the economy. Our responsibility in this Subcommittee is to make sure that the SEC is effectively utilizing the tools and resources Congress has provided.

Mr. PLATTS. I first want to just thank our witnesses for your patience. It is kind of Murphy's law—what could go wrong in scheduling did with a whole series of procedural votes. But I know how valuable your time is and do appreciate each of you and your patience with us today, and also your efforts in preparing for this testimony. I appreciate your extensive written testimony which has been submitted. I have had a chance to go through that, and I look forward to getting into your oral testimony here today.

The SEC certainly has gone through some challenging years of late, from its workload increase to changes within the organization. The General Accounting Office has certainly helped to bring to light some of the challenges and recommendations for how to meet those challenges, and with the new team leadership at SEC, we believe we are on the right track and anxious to hear what the new leadership team is doing as part of their efforts to meet those new challenges with added responsibilities that Congress has given the SEC.

I think what we will do is just swear in each of the witnesses and anyone else who is going to be advising witnesses here today, and then we will get into your opening statements and then questions. So if each of you could stand along with anyone who would be advising you.

[Witnesses sworn.]

Mr. PLATTS. The clerk will reflect that the witnesses have answered in the affirmative.

We will be hearing today first from GAO, Mr. Hillman, beginning with you, and then followed by the SEC Mr. Derby. I believe you are going to give the opening statement, and then both Mr. McConnell and you will take questions. Mr. Hillman, if you would like to begin with your opening statement.

STATEMENT OF RICHARD HILLMAN, DIRECTOR OF FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY ORICE WILLIAMS, ASSISTANT DIRECTOR, GENERAL ACCOUNTING OFFICE

Mr. HILLMAN. Thank you very much, Mr. Chairman.

I am accompanied today by Orice Williams, who is the Assistant Director at GAO who has led much of our work at the SEC. We both are pleased to be here today to discuss SEC's plans for spending the significant increase in its 2003 budget appropriation and its 2004 budget request, as well as its response to our recommendations for enhancing its strategic planning and human capital planning processes, which are critical ingredients for ensuring the new appropriations are put to the best possible use.

As you know, in February 2003, the Securities and Exchange Commission received the largest budget increase in the history of the agency. The increased funding was designed to better position SEC to address serious issues identified in the Sarbanes-Oxley Act and to better enable SEC to address numerous operational and human capital management challenges discussed in our March 2002 report entitled, "SEC Operations: Increased Workload Creates Challenges."

To help ensure that SEC spends its budgetary resources in an efficient and effective manner, this subcommittee requested us to re-

view the SEC's efforts to address the issues raised in our 2002 report and to report out on how SEC intends to utilize its new budgetary resources. Our final report on these matters is expected to be completed this fall. As requested, this testimony provides information on the status of SEC's current spending plan and preliminary observations on its strategic and human capital planning efforts.

Regarding our first objective on SEC's budget, we found that SEC's 2003 appropriations of $716 million increased SEC's budget 45 percent over its previous year's spending level, giving it additional resources to address critical staffing shortages and information technology needs. However, SEC spent the first 5 months of the fiscal year operating under a continuing resolution and thus could not fully implement a spending plan based on its new budget authority.

In addition, SEC faced difficulties in hiring accountants, economists and examiners, further constraining its ability to acquire needed expertise. Once it received its 2003 appropriation, it determined that most of its increase would be used to fund new positions and to upgrade its technological resources, including doubling the operating budget of the Office of Information Technology. However, given the late appropriation and hiring challenges to date, SEC has filled few of these positions and it is unlikely that SEC will be able to fully utilize all of its 2003 funds.

Regarding our second objective on SEC's strategic planning efforts, we found that it recognizes that it needs to develop a new agency-wide strategic plan and that such a plan is a vital component of its work force planning and human capital allocation processes. However, SEC has embarked on an effort to allocate resources and determine its needs without the benefit of its updated strategic plan. Instead, it has relied on views from its senior managers and on an internal study commissioned by then-Chairman Pitt that assessed the Commission's workload and evaluated the resources available for doing that work. This study, currently under review by Chairman Donaldson, has not been widely distributed throughout the organization.

We commend the SEC for conducting this study. Its findings confirm many of the workload and resource challenges we discussed in our March 2002 report and it includes numerous recommendations for improving the agency's operations. We believe this study should serve as a useful framework as SEC develops an agency-wide strategic plan.

We also found that SEC has also initiated a number of other efforts, but because all of them are grounded in SEC having a clear strategic direction and goals, all of them hinge on SEC completing a new strategic plan. Among these efforts include developing more outcome-oriented performance measures to gauge the effectiveness of its regulatory operations and for fulfilling its statutory mission and formalization of a strategic human capital plan. As our work progresses, we look forward to reviewing SEC's revamped strategic plan and determining how the agency has used this plan in allocating new staff and in developing new performance measures and a human capital plan.

In conclusion, SEC's dynamic regulatory environment and tumultuous past year has made focusing on a strategic direction and vi-

sion for the agency difficult. Although SEC has begun to take a number of important steps aimed at addressing its operational and human capital challenges, additional work is needed to ensure that it has appropriately positioned itself to operate more efficiently and effectively.

First, it is critical that SEC complete its strategic planning effort, which includes the systematic reevaluation of all its current approaches, efforts, goals and activities in light of its current environment. In this regard, we believe SEC would be benefited by reevaluating existing rules, regulations and regulatory approach and in working with the self-regulatory organizations and industry to ensure that it has accurately established priorities that reflect the current regulatory environment.

A second critical step involves identifying ways to leverage existing resources, be it through better technology or regulatory processes. For example, SEC needs to fully fund and follow through on technology initiatives that offer the greatest opportunities to increase its effectiveness. SEC's technology evolution could perhaps be one of the most important aspects in improving the efficiency of SEC's operations and will likely require a sustained and ongoing resource commitment.

Finally, aligning SEC's human capital with a strategic plan is an important part of strategic human capital planning. To date, SEC has taken important steps aimed at establishing a coordinated human capital management approach, but it needs to develop a formal plan that assures that it has the right amount of resources on board with the right expertise to meet its mission responsibilities.

Mr. Chairman, thank you for the attention to SEC operations and planning processes. The leadership this subcommittee has shown by holding this hearing should help maintain the momentum needed for change at SEC.

Mr. Chairman, this concludes my prepared statement. Orice and I would be pleased to answer any questions at the appropriate time.

[The prepared statement of Mr. Hillman follows:]

United States General Accounting Office

GAO

Testimony

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

For Release on Delivery
Expected at 2:30 p.m. EST
Wednesday, July 23, 2003

SECURITIES AND EXCHANGE COMMISSION

Preliminary Observations on SEC's Spending and Strategic Planning

Statement of Richard J. Hillman, Director,
Financial Markets and Community Investment

GAO-03-969T

July 2003

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Highlights

Highlights of GAO-03-969T, a testimony to the Chairman, Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

SECURITIES AND EXCHANGE COMMISSION

Preliminary Observations on SEC's Spending and Strategic Planning Efforts

Why GAO Did This Study

In February 2003, the Securities and Exchange Commission (SEC) received the largest budget increase in the history of the agency. The increased funding was designed to better position SEC to address serious issues identified in the Sarbanes-Oxley Act and to better enable SEC to address numerous operational and human capital management challenges discussed in the GAO report entitled *SEC Operations: Increased Workload Creates Challenges* (GAO-02-302). To help ensure that SEC spends its budgetary resources in an efficient and effective manner, GAO was asked to review the SEC's efforts to address the issues raised in the 2002 report and to report on how SEC intends to utilize its new budgetary resources. GAO's final report on these matters is expected to be completed this Fall.

This testimony provides requested information on the status of SEC's current spending plan and preliminary observations on SEC's strategic and human capital planning efforts.

www.gao.gov/cgi-bin/getrpt?GAO-03-969T.

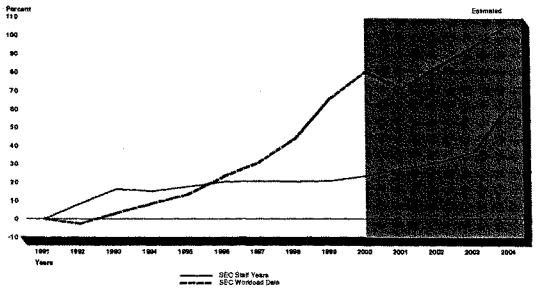
To view the full product, including the scope and methodology, click on the link above. For more information, contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov.

What GAO Found

In GAO's 2002 operations report, GAO identified a number of operational challenges facing SEC stemming from an increasing workload (e.g., filings, applications, and examinations) and staffing imbalances that threatened to impair SEC's ability to fulfill its mission. As illustrated below, SEC's workload had grown at a much higher rate than its staffing since the mid-1990s. In response to congressional concerns involving a number of high-profile corporate failures and accounting scandals, SEC's funding was increased 45 percent in 2003. SEC plans to spend most of its 2003 and 2004 budget increases to fund 842 new staff positions and double its information technology budget. However, given the late appropriation and hiring challenges, SEC has to date filled few of these positions, and it is unlikely that SEC will be able to utilize all of its 2003 funds.

GAO also found that SEC recognizes the need to develop a new strategic plan and that such a plan is a vital component of its staff allocation and human capital planning processes. A new strategic plan is also vital to SEC's ability to develop performance-oriented, outcome-based performance measures. GAO found that while SEC has not updated its strategic plan, it has begun efforts to overhaul its performance measures to make them more outcome-oriented. This effort seems premature given its lack of a new strategic plan. Moreover, while GAO found that SEC has completed certain aspects of a strategic human capital plan, including development of a new pay structure comparable to other federal financial regulators, greater flexibility to expedite the hiring of certain critically needed professions, plans for more training, and implementation of agencywide-worklife programs, the lack of a new strategic plan inhibits SEC's ability to develop a formal human capital plan.

Percent Change in SEC Staff Years and Workload, 1991-2004



Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the Securities and Exchange Commission's (SEC) plans for spending the significant increases in its 2003 budget appropriation and its 2004 budget request as well as its response to our recommendations for enhancing its strategic planning and human capital planning processes, which are critical ingredients for ensuring that the new appropriations are put to the best possible use.[1]

As you know, in March 2002 we issued a report entitled *SEC Operations: Increased Workload Creates Challenges* (GAO-02-302), which identified numerous resource challenges SEC faced as its workload increased in volume and complexity.[2] We also cited other issues, including a turnover rate among accountants, attorneys, and examiners that was almost twice as high as the governmentwide average for comparable positions that was draining staff from SEC and slowing its operations. To address these issues, we recommended, among other things, that SEC broaden its strategic planning process to systematically determine its regulatory priorities and the resource levels needed to fulfill its mission. We also recommended that SEC engage in a comprehensive coordinated workforce planning effort to ensure that critical human capital goals and strategies were implemented.

In the wake of several high-profile corporate failures and accounting scandals, in February 2003 SEC was given the largest spending increase in its history. Given this substantial budget increase and the importance of efficiently and effectively utilizing these gains, you requested that we review SEC's efforts to address the issues we raised in March 2002 and report on how well SEC has utilized its new budgetary resources. We expect to complete our report on these matters in the Fall. In advance of the completion of this study, this statement provides requested information on the status of SEC's current spending plans for 2003 and 2004 and preliminary observations on SEC's strategic planning and human capital planning efforts.

Our observations about the status of SEC's 2003 and 2004 spending plans and related planning activities to date are based on our review and

[1]All years are fiscal years unless otherwise noted.

[2]U.S. General Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, GAO-02-302 (Washington, D.C.: Mar.5, 2002).

independent analysis of workload, budget, and staffing data provided by SEC officials or presented in SEC's 2003 revised budget estimate and 2004 budget request. In addition, we solicited views from a variety of SEC officials, collected relevant information on SEC's strategic planning and human capital efforts, and analyzed statistics on staff turnover. This study was completed in accordance with generally accepted government auditing standards.

In summary, the 2003 appropriation of $716 million in February 2003 increased SEC's budget 45 percent over its previous year's spending level, giving it additional resources to address critical staffing shortages and information technology needs, among other things. However, SEC spent the first 5 months of the fiscal year operating under a continuing resolution and thus could not fully implement a spending plan based on its new budget authority. In addition, SEC faced difficulties in hiring accountants, economists, and examiners, further constraining its ability to acquire needed expertise. Once it received its 2003 appropriation, SEC determined that most of its increase would be used to fund new positions and upgrade its technological resources, including doubling the operating budget of the Office of Information Technology. However, given the late appropriation and hiring challenges, to date SEC has filled few of these positions, and it is unlikely that SEC will be able to fully utilize all of its 2003 funds.

