



THE CHAIRMAN

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

December 19, 2003

The Honorable George W. Bush
President of the United States
The White House
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20501

Dear Mr. President:

I am pleased to report that, overall, the management controls of the Securities and Exchange Commission (SEC) for the fiscal year ending September 30, 2003 are adequate and effective and are achieving their intended objectives in accordance with the standards prescribed by the Comptroller General. This letter fulfills the reporting requirements of the Federal Managers' Financial Integrity Act of 1982 as they apply to the SEC. A detailed discussion of the evaluation and review process supporting this conclusion is at Enclosure A.

I can provide qualified assurance, based on (1) the knowledge of the operations and evaluations conducted by the staff, (2) assurances by appropriate SEC officials, (3) the audits conducted by SEC's Office of Inspector General and the General Accounting Office, (4) the staff and the information security program under the Federal Information Security Management Act of 2002 (FISMA), and (5) other information provided that, taken as a whole, the agency's system of controls are achieving their intended objectives under Section 2 of the Act. This qualified statement of assurance considers the following corrections and exceptions.

The following material weaknesses were corrected in 2003.

- The SEC had not developed adequate internal control procedures to track purchases of accountable assets and to ensure reporting of these assets in its property management system. The ineffective controls increased the potential for theft and misuse of government equipment.

SEC property management policies and procedures were completely revised and updated by the agency's Property Accountability Task Force. The task force met weekly from January through June 2003, conducting a complete review of the property management system and updating, revising, and correcting inefficiencies and weaknesses in the system.

- The SEC needed to ascertain its regulatory and financial accountability and reporting authorities and responsibilities for disgorgement funds and whether these funds should be treated as accounts receivable and recorded and monitored in the Commission's financial systems. Until this decision was made, SEC could not ascertain appropriate internal controls to establish over these funds.

SEC officials have concluded that only disgorgements and penalties due to be paid to the SEC should be recorded as SEC accounts receivable. The Commission's fiscal year 2003 reports to the Department of the Treasury reflect this determination. Information on disgorgements to be paid out to court receivers will be included in the SEC annual financial report.

The agency continues to work aggressively on correcting the following material weakness that was identified previously and remains pending.

- ADP security controls should be enhanced, strengthened, and communicated to all SEC staff. Many of the security administration processes performed by the SEC are not standardized or formalized. Those that are formalized have no sanctions for noncompliance. The agency also needs to ensure compliance with OMB Circular A-130, Appendix III, regarding accreditation of applications and FISMA. The lack of formalized policies and standards for security administration has the potential to impair the mission of the agency. In addition, failure to certify sensitive application systems may result in loss of sensitive information if a problem goes undetected due to lack of timely review.

The SEC is continuing to make progress in developing, implementing, and maturing its information security program. During the year, the agency adopted critical policies regarding viruses and malicious codes, enterprise backup, and incident response. All SEC internal systems now enforce password aging and password complexity. Also, for the first time, senior program officials of the IT Capital Planning Committee were educated on agency responsibilities to certify and accredit ADP systems. The agency also established a specialized security training program for technical staff. This program will begin in January 2004.

A major effort is underway to certify and accredit existing major applications and general support systems. Last year, the SEC's IT Capital Planning Committee approved funding for the certification and accreditation of the SEC systems. Both SEC general support systems and financial applications will be accredited in 2004.

Additionally, the agency's financial management systems in use during 2003 were reviewed as required by Section 4 of the Act. The review was based on the principles and standards developed by the Comptroller General and implemented through OMB Circular A-127.

The results of reviews conducted of all of the agency's financial management systems, assurances given by agency officials, and other information provided indicate that the accounting systems, taken as a whole, are generally in conformance with the principles and standards developed by the Comptroller General and implemented through OMB Circular A-127.

The following instance of material non-conformance was identified previously and remains pending:

- The Disbursement and Penalties Tracking System (DPTS) could not be relied upon for financial accounting purposes. This had a substantial impact on the agency's ability to correctly report on the aging and status of the miscellaneous receivables to the U.S. Treasury.

Commission officials met the fiscal 2003 goal of replacing the Disbursement and Penalties Tracking System with an upgrade to the CATS 2000 system. Work continues to assure that the data in the replacement system is accurate, timely, and properly reported. Given the progress to date, we are reasonably certain that the replacement system will be fully operational soon and will meet the Commission's financial reporting needs for fiscal 2004.

Additional information regarding the agency's compliance with the Act and proposed corrective actions is contained in Enclosures B through D to this letter.

The Honorable George W. Bush
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I would like to emphasize that the SEC is committed to the effective and efficient management of the resources entrusted to the agency.

Sincerely,

A handwritten signature in black ink, appearing to read "William H. Donaldson". The signature is fluid and cursive, with a large initial 'W' and 'D'.

William H. Donaldson
Chairman

Enclosures

WEAKNESSES IDENTIFIED IN 2003 MANAGEMENT CONTROL CERTIFICATIONS

Organization	Weakness	Corrective Action Planned or Completed	Status
EEO	The EEO Office should complete investigations within 180 days of the date of filing an individual complaint. However, timeliness of complaint processing is still a weakness. (Reported in 1999, 2000, 2001 and 2002)	In 2003, EEO reduced the average complaint investigation time by 27% while the number of investigations increased. During 2004, EEO will expand its use of contractors to conduct investigations under the supervision of EEO attorneys.	Pending
EEO	The current system for complaint tracking and reporting remains a cumbersome process. This process increases the likelihood of errors in tracking time frames associated with the complaint process. (Also reported in 1999, 2000, 2001 and 2002)	OIT contractors have developed a complaint tracking system using Access. EEO is trying out the system to gain experience and determine whether it meets its needs.	Pending
ENF	As a result of Sept. 11, the Commission lost case documents when the