We also found that SEC recognizes that it needs to develop a new agencywide strategic plan and that such a plan is a vital component of its workforce planning and human capital allocation process. However, SEC has embarked on an effort to allocate resources and determine its needs without the benefit of an updated strategic plan. Instead, SEC has relied on views from its senior managers and on an internal study commissioned by then Chairman Pitt that assessed the commission's workload and evaluated the resources available for doing that work. This study, currently under review by Chairman Donaldson, has not been widely distributed throughout the organization. We commend SEC for conducting this study. Its findings confirm many of the workload and resource challenges we discussed in our March 2002 report, and it includes numerous recommendations for improving the agency's operations. SEC has also initiated a number of other efforts but because all of them are grounded in SEC having a clear strategic direction and goals, all of them hinge on SEC completing a new strategic plan. Among these are efforts to develop more outcome-oriented performance measures to gauge the effectiveness of its regulatory operations in fulfilling its statutory mission and formalization of its strategic human capital plan.

SEC Plans to Spend Most of Its Budgetary Increase on Staffing and Information Technology

In March 2002, we reported that SEC's workload and staffing imbalances had challenged SEC's ability to protect investors and maintain the integrity of securities markets. Appendix I graphically depicts SEC's workload and staffing imbalance from 1990 through 2000 as reported in our 2002 report and appendix II updates this graphic using SEC budget documents including its 2003 and 2004 workload and staffing estimates. As reported in March 2002, we found that SEC generally managed to bridge the gap between its workload and staff by determining which of its statutorily mandated duties it could accomplish with existing resources or only marginally increased resource levels. This approach, while practical, forced SEC to be largely reactive rather than proactive. We also reported that SEC tended to develop its annual budget request based on the previous year's appropriation rather than on what it would actually need to fulfill its mission. In 2003, this practice resulted in a modest increase over the previous year's request. But several high-profile corporate failures and accounting scandals, plus concerns that public companies should be held more accountable for information they report to investors, led Congress to pass the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act).[3] The act addresses a number of concerns involving corporate governance, auditor independence, regulation and oversight of the accounting profession, and SEC's resource limitations. In part because of the level authorized in the Sarbanes-Oxley Act, SEC increased its initial 2003 budget request of $466 million to $769 million. Ultimately, Congress appropriated $716 million. For 2004, SEC requested a budget of almost $842 million reflecting a supplemental carryover, annualization of new 2003 positions, inflation (pay and nonpay), and merit pay increases less one-time 2003 information technology costs.

[3] Pub. L. 107-204.

A Significant Portion of SEC's Budget Increase Has Been Allocated to New Staff Positions

SEC's planned allocations appear to be consistent with the Sarbanes-Oxley Act, which mandated that the $776 million authorization be used to:

- fund pay parity, allowing SEC to set salaries for certain staff positions at levels comparable to those at other federal financial regulators;[4]
- fund information technology, security enhancements, and recovery and mitigation activities in light of the terrorist attacks of September 11, 2001; and
- fund no fewer than 200 additional professional staff to increase oversight of auditors and audit services in order to improve SEC's investigative and disciplinary efforts as well as additional professional support staff necessary to strengthen existing program areas.

SEC's allocations were also apparently influenced by its internal review of operations and resource needs and on justifications made by each division and office. SEC determined that most of the planned increase would be used to hire an additional 842 staff, primarily accountants, attorneys, and examiners, and to upgrade its technological resources over the next few years.

Table 1 provides information on SEC's staff allocation as of July 1, 2003, by program area. The 2002 numbers include 125 new positions that were authorized by a supplemental appropriation to SEC's 2002 budget to deal with the increasing workload from financial fraud and reporting cases, to improve and expedite the review of periodic filings, and to deal with new programmatic needs and policy. According to an SEC official, the current and proposed budgets factor in the increased workload resulting from SEC's new responsibilities under various new laws including the Sarbanes-Oxley Act, Gramm-Leach-Bliley Act, and Commodity Futures Modernization Act.[5] For example, between 2002 and 2004, the full disclosure program is slated to receive the largest percentage increase in positions — 39 percent. This program includes the Division of Corporation

[4] The crisis in the thrift industry in the 1980s led Congress to pass the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). Among other things, FIRREA authorized certain financial regulators, such as the Federal Deposit Insurance Corporation, the National Credit Union Association, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision to determine their own compensation and benefits so that they could more effectively compete in the marketplace for qualified applicants. P. L. No. 101-73 §1206, codified at 12 U.S.C. §1833b. The Federal Reserve Board of Governors also has independent authority to set the compensation of its employees. 12 U.S.C. §248l(1).

[5] Pub. L. 107-204, 116 Stat. 745 (2002), Pub. L. 106-102, 113 Stat. 1338 (1999), and Pub. L. 106-554 (H.R. 5660).

Finance and the Office of the Chief Accountant, which are responsible for reviewing the financial statement filings for over 17,000 reporting public companies and providing rule-making and interpretive advice. In this area, staffing is driven in part by the Sarbanes-Oxley Act, which requires SEC to review the financial statements of each reporting company every 3 years. In 2002 SEC's average translated into a review once every 6 years. The area slated to receive the next largest percentage increase (35 percent) is the supervision and regulation of securities markets. This program includes the Division of Market Regulation and part of the Office of Compliance, Inspections and Examinations and is responsible for establishing and maintaining policies for fair, orderly, and efficient markets and conducting examinations and inspections of 9 registered securities exchanges and an estimated 8,000 brokerage firms among others. The prevention and suppression of fraud program, which includes the Division of Enforcement, is slated to receive a 21 percent increase, which SEC said would help with the increasing number of investigations into possible violations of securities laws.

Table 1: SEC Staff Allocations from 2002 to 2004

Program Positions	2002 Actual	2004 Request	Change in Allocation	Percentage Change
Full disclosure	508	704	+196	39 percent
Prevention and suppression of fraud	1,037	1,255	+218	21
Supervision and regulation of securities markets	465	627	+162	35
Investment management regulation	593	790	+197	33
Legal and economic services	175	194	+19	11
Program direction	387	437	+50	13
Total	**3,165**	**4,007**	**+842**	

Source: SEC.

Notes: GAO did not verify the reliability of SEC's budget data. SEC's 2003 budget estimate is omitted because these numbers were unavailable at the time of the hearing. The 2004 figures are estimates subject to revision.

SEC's staff allocations appear consistent with legislative requirements and what is currently known about its operating environment. However, because SEC's staff positions were allocated without the benefit of a strategic plan, we are unable to fully assess the appropriateness or effectiveness of this use of its budget increase.

Given that staff salaries and benefits average about 70 percent of SEC's budget, we would expect the spending allocations to roughly correlate to its staffing allocations. However, SEC was unable to provide us information to analyze SEC's budgetary allocation across each program area. At the time of this study, SEC was in the process of completing its 2005 budget request for OMB, which will include its allocation of its budgetary resources for its 2004 budget estimate by program area. SEC expects to have these estimates completed by sometime in late August or early September.

In 2002, we reported the difficulty SEC faced in hiring accountants for the 125 positions authorized by its 2002 supplemental appropriation.[6] SEC had identified the existing competitive service hiring requirements as hampering its ability to fill these and other positions because of the length of time involved. SEC subsequently asked for and received relief from competitive hiring requirements under the Accountant, Compliance and Enforcement Staffing Act of 2003, which was enacted in July 2003. This new legislation is designed to enable SEC to expedite the hiring of accountants, economists, and examiners so that the agency can more quickly fill the 842 positions created. As of July 1, 2003, SEC has only filled a few of the vacancies for the allocated positions but is now better positioned to hire under its new authority. It is too soon to determine whether this new authority will enable SEC to quickly fill the hundreds of vacancies it needs to fill by the end of 2004.

Information Technology Will Also Receive a Significant Increase

Information technology was another area identified in our 2002 report as having funding gaps that had contributed to existing inefficiencies. Like the rest of the government, SEC's needs in the area of information technology continue to increase, and SEC staff must have the necessary tools to successfully meet the agency's increasing demands. SEC maintains a list of technology improvement projects that have not been funded due to budgetary constraints, which SEC officials said include applications to improve the manipulation and connectivity of various SEC data systems and computerized reports. The budget increase has allowed SEC to begin improving its information technology capabilities. SEC's Office of Information Technology, which supports the agency's

[6]U.S. General Accounting Office, *Financial Statement Restatements: Trends, Markets Impacts, Regulatory Responses, and Remaining Challenges*, GAO-03-138 (Washington, D.C.: Oct. 4, 2003).

information systems and computer users, received an increase in its 2003 operating budget of more than 100 percent, from around $44 million to $100 million. Our understanding is that SEC plans to undertake a few small projects each year such as system upgrades and software purchases, to enhance its systems and will implement larger long-term projects over time. SEC began developing an enterprise architecture— a strategic approach to information technology planning in 2001. This architecture is designed to allow SEC to fund and develop information technology initiatives based on agencywide needs by strategically identifying and organizing technology projects. In 2002, SEC continued to develop its enterprise architecture in order to identify and document relationships between agency business functions and supporting technologies. SEC management also began incorporating the enterprise architecture into its information technology capital planning process. Although most of SEC's long-term projects are in the developmental stages, we are cautiously optimistic that, if properly implemented, they can improve SEC's operational efficiencies. Some of these longer-term projects include

- Converting SEC's Electronic Data Gathering Analysis and Retrieval (EDGAR) system into a searchable database that would help SEC conduct various types of industry and trend analyses. EDGAR is the database system that public companies use to file registration statements, periodic reports, and other forms electronically. Currently, EDGAR receives and archives data, but staff cannot immediately and easily analyze it. The goal is to create filings that will allow anyone to extract relevant data.

- Implementing a document management and imaging initiative, intended to eventually eliminate paper documents and allow SEC staff to review and electronically file the large volumes of information that are part of litigation, examination, and enforcement activities. Staff told us that the planned system will provide an agencywide electronic capture, search, and retrieval mechanism for all investigative and examination materials.

- Implementing a disaster recovery program that is being designed to store and move large amounts of data among regional or district offices without first going through Washington, D.C. The current project, when completed, will allow the agency to back up critical information and data on a daily basis at multiple locations.

SEC Has An Outdated Strategic Plan and An Incomplete Human Capital Plan

In 2002, we found that SEC had not engaged in a comprehensive agencywide strategic planning process and little has changed in this regard in 2003. As we have previously reported in earlier reports, high-performing organizations identify their current and future human capital needs—including the appropriate number of employees, the key competencies needed, and plans for deploying staff across the organization—and then create strategies to fill any gaps.[7] Given the SEC's role in the securities industry's self-regulatory structure, a critical element of SEC's strategic planning process is an evaluation of the external environment in which the agency operates. SEC's budget increase has heightened the need for strategic planning and the significance of the process, as SEC's spending plan will have to withstand considerable scrutiny. SEC's lack of a current strategic plan may also affect other aspects of SEC's operations as strategic plans are the starting point for each agency's performance measurement efforts and should provide the basis for strategic human capital planning.

SEC's Internal Study Provides a Framework for Strategic Planning

In 2002, SEC took a critical step toward developing a strategic plan when it conducted an internal study of SEC's current operations, workload, resource allocations, methods for assigning and managing work, and measures of performance, productivity and quality of effort. The study, which was facilitated by a consulting firm (McKinsey & Company) and includes discussions of staffing and resource allocation issues, appears to have been a factor in SEC's allocation of many of the 842 new positions. But this confidential study has not been widely distributed within SEC, and it is unclear whether it will be in the near future. This study serves as a useful framework for SEC as it begins developing a dynamic comprehensive strategic plan that will better enable it to identify its mission and staffing needs. More immediately, such an effort is vital as it determines how best to use its additional resources. We acknowledge that over the past year and a half, SEC has had to deal with a considerable amount of change, which has limited its ability to focus on a new strategic plan. SEC has had to acclimate itself to two new chairmen and adjust to new management teams, manage a 45 percent budget increase, negotiate its first agreement with its newly organized union, implement and manage a new fee rate structure, prepare for its first financial statement audit, and respond to dozens of new requirements under the Sarbanes-Oxley Act.

[7] U.S. General Accounting Office, *Securities and Exchange Commission: Human Capital Challenges Require Management Attention*, GAO-01-947 (Washington, D.C., Sept. 17, 2001).

However, since SEC issued its existing plan in September 2000, the financial world has changed significantly.

Although SEC's Government Performance and Results Act (GPRA) annual reports attempt to provide a tactical focus, a new long-range planning effort is long overdo. As stated in SEC's 2000 plan, "Our strategic plan is a living document, one that must be continually reexamined and modified to assure it remains responsive and relevant in an ever-changing environment." In addition to the changing external environment, a number of internal processes and organizational efforts within SEC hinge on SEC completing a new strategic plan, including developing more outcome-oriented performance measures to gauge the effectiveness of its regulatory operations in fulfilling its statutory mission and formalizing its strategic human capital plan. Rather than measuring outputs, SEC is working to develop measures for how effectively its actions achieve its goals and fulfill its mission. SEC is also beginning to take steps that will improve its ability to leverage its technological capabilities.

SEC Has Embarked on an Effort to Develop Outcome-Oriented Performance Measures

Consistent with the findings in our March 2002 report, SEC's subsequent GPRA 2002 annual performance report continued to use measures of outputs rather than outcomes.[8] For example, under the goal of protecting investors by improving public awareness and educating investors, SEC tracks the number of investor education events organized by senior Commission staff in a given year. Within the goal of maintaining fair, honest, and efficient markets SEC uses the number self-regulatory organization rule changes reviewed as a measure of performance. As we reported, performance measures can help to provide detailed information SEC needs to make informed workforce decisions, including (1) the relationship between its budget request for full-time equivalent staff years and the agency's plans and ability to meet individual strategic goals and (2) any excesses or shortages in needed competencies.

In late June, SEC began to take steps to transform its annual plan into a management tool aimed at helping SEC move to a more outcome-oriented approach to measuring the performance of its regulatory activities—an important part of strategic planning. To achieve this end, each program area is to develop a "performance dashboard"—a collection of measures

[8]In 2003, as directed by OMB, SEC is merging its GPRA annual plan with its annual budget document.

identifying those key performance measures that will allow each program area manager to track performance. This movement to a performance dashboard, also involves managing the budget at the program level with each division head being held accountable for managing its individual budgetary resources.

While this outcome-oriented approach is promising, we are concerned that SEC is developing new performance measures before it has completed or even started its new agencywide strategic plan. By identifying performance measures before it develops a new strategic plan, SEC runs the risk of having to redo any measures that are inconsistent with its newly defined strategic vision or allowing the existing measures to constrain its planning so that the new plan is consistent with them. We see this approach as analogous to a commuter rail company exploring the most efficient way to expand rail service to a new location before deciding whether that location is the best place for the new line.

An Agencywide Strategic Plan is Vital to a Strategic Human Capital Plan

We are also reviewing the status of SEC's strategic human capital planning. As you may recall, in our September 2001 report, we examined SEC's strategies for managing its human capital and found that its human capital practices were driven by its need to confront its growing staffing crisis. This crisis was evidenced in a turnover rate that was almost twice the government average for attorneys, accountants, and examiners; hundreds of vacant positions; and the average tenure for examiners and attorneys had fallen below 3 years. We found that to counter its compensation challenge, SEC—more than the rest of the government—was aggressively using special pay rates and retention allowances to improve staff compensation. However, such actions were not stemming their turnover problems. We also identified a number of nonpay issues that threatened to impair SEC's ability to carry out its mission and thus warranted SEC management's attention.

As we have reported, strategic planning is a key part of human capital management. Strategic human capital planning focuses on developing long-term strategies for acquiring, developing, and retaining an organization's employees and for implementing human capital approaches that are clearly linked to achieving programmatic goals.[9] In our 2001 human capital report, we found that SEC had begun to take key steps

[9]GAO-01-947.

toward developing a strategic human capital plan but lacked adequate succession planning because of its high turnover rate. Moreover, we found that SEC had not articulated the details of its plans for carrying out its recruiting and retention efforts. SEC also lacked any formal mechanism to evaluate the effectiveness of its recruiting efforts and ways to gauge the effectiveness of its worklife programs. We also found that SEC had not created a culture that ensured ongoing attention to human capital issues, that human capital management was still focused on traditional personnel functions, and that it was not a priority for senior management in decisionmaking. We made a number of recommendations to SEC aimed at improving its human capital management, including a recommendation that it expand its annual performance plan into a comprehensive human capital plan that includes all program areas.

We are looking into SEC's progress in the above identified areas. However, we have found that SEC has not yet developed a formal strategic human capital plan that articulates how it intends to align its human capital approaches with its organizational goals. While it has yet to do this, we have found that SEC continues to take important steps to improve its strategic human capital management. First, as previously discussed, SEC has taken steps to improve its recruiting/hiring process. Second, SEC has begun to take steps to develop its people and has announced plans for an agencywide training program. One key training component that is currently in the early stages of development is targeted training for supervisors—which was an area identified in our 2001 human capital report as warranting management's attention. However, it is too soon to determine the effectiveness of this new training effort.

Third, SEC has taken actions to retain its human capital and address its staffing crisis. Most significantly, SEC has negotiated an agreement with the union, which outlines a uniform program for various worklife programs, such as flextime, flexiplace, and tuition reimbursement, among others, and has standardized various of these human capital policies. Historically, many of these programs have varied by division and office. SEC has just begun to review the use and effectiveness of these programs, therefore, it is too soon to determine what effect, if any, they will have on employee retention and morale.

In our 2001 report we found that the single largest retention issue among attorneys, accountants, and examiners involved compensation. To

enhance SEC's ability to adequately compensate its employees, Congress enacted legislation that allows SEC to create a new pay system.[10] In May 2002, acting on its new compensation authority, SEC implemented a new system, which established a pay structure more comparable with other federal financial regulators. This new pay structure increased base pay for attorneys, accountants, and examiners similar to that of other federal financial services regulators. More specifically, this new system structure consists of 20 grade levels, some with up to 31 steps. This new system has also provided additional compensation based on performance and has established new pay categories to compensate staff in supervisory positions. In conjunction with this new merit-based compensation system, SEC has also implemented a new performance management system, which is also an important part of the human capital planning process.

Since our 2001 human capital report, we found that at least one symptom of SEC's staffing crisis has improved. SEC's turnover rate for attorneys, accountants, and examiners has decreased from 9 percent in 2001 to 6 percent on average in 2002, which in part may be attributed to pay parity. To date SEC reports that its average turnover rate is about 4 percent. However, the declining turnover rate may also reflect the state of the economy and resulting changes in the job market.

Observations

SEC's dynamic regulatory environment and tumultuous past year has made focusing on a strategic direction and vision for the agency difficult. Moreover, because SEC operated under its 2002 allocation for five months of the year, and had difficulty hiring needed expertise, it has been unable to fully implement its 2003 spending plan. Although SEC has begun to take a number of important steps aimed at addressing its operational and human capital challenges, additional work is needed to ensure that it has appropriately positioned itself to operate more efficiently and effectively in the 21st century. First, it is critical that SEC complete its strategic planning effort, which includes the systematic reevaluation of all of its current approaches, efforts, goals and activities in light of its current regulatory environment. An important part of any such effort would include working with the industry to ensure that SEC has accurately established priorities that reflect the current environment. For example, SEC would be benefited by reevaluating its existing rules, regulations, and regulatory approaches to ensure that they continue to reflect the realities

[10] P.L. 107-123

of today's financial markets and are consistent with the mission and goals established by SEC. Second, a critical step involves identifying ways to leverage existing resources, be it through better technology or regulatory processes. For example, SEC needs to fully fund and follow through on technology initiatives that offer the greatest opportunities to increase its effectiveness. SEC's technology evolution could perhaps be one of the most important aspects in improving the efficiency of SEC's operations and will likely require a sustained and ongoing resource commitment. SEC could also reevaluate its historical focus in areas such as small businesses and initial public offerings to ensure that it continues to meet the needs of the securities markets. Finally, aligning SEC's human capital with its strategic plan is an important part of strategic human capital planning. To date, SEC has taken important steps aimed at establishing a coordinated human capital management approach but still lacks a formal plan.

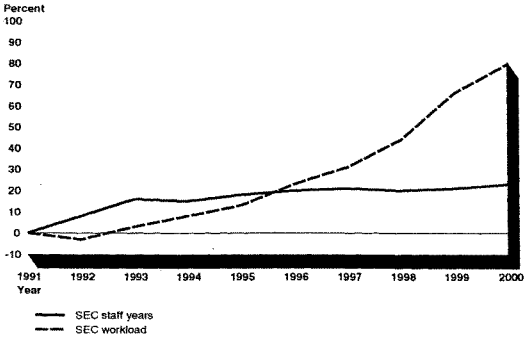
Thank you for your attention to SEC's operations and planning processes. The leadership this subcommittee has shown, by holding this hearing should help to maintain the momentum needed for change at SEC. Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions you or other members of the subcommittee may have at this time.

Contacts and Acknowledgements

For further information regarding this testimony, please contact Orice M. Williams at (202) 512-8678. Individuals making key contributions to this testimony include Toayoa Aldridge, Joe E. Hunter, Jose Martinez-Fabre, and David Tarosky.

Appendix I

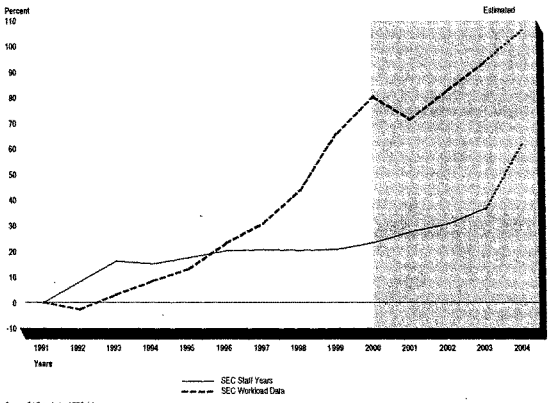
Figure 1: Percent growth in SEC staff years and workload, 1991 - 2000



Source: GAO.

Appendix II

Figure 2: Percent growth in SEC staff years and workload, 1991 - 2004



Source: GAO analysis of SEC data.

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Mr. PLATTS. Thank you, Mr. Hillman.

Before we begin, Mr. Derby, with you, I would like to recognize the ranking member, Mr. Towns from New York as well as our vice chair, the gentlelady from Tennessee, Ms. Blackburn. I appreciate both of you being with us. I submitted my opening statement for the record, and if each of you have a statement perhaps you could the same, because of the patience of our witnesses and letting them get on with their statements.

Mr. TOWNS. So agreed.

[The prepared statement of Hon. Edolphus Towns follows:]

Statement of Congressman Ed Towns
Subcommittee on Government Efficiency and Financial Management

SEC Strategic Planning – Will Additional Resources Help SEC Fulfill its Mission?

July 23, 2003

Thank you Mr. Chairman, and welcome to our witnesses.

Today's hearing on the Securities and Exchange Commission comes at a critical point in time. We have seen a huge increase in the workload at the SEC over the last decade, fueled by growth in the capital markets and the increasing complexity of some of the newer financial products. For example, the volume of shares traded on US stock markets in 2000 was more than 30 times higher than it was in 1980.

More recently, the collapse of Enron and other highly publicized corporate accounting scandals have increased the pressure on the SEC to ensure that investors receive accurate financial information. The scandals also led to enactment of the Sarbanes-Oxley Act last year, which created additional new duties and responsibilities for the SEC.

More and more Americans are also investing in stock and other capital markets, principally through mutual funds. The smooth and

efficient functioning of the SEC is therefore important to an ever-growing portion of the population, making it imperative the SEC has the resources necessary to do its job.

Congress and the Administration have addressed these challenges in a number of ways. Perhaps most important has been the significant expansion of the SEC's budget over the last two years, growing to an administration request for fiscal year 2004 of 842 million. This would represent a 73% increase in the last two years. Most of this additional money will go toward hiring the staff needed to perform the SEC's current workload, nearly 850 new, permanent positions.

Congress has also provided additional personnel tools by passing legislation to give the SEC the authority to increase pay and use flexible hiring procedures.

Today, we will hopefully hear detailed plans from our SEC witnesses on how it will use the significant additional resources it has been given. Effective and efficient use of a budgetary increase the size of which the SEC has been given is no easy task. I hope it will be up to the job.

Mr. PLATTS. OK, great.
Mr. Derby.

STATEMENT OF PETER DERBY, MANAGING EXECUTIVE DIRECTOR FOR OPERATIONS, OFFICE OF THE CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY JIM MCCONNELL, EXECUTIVE DIRECTOR, SECURITIES AND EXCHANGE COMMISSION

Mr. DERBY. 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 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.

When Chairman Donaldson took the helm 5 months ago, the SEC had reached a critical juncture. Recent accounting scandals, earnings restatements and bankruptcies severely shook investor faith in the fairness of our markets. To combat the wave of corporate fraud, Congress approved a substantial expansion of the SEC's budget and work force. We knew that the ways we address these challenges would determine where we go not only tomorrow, but for years to come.

As the chairman's managing executive for operations, I am excited to be here today to tell you about a few of the aggressive initiatives we have launched in these few short months that will prepare the SEC organizationally to meet these challenges.

First, at the direction of Chairman Donaldson, we are in the process of creating within the SEC a new risk assessment arm. The Office of Risk Assessment as currently proposed will support the SEC's divisions by identifying risks that may affect the SEC's performance of 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. This will allow us to proactively adjust operations and resources to address these new challenges.

Another of the chairman's aggressive new initiatives is a systemic approach to program management through the use of dashboards that will allow senior managers to determine their progress in meeting budget, staffing and performance objectives. These management reports will provide a more detailed picture of the commission's operations and effectiveness than we have 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 their activity.

We have also undertaken a new effort to redesign and expand our staff orientation and training program. 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 value. Our new SEC university will ensure not only that our

new 842 employees learn their new responsibilities, but that all our staff continue to build their knowledge of the rapidly evolving market. 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 new career opportunities within the SEC.

The commission is also focused on our financial system as we prepared audited financial statements for the first time in our history. We have made substantial progress to date on a variety of fronts, including undergoing a rigorous audit of our financial management system controls, selecting the GAO as our auditor, adding staff to work full-time on our financial statements, and establishing five internal task forces.

We have formulated an aggressive plan to resolve outstanding issues such as verifying the selection of security transaction fees, replacing our system for tracking fines and penalties, and enhancing the security of our information systems. Although private companies going public generally take 3 years to move to audited financial statements, and large Federal agencies were given 5 years to do so, we expect that our plan will obtain a clean opinion in only 18 months.

Finally, on behalf of the chairman, I want to thank Congress for its strong support for added resources, pay parity legislation, and expected service hiring authority for which we owe this subcommittee a special debt of gratitude. With these tools in place, we can now hire the additional workers and make the information technology investments that are so essential to our success. As you will see in my written testimony, we have planned extensively for these moves through a comprehensive study of our operations and resources. Through detailed review of each division's budget and personnel needs with division directors, and through our IT capital planning committee, we will build on these planning efforts over the next several months as we develop our 2004–2009 GPRA strategic plan scheduled for release this coming fall.

Strategic planning, performance measurement, better training, and stronger financial controls, these initiatives will provide a solid foundation for the commission to achieve its most fundamental responsibility now, to restore investor confidence in the integrity of our securities market. After a few short months, many of these initiatives are only in their early stages, but we are making great strides forward and we look forward to sharing with you the results of these labors.

Thank you again for the opportunity to testify today.

[The prepared statement of Mr. Derby follows:]

TESTIMONY OF

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)

CONCERNING
STRATEGIC PLANNING AND OPERATIONAL EFFECTIVENESS

BEFORE THE SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT

COMMITTEE ON GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

JULY 23, 2003

U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

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.

Mr. PLATTS. Thank you, Mr. Derby and Mr. Hillman.

As we begin questions, we will stick roughly initially to the 5-minute rule to allow each committee member to begin questions before we get into the second or more rounds.

I would like to begin, Mr. Derby, with you. I appreciate your statements and the important mission that your agency has in being responsible with taxpayer funds and how the agency spends its funds, and then also the fiduciary duty you have in ensuring the integrity of the markets where our citizens have their money invested. So it is kind of a dual responsibility to American citizens, whether it is how you spend their money or how you seek to ensure the integrity of the system in which they are investing their funds.

Throughout your written testimony, and you referenced it here today, you talk about the draft study on operations and resources that is apparently playing a significant role whether it is your human capital management plan or your information technology, or the various parts of your strategic plan for the future. Are you referring to what has been described as the McKinsey report? Is that the study you are referencing?

Mr. DERBY. That is correct. It is really not the McKinsey report, though. That is what people have spoken about it as such. It is actually an internal special study performed by the senior managers at the Securities and Exchange Commission, with assistance by the authors from McKinsey to help formulate the processes to come up with the study.

Mr. PLATTS. So the work of the McKinsey Co., that is kind of part of the efforts of the internal review and study that has been done?

Mr. DERBY. That is correct.

Mr. PLATTS. And where does that study, as you refer to, the draft study, but apparently you are acting on that, where does that study stand? Is it close to being a final study that you are going to put forth as this is our recommendations for, in essence, a strategic plan, and share with the industry, with the regulated community, with Congress, with GAO? To seek additional comments from outside the agency? Or is it still in a draft form?

Mr. DERBY. It is still in a draft form, but actually the process in its drafting there was a great deal of interaction with outside stakeholders in work groups and roundtables, in direct interviews and discussions. So that study did have a lot of interaction to focus from the external. It is the only way you are really going to get good feedback and good reviews on it.

Mr. PLATTS. That would include the regulated community, the stakeholders?

Mr. DERBY. Yes.

Mr. PLATTS. OK.

Mr. DERBY. And it is currently in its draft form. When the chairman came in 5 months ago, we had to take a look at that study in its draft form and really use it as a basis for which to really do what we were focusing on, and that is what was going to be the strategy going forward; what is the vision for the agency going forward; what are our particular goals and objectives. So it was just the foundation from which, instead of continuing with that to some final conclusion, we really just moved on. We used it as part of our

discussion with division directors, part of the human allocation of staff. We really got into the details of each of the divisions and formulated the priorities for them. The chairman spent quite a bit of time in multiple meetings, a series of meetings to really focus very detailed on where he was going forward. We did not spend time or maybe waste time to really kind of conclude and bring it to a publishing form. We just kind of moved on from that.

Mr. PLATTS. The input from the stakeholders, the regulated community, I guess to start with. It sounds as if there were some from the regulated community that were asked to provide feedback or insights into what was being proposed. But at this point, you have not shared anything in a more broad public sense to invite comment from anyone in the regulated community. Is that correct?

Mr. DERBY. After those initial extensive reviews, we have not. But we continue to have interaction with the regulated community as we go forward on the policy side, on things that we are doing.

Mr. PLATTS. How about with the General Accounting Office, given that their report of last spring really seemed to capture well some of the challenges that the SEC was facing and the needs of the agency. We keep giving you work, but we don't give you any resources and help to bring to the attention of Congress. It is one thing to say, hey, do this, but unless we are going to step up and give you the allocation of resources, we are not being very fair or responsible.

Are you actively engaged in interacting with the GAO and saying here is what our draft study is; we welcome your comments on how you think it is going to meet the challenges or problems of the past as we go into the future.

Mr. DERBY. I think the GAO is familiar with the work on the study and has given us great input in just the work that they have been doing prior to the study, in the first report and the whole study process. You really found that people at the agency that really care and love this agency, and they were willing to understand that the agency had tremendous challenges coming before it. Instead of getting swamped and overwhelmed and tainted, they decided to really take a hard look.

I think that process that was done was one that really benefited the agency. Certainly the new chairman and myself coming in to take a look at what was being thought and being said, and we really took that as a floor, but not to work it to its final conclusion in the line it was, but as the raw materials upon which we really go into dealing with where we were going to be going as new priorities for the agency, the different divisions there; programs as they saw them going forward. That report started almost a year before.

Things have changed through that process. We had Sarbanes-Oxley implementation, a tremendous amount of responsibility there. So we just moved directly into going forward.

Mr. PLATTS. I know one of the pieces of material I have reviewed in preparation for the hearing, I saw a quote from Chairman Donaldson where he referenced wanting to draw on the knowledge and experience of the many dedicated long-time staffmembers at SEC who given the leadership and given the resources will rise to the challenge before the SEC. I commend the chairman for that ap-

proach in embracing the hard-working public servants of the SEC and working with them.

Before I go into additional questions for now, I am going to yield to the ranking member, Mr. Towns, for the purpose of questions.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Let me begin by apologizing for being late. I am from New York, and just a few minutes ago we had a shoot-out at city hall in New York, and one of my political allies, Councilman Davis, was shot and killed. So I was sort of monitoring that, trying to get as much information as possible on it. That is the reason why I was late coming. So I want to apologize for my lateness, but I hope you understand in terms of the situation we are facing in our city.

Mr. PLATTS. Mr. Towns, we certainly will keep Councilman Davis' family in our prayers and all those involved in that incident.

Mr. TOWNS. Right. Thank you.

Let me also thank you for holding this hearing because I think that it is a very important hearing. I think it is very timely, given the fact that we are ending the fiscal year and I want to get a report as to how things are going.

First of all, given the fierce competition for certified public accountants after the Sarbanes-Oxley era, what strategies has the SEC developed to attract these individuals? How will the flexibility recently granted to the SEC upon enactment of H.R. 638 improve your ability to meet your staffing needs? I can just imagine the competition must be really stiff out there, so how are you dealing with that?

Mr. MCCONNELL. If I may? You are right. The competition is stiff and we have an enormous challenge in front of us to hire a large number of accountants, CPAs. The CPAs that we need must have public accounting experience. We are not in a position to bring people in and really train them, entry level accountants. We need people who have actually been in public accounting, have been in firms, have been auditing. So that just doubles the challenge.

Fortunately, the SEC has always been a great place for accountants to come. They enjoy the work. We attract a lot of very highly qualified applicants. One of the problems that we have had is that the process to date, until recent changes in the law, it has been extraordinarily difficult to obtain accountants. So they might apply for jobs to us, but if it takes 3 or 4 months to get them, during that period of time they become disgruntled and move on to other positions.

So we still have the ability to attract lots of applications. Now with the ability of the excepted service hiring authority, we think we will be able to move rapidly enough on those applications so that we will be able to meet the goals that we have for bringing accountants on.

We have also followed traditional methods of recruitment in terms of we are very aggressive in the industry among the accounting firms, at schools, to attract people. We think that we will be in a position over time with this new authority to bring on the people that we need, with the experience that is so essential.

Mr. TOWNS. Right. Thank you.

Mr. Derby, according to your testimony, you have allocated 840-plus new staff slots among the various bureaus and offices of the

SEC after exhaustive analysis, which included a draft plan on operations and management and interviews with division directors and program managers. Would it have been helpful to have a strategic plan in place prior to making these allocations? If once the plan is completed it dictates allocations other than currently planned, do you have the flexibility right now to reassign individuals and to be able to meet these needs?

Mr. DERBY. Certainly a strategic plan is always beneficial to have at the beginning. It gives you clarity of the direction and formalizes it. However, we proceeded and acted in such detail that we really were thoughtful and responsible as we looked at the challenges and the agenda that was being formulated to address them.

So I believe that the human capital plan, which by the way I think our chairman used, that employees of our agency are our most valuable asset. As Senator Akaka had once said, if I may, a strong work force comes from having the right people at the right skills at the right place and at the right time. Only then will government operate in an effective, efficient and economic matter.

We have worked closely with our union, and also I think that the president of our national union, the National Treasury Employees Union, had said the fact is that we all share the same goals. We want the Federal Government to be the employer of choice, to create an environment where the employees who are here who are dedicated and committed want to stay, and where we are able to hire those who are looking to enter the Federal service.

I believe that the actions that we have taken in reviewing the internal operation, and it was done by Jim McConnell, our executive director, in the special study, and by the senior managers, really went into great detail in looking at what the challenges are for this agency. As we allocated, we got down to staff hours, how many hours it takes to review a particular filing, how many hours it takes to start an examination, and allocated those to those different divisions that consolidate the programs.

Mr. TOWNS. Well put.

You have 842 new slots. At the end of the fiscal year in September, how many of these people do you plan to have in place?

Mr. DERBY. Considering we started July 3 since we received the excepted service July 3, we started even before, since February's funding, to start posting for accountants, but since we got the excepted service just several weeks ago, we probably believe it will take 6 to 9 months to really fill those slots. We have allocated the slots among the different programs, and the answer to your question a little bit before, can we reallocate them, considering that we are managing this agency very, very tightly and reviewing quarterly, not only now and into the future, based on our dashboards, they will be able to reallocate staff as well as resources to address it as we go forward.

So the hiring will take some time. As that is happening, we will monitor it to see where and how, given new challenges that arise, or how well it is being implemented, to adjust.

Mr. TOWNS. Thank you, Mr. Chairman. I yield back.

Mr. PLATTS. Thank you, Mr. Towns.

Mr. Hillman, in my initial question with Mr. Derby about the draft study and the basis this McKinsey & Co. apparently formed

a foundation for that, my understanding is GAO has not really seen anything in detail regarding the draft study or any form of strategic plan or equivalent strategic plan at this point. Is that accurate?

Mr. HILLMAN. We have seen the draft study that was prepared, and we commend the SEC for undertaking this study. It was developed by a cross-section of over 20 staff within SEC. It confirmed many of the problems that we had identified in our March 2002 report. It also includes a host of recommendations for improving the efficiency and operations of SEC. However, we have not seen a strategic plan and do not believe that this study is a substitute for an agency-wide strategic plan.

A strategic plan is really a visionary document that requires the agency to look out on a 5-year horizon and determine what the critical priorities are that the agency needs to address in the future. This internal study did a good job of defining SEC's existing challenges, but it did not look out on a 5-year horizon. The agency did not even have an opportunity to fully consider the Sarbanes-Oxley Act and the immense new responsibilities that were placed on them because of that act.

So while we commend them for conducting the internal study, we still believe that an agency-wide strategic plan is going to be critical in establishing a vision and a direction for the agency in the future.

Mr. PLATTS. I stand corrected, that what you are looking for is that visionary plan, a strategic plan. The SEC, Mr. Derby, the way I hear your statements today, is really moving forward as quickly as possible to address the immediate challenges, recognizing you have identified that ideally you would have the strategic plan up front before you moved forward, but I take it the necessity to get the train back on the track as quickly as possible, but you are looking at that strategic plan being developed. Is there a timeframe for when GAO and Congress and the regulated community, will see that more visionary strategic plan in place and that you will be in a position to share that for comment from all the shareholder parties?

Mr. DERBY. The agency that we envision would be organized around critical missions, with management keyed to its performance. We believe that a dynamic agency is prepared to meet the many multi-faceted and evolving needs that are in a complex marketplace. The strategic planning as we have gone forward currently has been one that, as you have said, dealt with certain specific details that we needed to address as we were evolving with the agenda. That did go into an in-depth review of the goals, the objectives of each of the divisions.

We are required as part of the Government Performance and Results Act to do a strategic plan every 3 years or 5 years. This fall of 2003 is the update, since the last one was done in the fall of 2000. So that process is going forward. We have had senior members of the commission, senior staff members, working diligently on prioritizing the objectives and goal so that as we get into that in more detail, we will formalize that, and certainly by this fall be submitted to Congress and the administration.

Mr. PLATTS. Maybe a little bit of a repetitive question, but as you are developing that GPRA report and 5-year plan, it sounds like you envision that being your strategic plan for the next 5 years. What are the plans of the SEC to involve the regulated community, GAO, in getting feedback up front while you are developing the plan, including and our subcommittee and our oversight responsibilities, rather than you putting the plan out there and then there will be comments for or against or critical or supportive after the fact? Is there a structure or plan in place to seek out that feedback?

Mr. DERBY. I think the agency had shown in the special study that it really understands that reaching out to the broader community to get good feedback only benefits the agency in understanding the trees from the forest. It also believes that it needs to give some parameters in which, some framework of a plan first. It is the responsibility of the staff and the executive officer, being the chairman of the commission, to put together, put one forward that we can all then discuss and debate and finalize.

Within the development of that process, again as the special study showed, the agency is very much inclined to interact with many stakeholders in its own development of proposals. So I believe that will be the way it will continue and go forward.

Mr. PLATTS. I hope that is the case, especially with the wealth of knowledge that the GAO personnel have in this area, that they are a welcomed stakeholder in the process as you develop that plan. I think that would serve everyone's interest in good fashion if that is sooner and earlier in that process as that occurs.

I would like to recognize the gentlelady from Tennessee, Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman. I apologize to the committee and to the witnesses. Mr. Towns was relating the reasons that he has been in and out and was tardy into the meeting. We find ourselves with a situation where Memphis, TN, which is on the western end of my district, was hard-hit by a straight-line winds yesterday, with a state of emergency in the city. It seems like the calls from all of the county, the mayors of the towns in the county. It is keeping us very busy today. So I apologize for having to leave out of the hearing.

I want to talk with you for just a minute, if I may, and Mr. Derby, I do not want you to feel like you are being picked on, but I think I am going to start with you.

Mr. DERBY. Sure.

Ms. BLACKBURN. And talk about human capital, and addressing human capital. In Mr. Hillman's comments, he mentioned proper use and direction of human capital, and then in your comments you mentioned a couple of times in followup questions, you have mentioned the mission. I did not know if you could state for me what the stated written mission of the SEC is or if you have that before you in a document.

I think it would be wonderful to have it as part of the record.

Mr. DERBY. Sure, investor protection, investor protection, investor protection. But in the GPRA, it has it on the first page. It says the mission of the Securities Exchange Commission is a law enforcement agency. Its mission is to administer and enforce the Fed-

eral securities laws in order to protect investors and to maintain fair, honest and efficient markets.

The goals are four: investor protection; maintain fair, honest and efficient markets; facilitate capital formation; and, sustain and improve organizational excellence.

Ms. BLACKBURN. OK, great.

I know that it is probably fair to say, and I will ask you if this is a fair assessment, that there have been some criticisms of the SEC by employees. You say that only a few top officials ever receive training or guidance, and I know you are looking at starting the SEC university that would deal with new employees in your mission, your vision, your culture, and training on guidance. What are your plans for working with your existing employees to have them become your partners in creating a successful agency?

Mr. DERBY. Our chairman believes in partnerships, being from the business world that he was and the group of people that he started the firm with in 1959. He certainly treats myself and the other managing executives in the office as a partnership. It is something that he is very accustomed to and supportive of.

We actually want to go a little broader, and the most important asset, as I said, is the employees at the agency. So if we are going to be the employer of choice, how do we attract the best? How to we retain the best? How do we train the best? Our orientation program is very important, on how to bring in and have a graduating class of each group that comes in, that also will help us in the silos, as they say, where we have so many.

Ms. BLACKBURN. Mr. Derby, I am asking about existing employees. Before you bring these 800-and-something in, what are you going to do for those existing employees to be sure that they are your partners? Somebody has to be there to mentor new employees. Somebody has to be there to mentor out-source employees. So building that team that is going to carry your forward, and Mr. Donaldson has said there are some wonderful dedicated people there, how are you going to capture that human capital to build that in to attain?

Mr. DERBY. The existing idea put forward of the SEC university is really to have a comprehensive training program for all employees. We have started e-learning just the other week, which has over 2,000 courses. They can take it anytime, anyplace. We are putting together, we have a new training and development officer who has come in. We have met with all of the offices and divisions and specifically want training to be tailored to their specific areas of expertise and needs, not to just if we build it they will come, but actually tailor it so it is effective and efficient.

We have existing training programs that we want to consolidate under the umbrella of the SEC university, to give it not a community college level, but a real university content level, to encourage the existing employees to take the challenge of increasing their knowledge and their education. We have pay parity which requires performance-based compensation. Part of that parity system could be where the managers are encouraging employees in their advancements, including educational aspects of their advancements, so it would be desirable.

We view the whole area of human capital as important.

Ms. BLACKBURN. OK, your plan for your SEC university, how long do you think it will take you to put that in place?

Mr. DERBY. Well, we have started it already. We have a wonderful beginning. We have met with all the divisions and offices and concluded that I believe last week. I think last week was the last meeting on that. We have several divisions with training directors within those divisions. We have a pretty strong program that we want to now consolidate within the university. It will help the logistics. It will help for providing the ability to have cross-division training.

Ms. BLACKBURN. Are we talking a year, 4 years?

Mr. DERBY. We started it just about 2 months ago, the beginnings of it. We are moving forward fairly quickly on it.

Ms. BLACKBURN. What is your goal?

Mr. DERBY. Our goal?

Ms. BLACKBURN. To have it completed.

Mr. DERBY. I think education is an ever-evolving goal. We have put together an advisory council on curriculum to make the content valuable. We have put together a trustee group to make sure that it answers the needs of the agency, not just this 4 or 5 or 6-month planning period that gets it up and running, but a consistent basis.

So I do not have a specific timetable that we have put together and said we will have the university completed by, but we have been very actively building.

Ms. BLACKBURN. When will your first class start?

Mr. DERBY. It started 2 weeks ago.

Ms. BLACKBURN. OK. Great.

Mr. DERBY. That is the e-learning part.

Ms. BLACKBURN. OK.

Mr. DERBY. Ongoing training has been going on. The Division of Enforcement has a training officer and it does training in the past and continues.

Ms. BLACKBURN. And the price tag for this?

Mr. DERBY. Jim, do you want to say what the budget is?

Mr. MCCONNELL. Actually for our 2003 budget, we added $5 million to our training account. So we have a total right now of $7 million associated with our training program, so we have been able to really take advantage of this increase in resources to more than redouble our efforts in the training arena. So we are quite optimistic.

Mr. DERBY. Just to comment on the morale and the retention, just to reflect on it, with pay parity coming in, we have seen the rates for attorneys and accountants, the turnover rate that was as high as 17.5 percent almost for attorneys and over 13 percent, almost 14 percent for accountants, drop in this past May to 6 percent for attorneys at 3.5 percent for accounts. So we have seen some changes within the human capital of the agency for retaining. I think it has a lot to do with pay parity.

Ms. BLACKBURN. OK, thank you. Mr. Chairman, may I?

Mr. PLATTS. Yes.

Ms. BLACKBURN. OK, thank you. I do have a couple of other questions. Out of the 840 new employees that you expect to hire, what portion of these new individuals will be contract and what will be full-time employees?

Mr. MCCONNELL. They are all full-time employees.

Ms. BLACKBURN. They are all going to be full-time employees. And the reasoning?

Mr. MCCONNELL. The employees were distributed throughout our program areas to increase the number of enforcement cases we are doing, to increase the number of filings we are reviewing. All of these are only government-kinds of positions. In the program areas, they are attorneys, accountants and examiners who are critical parts of our program areas. So we are not contracting those out.

Ms. BLACKBURN. OK. Mr. Hillman, just to you very briefly, you mentioned their technology needs. If you would expand on that for me for just a moment and address a little bit about their technology needs and expansion. I think they have a disaster recovery plan that they have been implementing, so if you would speak to the technology needs. I think one of the things that is frustrating sometimes for us is that we review agencies; they talk about spending hundreds of millions of dollars, and there is never one system talking to another system. Everybody goes back to square one to invent any kind of form and then nobody knows that somebody is retrieving information off of another form that another agency has.

I am certainly no technology wizard, but I do know what seems to be frustration with dollars wasted. So if you would speak to that, I would appreciate that.

Mr. HILLMAN. Yes. Even with SEC's budget shortfalls, it had maintained a list of its technology improvements that it needed to conduct once they got additional resources. Their internal study that they conducted, each of the program areas documented a wide range of problems that they thought could be solved through state-of-the-art technology.

With this budget increase, SEC has now been able to double its budget in its information technology area and it is beginning to move out in very important areas. One of its most important areas deals with its plans to convert their Edgar system. This system houses regulatory filings and other reports, and it is currently very difficult to access and analyze information, to gather trends off of filings and other statements. SEC hopes to convert this system into a searchable data base that will help SEC conduct various types of trend analyses of industry data and filings.

Another important initiative involves plans to implement a document management and image processing system. This system is intended to eliminate paper documents and electronically file the large volumes of information that are part of litigation, examinations, and enforcement activities. Just walking through the halls of the SEC, you can see boxes and boxes and boxes of information associated with the many enforcement and examination activities that they must conduct. It is very difficult to go through that information. It is even more difficult to share that information across the organization when it is sitting in boxes.

Ms. BLACKBURN. Let me ask you this, and I hear we are going to have another vote, when the SEC is investigating a company, do they have access to the IRS filings of the individuals that they are investigating within that company?

Mr. MCCONNELL. I am not sure about that. I will have to get back to you. I know that we have had interactions with the IRS

in several areas. Sometimes it has been very difficult, I know, to share information with them, but we have to get back to you.

Ms. BLACKBURN. Do you all have access to any of the personal financial data of individuals at the companies that you are investigating?

Mr. MCCONNELL. Other than that which is required for our own disclosure, some financial information on individuals with companies is required under our disclosure scheme, but I don't think we do, but I want to make sure that we give you the right answers, we will get back to you.

Ms. BLACKBURN. OK. Mr. Hillman, back to you to end my questioning. I do not want to take the chairman's time. So with the Edgar system, what you are saying is what you envision is building into this system a query mechanism that analysts can go in and as reports come in, and that information has been either electronically entered or imaged into the system. Then an analyst can query that to pull in the trends, to look for the trends.

Mr. HILLMAN. That is correct. It is a data tagging process that will allow SEC to pull information from their filings.

Ms. BLACKBURN. So you are not pulling it by company necessarily, to sort out that company, but you are pulling it for the trend?

Mr. HILLMAN. Exactly.

Ms. BLACKBURN. OK. Let me ask one thing to followup. As you query that, then would the data that you query, the company that data is attached to, would they remain anonymous in that query?

Mr. HILLMAN. Depending upon the type of query that you might conduct, it could be or it could follow along with the data.

Ms. BLACKBURN. Thank you.

Mr. DERBY. Let me just follow on that one point. It is an important point since we are going through this process of evaluating. There is a lot of different formats there. EBRL is an example of one where there is tagging of information. Currently, the Edgar system is organized as it gives the pictures or the community and the registrants that file with us. It is really a scanned copy and we do not really get a chance to really use that data. So the idea is to try to use a format and have registrants tag the data that then the SEC could use in its own queries in any way that it sees fit. The banking community, the investor community, anyone else could use it as well. So it makes the data much more effective and usable for a broader sector of users. We are thinking about that process, that tagging process.

Mr. PLATTS. Before I go to the ranking member, I would like to follow up on Ms. Blackburn's line of thought. In your written testimony, you talked about the new Office of Risk Assessment. I take it that one of the advantages of this revamping of your technology is that you can be more proactive in doing this trend analysis and getting ahead of the game, rather than just being reactive all the time. Is that a correct understanding of what your risk assessment office is, one of the intentions of that new office?

Mr. DERBY. That is just one of the intentions. I mean, we are really looking at trying to make the agency become proactive across the board, to be able to see what is coming over the transom, look around corners. The best way we find to do that is to have an office

focused on that, with staff and others from within the different divisions and offices really thinking that way and being dedicated, as well as managing all risks, internal risks, external risks, security risks, systems risks, all different risks.

Mr. PLATTS. I assume that this office would have staff management from the corporate filings, from enforcement, so that you break down that silo approach and have staff from all corners of the agency working together to look around those corners, look ahead?

Mr. DERBY. That is one of many ways we are attempting to better interaction and sharing of information, the enterprise architecture within systems to do that, the risk management area to do that, as well as other communications that we would like and are formulating among the different divisions and offices. The interaction we find to be important and it makes things a lot more efficient.

Mr. PLATTS. I do want to yield to Mr. Towns. I believe Ms. Blackburn has gone over to get her vote in and then will come back, so then I can run over. I want to yield to Mr. Towns. Before I do, I would like the record to reflect that Mr. Towns celebrated his 29th birthday for the 40th time I believe this week. [Laughter.]

So a belated happy birthday, Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman. You have it accurate. [Laughter.]

Mr. Hillman, in your statement you indicate that GAO believes that the SEC would benefit by reevaluating its existing rules and regulations and regulatory approaches to ensure that they continue to reflect the realities of today's financial markets. Could you elaborate on that? What do you really mean by that? Do you have any specific examples of rules and regulations that may be outdated or should be changed?

Mr. HILLMAN. What we have observed from our March 2002 report is that SEC's workload is increasing at an ever-increasing rate, Congressman. We have a graphic on our highlights page of our written statement which depicts a significant upward increase in workload at the SEC that is produced largely by increasing filings that are coming in, increasing rule reviews, increasing inspections, examinations and investigations. The workload that SEC is facing is being eclipsed by a much less increase in its resources.

There continues to be a significant gap between its increasing resources and its planned increase in staff. Something must be done in order to reduce that gap. One of the many things that SEC should begin to consider doing is looking at its internal processes; looking at those things that are required by law and also those things that are required by their own initiative, through their rules and regulations and processes, and evaluate whether or not today's financial markets continue to require those rules and regulations to be in place, so that we can narrow the gap between their increasing workload, and the resources that they have to devote to that workload.

Mr. TOWNS. Are you saying they might not have enough money? Let me make sure I understand what you are saying here.

Mr. HILLMAN. As this graph that we have depicted shows, it provides what SEC believes its workload requirements are through fis-

cal year 2004. It also shows on the staffing side what is likely to happen with an increase in resources of 842 positions in fiscal year 2004.

Mr. TOWNS. Right.

Mr. HILLMAN. What that graph shows is a significant narrowing of the gap between their workload responsibilities and their staffing responsibilities, but that gap is still there. So the SEC must do a number of things, we believe, to increase its efficiency. One of the main things we believe it needs to do is leverage its technology and look at its own internal rules and regulations.

Mr. TOWNS. OK. Thank you very much, Mr. Chairman. I yield back.

Mr. PLATTS. Thank you, Mr. Towns.

Following up where we stopped there, I want to get into that technology issue and the importance as you are looking at that GPRA report, the strategic plan, your plan for investing in technology. I know you are doubling your budget this year, and you envision technology achieving some of that objective that GAO is talking about, closing that gap. Where do we stand today in your plans for technology, as opposed to manpower. We know we are going to have a lot of new manpower coming into positions, but how is technology going to play its role?

Mr. DERBY. As shown there, that gap, and in our written testimony we reflect on the increase in enforcement cases that were up by 81 percent; our staff by 21 percent. Annual filings increased 73 percent. Our staff increases 29 percent. That is reflective of what that graph has shown. To address it, we really need to understand the obligations and the workload put forth by Sarbanes-Oxley; the fact that every 3 years we need run through one-third of the filings. So there are certain things and a certain amount of that workload that is now legislated.

But to give our taxpayers the best value, we believe that by adding a multi-faceted approach to achieving that risk assessment, are we looking at filings that cover 5 percent of market cap, 5 percent of investors? Are we looking at filings that protect 85 percent of our market cap and those investors? So risk assessment is an important part. Strategic planning, if you are able to take a breather and really put together a thoughtful strategic plan on how to address those challenges, the effectiveness of that process, I believe will enhance the performance; training of staff, the morale within the agency, rewarding through recognition and compensation of the staff and doing so.

There are many ways that we are addressing that, but it is true that gap has existed, and going forward, the resources that we have received addresses a lot of it. We looked at those resources and allocation of human capital in referring to the human capital plan, to address the filings under the corporation finance division, inspections, increasing the number of or the time that we review the different broker-dealers, investment advisers.

So it is correct that workload is one that needs to be very, very thoughtfully addressed as we look into what our vision for the future of the agency is.

Mr. PLATTS. My understanding is in the technology aspect of meeting that workload, that you are in the process of developing

an enterprise architecture related to technology upgrades. Could you tell us where that enterprise architecture stands today, and where you see it going?

Mr. MCCONNELL. We have been working on a new enterprise architecture for about 18 months now. These new resources obviously give us the ability to really move that forward. The three critical elements of the architecture, two of them are really designed to improve efficiency of our operations. You need more people, but you also need to have those people working better.

The document management one is absolutely essential. As Rick pointed out, we are drowning in documents, not just in our enforcement program, but also in our examination program. So this document management system over the next probably 2.5 years will digitize all those so that we can use them much more effectively. So that is a major part of the stool that we are building for our enterprise architecture program.

Edgar is another one. Edgar right now has been modernized so that its software and its hardware are very robust and can handle new technology quite well. It is a Web-based system so we can deal with all manner of new applications. The problem is that we need to get registrants, issuers, companies to work with us in a different way. So we will build that system so that they provide us with information in a digitized fashion so that we can search it and be much more efficient in our reviews, and the manpower that we apply to it can be more effectively utilized.

The third part of the enterprise architecture system that we are working very quickly on will be probably ready, the earliest is the security and backup and recovery part of it, so that we will not have problems like we had in New York where we lost lots of documents. We will have the ability shortly by this fall to have a point-to-point system, rather than a hub-and-spoke system so that we can literally back up all of our information throughout the country. That is another important part of it.

Mr. PLATTS. You mentioned this fall from the security standpoint, that aspect being the earliest. Is there a good timeframe you can share with us on all three parts?

Mr. MCCONNELL. The Edgar one is going to take the longest. The technology part of Edgar is really done. We finished that last year. It is the working with the registrants, and I think it is several years to really get the registrant community to the point that they have adopted a whole new standard. We have across industry lines established new standards for filing documents so that the financial statements, the M&A statements and even maybe the narrative statements come in so that they are fully tagged, searchable by us and by the public, because everything that is filed with us is immediately public, so the entire investor population can look at these filings in a much improved may, but that is a long-term effort. Document management is probably 2 years, I think, before we get that done.

Mr. PLATTS. On the timeframe from the staff side now, as you try to close that gap, one, I appreciate a report out in Bloomberg news today of the SEC stating that because of the lateness of us getting the money enacted with the 2003 appropriations bill, that it looks like you are not going to be able to spend approximately

$103 million of your total allocation, and that your plan is to return that, rather than what is unfortunately a case here where you are in a use it or lose it mentality. One, I commend the SEC and your leadership for your statements that I understand Mr. Derby you have made today that your intent is to return those dollars and be very responsible with taxpayer funds. The responsibility lies with Congress for our inability to get a budget passed in a timely fashion.

But where are we now with the new dollars in the pipelines this fiscal year and the coming fiscal year in bringing all those new staffmembers on board? We know you have new hiring abilities, new incentives because of pay parity, and a whole new attitude at the SEC and SEC university and things that will help to attract people, but how quickly do you envision getting everybody in place from a manpower standpoint?

Mr. DERBY. You are correct to say I understand it is quite unusual for someone to return funds not utilized the way they were intended to be utilized.

Mr. PLATTS. We hope others in the government are watching and taking good notes.

Mr. DERBY. It would be great if this committee made it its mantra that use or lose it ends as of today in the government. Personally as a taxpayer I am personally shocked that is the way things get done around here. But anyway that being said, we have our values, our virtues, our values set and we decided that the funds allocated to the staffing that were not utilized were appropriately returned. Those funds still would be needed because we are going to staff up the 842 individuals, and we do believe, thanks to the excepted service legislation, that within 6 to 9 months we will be able to be fully staffed and the funds that we had requested for 2004 fiscal year would be ones that are quite close to what our actual needs are, without the lag, and we are really moving on that.

Mr. PLATTS. And from your previous statements, the changing approach with the continuing education aspect and with existing employees, with new employees, and getting everyone the same, your belief is that the changes you are or have made or are in the process of making will allow you to even if the economy picks up, there are a lot more people out there in the workplace maybe looking for positions today, but if we return to the tight markets we had in the 1990's, that you will be able to retain those new employees because of the new structure, new employee aspects that you have in place. Is that a fair assumption?

Mr. DERBY. It is a fair desire. I would certainly hope that others share the fact that the SEC is at a very critical juncture in its future. Sarbanes-Oxley does not come around every 10, 20 or 30 years. This is an institution that is the place to be when it comes to the securities industry, and if we get it right, as we hope to do, it will really reflect on many, many years. So we would hope that the accounting profession, the securities legal profession, would certainly respond and come to the SEC and help to create its future which is so important.

Clearly, there will be competition. We have the PCOB that is staffing up as well. So there will be some of that, but I do believe

we are positioned well. Pay parity is something new at the agency this year. The first performance evaluations are coming out this year, so I think there will be a little bit of a learning aspect to that. But we understand and I repeat again that the most valuable asset that we have are our employees, our people existing and in the future, and we want to be comprehensive in how we address that.

Mr. PLATTS. The good news here I think is with this administration and the President's management agenda, a greatly heightened focus on outcomes and financial responsibility and how we spend the taxpayer funds. I think the agency is setting a good example in this fiscal year returning dollars that will not be spent. The challenge of that good news is that you are one of many entities that are looking for similar type of professionals. We had DOD in recently as they are trying to clean up their books over the next 6, 8, 10 years.

One of the challenges is going to be having enough staff accountants and auditors and others in the financial field available to them to meet their needs. You are all going to be competing out there. So hopefully we can be successful in getting people, not to say that there is some pay parity and some other good benefits, but also inspire them to want to be part of your efforts and DOD's and others from a public service standpoint as well.

I would like to yield again to the gentlelady from Tennessee, Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman. Are you going to need to head to vote?

Mr. PLATTS. I think we are going to have to skip that vote and continue here.

Ms. BLACKBURN. You are going to skip that one? Well, I tell you what, it was a nice fast run over there. [Laughter.]

Mr. PLATTS. I appreciate your making the effort, but one, I have a feeling I would not be fast enough, and rather than break the hearing here.

Ms. BLACKBURN. Sure.

Looking again at hiring practices in a post-Sarbanes-Oxley environment, I guess that we can say that traditionally the SEC has hired attorneys more than accountants, but you are shifting that and you are going to be hiring accountants to fill more of those spots. It sounds as if you are changing your recruiting strategies to do more in attracting CPAs. Is there anything additional other than the comment you just gave to the chairman that you are doing to change your recruiting strategies or to encourage those that are current employees who may be in the accounting department, but are not CPAs, to further their education, other than SEC university?

Mr. MCCONNELL. We are looking at our overall hiring and staffing makeup. We have moved dramatically, as we stated earlier, into hiring more accountants and lawyers. In some program areas, the 142 will be used predominantly to hire accountants. The other major area that we are going into is in the examination program. We intend to change the nature of the work force, too, if we can.

Typically for the examination program, we have hired people pretty much right out of school, and we have our own multi-year training program that we put them through. We have decided now

that we really need to try and focus more on people with back-room experience, people who have been in the industry longer.

Ms. BLACKBURN. OK, when you say "back-room," you are talking about accounting back-room experience, is that correct?

Mr. MCCONNELL. Experience in the back rooms of brokers and dealers, investment advisers, investment companies, so that they know the capital situation of those companies well, and they have seen it first-hand. So we are going to undertake an effort to raise the level of experience for the examination program we will bring people in for, so that we will have a combination. We will still bring those entry-level people in and train them, but we want to have the ability from working with people that have more seasoned experience. That is sort of the major new area.

Ms. BLACKBURN. OK. And the average tenure of an attorney at the SEC has been what?

Mr. MCCONNELL. The tenure has changed pretty significantly the last couple of years. Right now, the average tenure for an attorney is 7 years, 8 months. You have to put that into perspective. Sixty-one percent of our attorneys, though, have been here less than 5 years. So while the average does not look too bad, there are an awful lot of people still at the early stages. That, of course, is going to be compounded because with these 842, there are going to be an awful lot of people who have only been here 1 month.

Ms. BLACKBURN. OK. And the CPAs, your accountants, what is the average tenure?

Mr. MCCONNELL. The average right now is 11 years, 6 months. Again, 34 percent of our accountants have been here less than 5 years.

Ms. BLACKBURN. And how long does your training program last?

Mr. MCCONNELL. For accountants?

Ms. BLACKBURN. Accountants.

Mr. MCCONNELL. When we hire accountants, we hire trained public accountants who have been in the industry for years. Then we have an orientation that is a fairly, more of a work on the job, learning on the job for accountants. Now, examiners we bring in, we put them through an extensive multi-year training program, where each year they must go through various learning components. But accountants, we hire experienced accountants who have already been in public accounting long enough so that they can come in and start dealing with filings immediately.

Ms. BLACKBURN. OK. Mr. Hillman, is the GAO comfortable with the SEC's staff allocations and the shift in the focus in their hiring?

Mr. HILLMAN. The 842 positions that they have allocated to their divisions and offices seems very consistent with the requirements in the Sarbanes-Oxley Act. The allocations also seem very consistent with the internal study that SEC conducted of its own operations identifying critical needs in the examination, enforcement and corporate filings areas, all of which the increases in staff is intended to go toward.

We are not, however, able to fully certify that these resources are being put in the most appropriate places until the organization has developed its agency-wide strategic plan that determines what its missions, goals, priorities and strategies are for the future. Hope-

fully with that in place, we will have an opportunity to ensure that those resources are in the right place.

Ms. BLACKBURN. OK. Thank you. May I ask one more? OK.

I want to go back to this question where I was when we took the break, regarding the Edgar system and the query mechanism that you all are looking at establishing. I had asked you about anonymity as you are searching those trends. We talk a lot about privacy issues and the need for privacy. As we all know there is a tremendous difference in what is confidential and what is anonymous. I think that it would be very important as your analysts are looking at trends that they allow anonymity to tax filers if you all are pulling IRS information that there be anonymity.

Mr. Hillman, this would be directed to you. Should we have the SEC submit their software to you all or to us, to submit this new system and its software capabilities to us so that can be reviewed, the financial management of that could be reviewed prior to its implementation? And should the security measures of the firewalls be submitted and be reviewed so we can allow people to know that we are allowing them to retain their privacy?

Mr. HILLMAN. I think you are raising a very important issue, and an issue that I am sure the SEC is concerned about as well. I am not sure that it would be appropriate necessarily to submit those requirements to us, but I suspect that as part of developing those requirements and implementing the system that the SEC would be coordinating with their public companies that will be providing information in these public files to provide them assurances that the systems that are being developed are going to be robust enough to meet their security needs.

Ms. BLACKBURN. And you do consider them public files?

Mr. HILLMAN. Yes, they are.

Ms. BLACKBURN. Mr. Derby.

Mr. DERBY. I think you might be raising the question that our software is going to reach out and go into their——

Ms. BLACKBURN. No, sir. I am not expecting that at all. I am not expecting that your software would query the companies. I will go back to as we started this discussion, my understanding of what the Edgar system would be. It would be a system where what the reach-out portion from you on your back-end work of your technical system, your reach-out portion would be that a company could come into your system, grab a form, electronically complete that form, and submit that by electronic transfer into your system. Then, there would be some companies who would submit manually completed forms. Those would be imaged. Am I on the right track here on my understanding with you? Those would be imaged and inserted into that electronic system. I am still understanding this correctly? You are nodding yes.

Mr. DERBY. Yes.

Ms. BLACKBURN. OK. Thank you. Then, there would be analysts and accountants who are searching for trends and for movement in the industry. They would query this in search of those trends. Am I still following this? OK, we are nodding yes. Then, what I am seeking is, there needs to be some firewalls and some assurances, understanding that there is a broad difference between confidentiality and anonymity, that there needs to be an allowance for indi-

viduals and for companies to know that individuals who are searching this are not looking at that company and that information if they are just looking for trends, that we have a privacy component that is built into that, not you going out into those companies, but the information that is being entered.

Mr. DERBY. The information that comes is public information.

Ms. BLACKBURN. OK.

Mr. DERBY. So everything that was submitted is for public use and our view is to really assess individual companies when we review them, and do more number crunching and more analysis, as well as across industries.

Ms. BLACKBURN. OK. Thank you, Mr. Chairman.

Mr. PLATTS. The technology aspect is something that certainly will have a dramatic impact as you move forward first, on the security. The security we talked about earlier was really the security of keeping your files, and if there was another incident of attack, as in September 11, that you are prepared for that, a different issue than Ms. Blackburn was raising.

Maybe to help me understand the security of the information, are there parts of what is filed with you that is not public information but is part of what would be accessible, that is in the same electronic entity that can be accessed by the public? Or is that, when you get that information, the part that is not to be public is actually in some other file? Or is it possibly in the same one, but you just allow access to one part of that file, but not another?

Mr. MCCONNELL. Each company has the ability to submit requests for confidential treatment of certain information that they submit as filings. We separate that. It is not available to the public. It is not public information at all.

Mr. PLATTS. So that would not be in the Edgar system that the public could go into?

Mr. MCCONNELL. Our staff can see it as they need to, but it is not part of the public information data base that would be available through any public queries.

Mr. PLATTS. Ensuring the security of those confidential files.

Mr. MCCONNELL. We have tested those systems. We have tested our firewalls. We have had NIST and test our firewalls. Information security is a huge issue for us right now, as it is for everybody because of the certification requirements. But in terms of testing firewalls and penetration possibilities, we are highly confident that information is protected.

Mr. PLATTS. OK, thank you. On the workload aspect and whether the technology being put in place to help with workload or the new staff positions, when I look at some of the numbers from 1980 to 2000, 30 times higher volume of shares traded; 50 times higher the number if IPOs issued in 2000 versus 1980. Clearly, the graphs that you are talking about are dramatic including the increased workload. Sarbanes-Oxley adds more to that with the 3-year review requirement. What is a realistic assessment of your ability in the short term to meet that 3-year review requirement with the additional resources you are being given?

Mr. DERBY. Our whole staff allocation process, as I said, was very detailed and evolved, asking for the objectives and the goals of each of the divisions to meet Sarbanes-Oxley requirements, what

their vision for that area is, took into account the allocation of staff to meet the 3-year filing reviews, and also to meet the enhanced enforcement proceedings, as well as a timely basis for completion of those enforcement proceedings; to review based on risk assessment in the investment management and brokerage areas. So a lot of the Sarbanes-Oxley not only does it, but the spirit in which we try to address it. We have allocated a detailed analysis to meet those requirements.

Mr. PLATTS. So it is your assessment at this point in time that Congress has it fairly right in the amount of resources we have given you for new staff, and for technology?

Mr. DERBY. Our assessment has been that we have in an effective, efficient way allocated it very much tight. There is not a lot of room for error, as well as there are other issues that are being currently reviewed, hedge funds, other questions with regard to the regulations of possible other entities that might be given to us. So these would all be additional things that we might have to think about how we can address.

But under the current agenda and the current items that we have under Sarbanes-Oxley, it is tight, but we have been allocated to meet those objectives, understanding that there will be efficiencies from technology, from risk assessment, from statistical analysis on how we formulate the reliability of the different inspections, the kind of way we approach it. So we think that will enhance the efficiencies.

Mr. PLATTS. And that is all going to carry over into the enforcement issue as well? My understanding is that there is an estimated 5-year backlog of enforcement examination actions. In that strategic review of allocation of your new resources, is that going to help cut into that backlog in a dramatic fashion?

Mr. DERBY. You probably mean the Office of Inspections, Examinations and Compliance. They have been on a 5-year cycle. We are going to cut into that on a 2-year cycle based on risk, the larger, more significant institutions; the others on a 4 to a 5-year cycle. A 5-year cycle, we do not want to lose, for that to go to 6, for sure. We will try to cut that down if it possible, 5 down to 4, but at least out of that 5-year cycle, take a look on a risk-assessment basis down to a 2-year cycle.

Mr. PLATTS. And the largest impact?

Mr. DERBY. The largest, most important, best managers there. So we are cleaning out the backlog of other cases from enforcement quite a bit this year, and I hope that by the end of this calendar year to really have that under control as well. So a lot has been going on in the last 6 months to a year. I must say when we got there, there was a tremendous amount of accomplishment. It is not just that it was a period that stopped and changed. I am really here to talk about the accomplishments of the past and our vision and opportunity and the future.

Mr. PLATTS. Mr. Hillman, what is GAO's assessment from allocation resources standpoint on what Congress has done, more manpower, more technology. Do you think we are still asking too much of SEC with the resources that they have? Or are we at about the right level for the demands we are placing on the agency?

Mr. HILLMAN. Based on the results of our study in March 2002 and in then the serious corporate and accounting scandals that have occurred in the markets leading to the Sarbanes-Oxley Act, it was very clear that the SEC needed additional resources to meet its mission responsibilities. This 842 staff years is the largest increase in the agency's history. Its challenge right now, Mr. Chairman, is to bring in the best talent it can as quickly as it can.

You had mentioned that the corporate filings area was an important topic in the Sarbanes-Oxley Act, requiring SEC to review every filing on a 3-year cycle. With the resources that they had in place, they have only been able to review those filings on about a 6-year cycle. So they need to double up in order to review the filings within the required 3-year cycle.

In discussions with the division heads in that division, they tell us that today they are still triple-digit behind in hiring the necessary accountants that they need in order to meet that threshold of a 3-year cycle. They have been seriously constrained in their ability to hire accountants. The new legislation that Congress has passed should help alleviate that process. The Division of Corporate Finance tells us that in the past they have only been able to bring in about four additional accountants per month. With this new legislation, they are hoping that this is going to free up the ability for applicants to apply more easily, for them to review and interview applicants more easily so that they can increase the number of accountants that they bring in in a more expeditious fashion. Whether that is done in a 6 to 9-month period of time, I currently feel that is an ambitious target.

Mr. PLATTS. The four accountants per month, how recent is that data? I mean, when is that saying it was?

Mr. HILLMAN. That would be from about the beginning of this year, as they are beginning to gear themselves up. That is about the level of resources that they are able to get in under their old process.

Mr. PLATTS. Where is SEC today? In the last month, how many new accountants have you been able to get on hand?

Mr. MCCONNELL. We are still right now operating under the old, well, we have not had a chance to move to the new hiring regimen. We have only had it in place for a couple of weeks. We have built systems. We spent 2 weeks working on the procedures that we will follow to really kick it up. We have plenty of applications so that we know that it is possible to get there. But the GAO findings are absolutely correct. We have had an enormous problem hiring accountants in the past. We received, and this is public knowledge, the ability to hire 54 accountants, I believe it was, last August. We still have not hired them all. I think we have hired 48 of them. So that is the kind of process we were going through at that time.

We now have to hire about, it is triple-digits. It is 150 to 190 new accountants with these new resources we have been given. I think it is optimistic that we will do it.

Mr. PLATTS. Your human resource department over the next 6 to 9 months should not plan on taking any vacations. They are going to be busy processing a lot of people.

Mr. MCCONNELL. Right.

Mr. PLATTS. We hope they are going to be busy processing a lot of people. I think that goes to Mr. Hillman's comment that he hopes you are accurate in that ability, and successful, but it is a pretty daunting task ahead, but it is a necessary task to be fulfilled if we are really going to meet the requirements of Sarbanes-Oxley and the broader mission of the SEC.

I have some other questions. Ms. Blackburn, did you have others?

Ms. BLACKBURN. No. I am fine.

Mr. PLATTS. OK. And to follow-on on the resource issue and the budgeting process. In the past, it was more of an output-based, kind of a more traditional government, here is what we did with the money, the number of reviews conducted or examinations done or enforcement actions, as opposed to what are the true outcomes in fulfilling the mission of protecting investors.

My understanding is that is dramatically changed, again with the leadership of the White House and the President and the broad management agenda. At the SEC are you really looking at outcomes in how you have set your 2004 budget request and looking to the future. Can you expand on that a little bit?

Mr. DERBY. That is hugely important. Just to focus on output does not really solve the problem. Even filling out GPRA requirements and just sending it in is not such a great thing until you can convert into dashboards and other things, and use it as a great management tool internally so that we are in sync between what Congress thinks we are doing and what the managers are really doing, and we can actually manage that.

Part of the administration's program called PART, which is the Program Assessment Rating Tool, we are really focused on what the outcome of each of these programs are, and what the costs of that outcome is as well. Once you are able to shine a spotlight on things, people take it more seriously and actually get efficiency and effectiveness in those different areas.

So clearly, outcomes is a very important thinking approach on how to deal with the challenges that we have, and we are pleased that everyone is focused on that across this administration. You know, the red, yellow and green components, those are important, and I wish this administration by July of next year really get to yellow.

Mr. PLATTS. I agree. Your points are well taken on GPRA. Just complying is not really what we are after. It is that compliance leads to benefits to the entity and therefore to the American taxpayers ultimately, and that PART does help to focus attention and shine the light on what actually is being done and what are the results. That translates to the issue of your internal financial management. You are undertaking your internal audit and GAO's doing it for the initial year because of the challenge in a quick time fashion for you to go out into the marketplace and find somebody who would not have a conflict to do this audit for you.

In the past 6 months, what we have heard and what we have seen is entities that have gotten clean audits, but because of a heroic effort at the end of the year. So the output is a clean audit, but the outcome again is different, that it is not something we

want to be doing every year. The agencies really have not changed their financial management processes.

Where do we stand at SEC so that we do not just get a clean audit, but that we have in place those internal controls, that it will be year to year, month to month that you can look at your internal financials and say, here is where we stand, here is what we are spending, here is what our finances look like.

Mr. DERBY. About the audit process?

Mr. PLATTS. In that it is truly a long-lasting plan you are putting in place so that your annual auditing is not going to require a heroic effort every year, that you drop everything just to fulfill this requirement, but that it is more of a natural result of the processes you have in place.

Mr. DERBY. Clearly, putting in the proper systems and controls and manuals and really designing it so it is forever lasting is very important.

Mr. PLATTS. Right.

Mr. DERBY. We put together a pretty aggressive plan on trying to complete the 2004 audit, attaining a clean opinion on that. We submitted that to the Office of Management and Budget. We hope that they endorse our plan and how we are going to go forward. It has been one with many milestones already. Just in November of last year, the act was passed in November 2002, it was the Accountability of Tax Dollars Act of 2002. So since that time, we have put together a pretty aggressive plan. We have contracted with the GAO, since we are not allowed to contract with anybody else in the accounting profession. It is a conflict of interest. We have had internal controls assessment done and put together five task forces to address the areas that were found there to need addressing, and some of those are going to be done very, very shortly.

I think going forward as we have addressed the agency's financial management, we have enhanced the system. We have had a system I believe this past July, this month or June, that was additionally integrated into our budgeting process. So I think everything that we are doing to complete it is actually something that is not to just review and then change. We are in the process of making long-term changes so that the audit when it is done is really going to be the basis, and effective use of resources that the government wanted, and the GAO wanted, and does review it, as a basis for many years to come. We are addressing a lot of those issues in this process.

Mr. PLATTS. Mr. McConnell.

Mr. MCCONNELL. Just quickly. Our financial management system is new as of 2002. So that is a system that will allow us to have a repeatable process for this going forward. That will be certified in January 2004 for audited financial statements. The work of those task forces is critical. Those task forces are changing the systems in place. That is their mission. They each have a certain system that they are working on, and the intent is to have that system changed prior to the initiation of the first balance sheet.

Mr. PLATTS. I want to ask GAO's assessment of where you are and where you are going. One of the issues that has come to my attention with GAO doing your 2004 audit is that they have agreed to do that in the short term, but do not want to be long term your

auditor. What are your plans for the long term regarding your financial audits?

Mr. DERBY. That is a good question. As best as I could answer that in my brief discussions with our IG, inspector general, they clearly do not have the resources right now to be able to do that. If we have several years of perfect audit and internal procedures and controls in place, then possibly it could be the IG in the future. I think it is by statute that they have that opportunity.

Mr. MCCONNELL. That is their responsibility.

Mr. DERBY. It is their responsibility to do it.

Mr. PLATTS. Your IG office is nine attorneys. It is pretty small.

Mr. MCCONNELL. Let's kick them up to 10.

Mr. PLATTS. OK, an 11 percent increase. [Laughter.]

Mr. DERBY. But I think in the near future, it is GAO, and after really having good audit documents, it is possibly the IG. I think the intent would be to ultimately do that.

Mr. PLATTS. Mr. Hillman, your thoughts on the permanent changes that are taking place, so we do not have those heroic efforts. Are we getting there? And on the role of GAO regarding the annual audit process?

Mr. HILLMAN. Mr. Chairman, GAO agrees with you that it does not make a lot of sense to conduct a heroic effort at the end of a fiscal year in order to produce financial statements, and that we would support more of a rational approach to fixing the systems and processes in place to produce the right numbers from the beginning. That is exactly what we believe the SEC is attempting to do. They have outlined system improvements that they believe will get them over the hurdle so that they will have a capability to produce repeatable results in a fashion that will allow us to audit those financial statements. At this time, we feel that the steps that they are taking should allow us to begin to look at their fiscal year 2004 financial statements, their opening balances beginning the first part of the year.

Mr. PLATTS. And as to GAO's sentiments long term as being the auditor?

Mr. HILLMAN. We acknowledge that the SEC has a conflict of interest in that it regulates the accounting profession in a material way, and have agreed to provide resources to their efforts at least in the short term. We would, however, encourage the Securities and Exchange Commission to beef up their inspector general's operations in order to be able to do what other IG's do across government, and that is review the financial statements of their own internal units.

Mr. PLATTS. Well, if we have an 11 percent increase, we will see where that leads to. But I hope that we are on the right track there so that we do have that annual review become just the natural product of the changes you are making.

Ms. Blackburn, did you have any other questions or a closing statement before I begin to wrap up?

Ms. BLACKBURN. No. One other question that I think follows up on what you were saying about their financial management. Mr. Derby had mentioned PART and some other different management initiatives.

Mr. Hillman, for you, is your current assessment that the SEC would be compliant with the provisions from FFMIA? That they are doing all they can in their financial management?

Mr. HILLMAN. There are a number of issues that the SEC is working on in order to develop systems and processes that can provide repeatable results. FFMIA weaknesses are among those, as well as other internal control weaknesses that were identified as part of an external study that was conducted earlier this year.

We believe from discussions that we have had with the SEC that it is developing a rational approach to deal with the issues that it has identified. We are hoping that we will be able to review their statements next year.

Ms. BLACKBURN. Thank you. Thank you to all of you for your patience. I appreciate it.

Thank you, Mr. Chairman.

Mr. PLATTS. Thank you, Ms. Blackburn.

Before I make a general closing statement, I would hope that the discussions as we look for your GPRA 5-year plan, what you are kind of describing will be your strategic plan, that you do embrace GAO in developing that plan, and that they are an active partner in your efforts. We certainly rely on GAO as a committee and as a Congress in total, and we will be looking to them and their assessment of what you are doing. If they are able to be a part of that, then certainly I think we will all get to a better end result later this year.

I also will tell you in doing a lot of reading in preparations for the hearing, an article earlier this year, I believe April in Government Executive, regarding where SEC was, is and is going. The president of the Treasury employees' union local at SEC was pretty critical of SEC in being very reactive, not proactive; no incentive to get into some of the more challenging reviews because it was a straight quote. It did not matter how important a review was, it was just how many you did. His comments were pretty frank and pretty hard-hitting.

When I read, Mr. Derby, your statement last night, you said all the things that I was hoping to hear and I would think he would like to hear about the changes that are occurring and where Chairman Donaldson and your leadership team want to see the SEC 6 months from now, a year from now. If all this comes to fruition, I think we will hopefully hear different statements from this gentleman regarding the manner in which the SEC is fulfilling its mission and in which the employers are being empowered to do their jobs in the most efficient, responsible and effective manner possible.

My hope is that the goals you have laid out in your written testimony and orally today do come to fruition, and that we do get the SEC back to where it plays a critical role in restoring investor confidence across the Nation.

That really goes to my final comment, which is how important your work is. The marketplace is so different today. My mom is 70 years old and one who never in her life cared about the stock market. But as a retiree, she talks to me about the stock market all the time because my late father invested his retirement in an in-

vestment plan is something that is critical in how the market is doing and various aspects of the market.

If Babs Platts is actually looking at what the market is doing and how it impacts her daily life, that tells us that it is truly the norm out there and the numbers reflect that. The percentage I think is 52 percent or so now from where we were. That just goes to how critical your work is, and that we do not repeat the Enrons and the debacles of the past. Your mission is all about not allowing that to happen.

So I do wish you and all the employees, top to bottom at the SEC, success in your efforts. We look forward to continuing to work with you and your colleagues at the agency, and with GAO. I tell you, some think of GAO as out there to just critique and criticize. I see them out there to analyze and assist. I hope that your agency will embrace them in that fashion and embrace our efforts, if there is something we need to do legislatively. I wish we were the Appropriations Committee. We are not, but we certainly could advocate. But if there is something you need from Congress, we want to be of assistance, too. Oversight does not mean that we are looking to just create problems. We are looking to help fulfill that mission as we all want to do right by our fellow citizens.

So I wish you well. We thank you again for your testimony, all of you here today; your work in preparing for this testimony, and certainly your patience with our voting schedule today as you sat and waited and waited.

With that, I will tell you we will leave the record open for 2 weeks for any documents that will be submitted after the hearing. This hearing stands adjourned.

[Whereupon, at 5:13 p.m. the subcommittee was adjourned, to reconvene at the call of the Chair.]

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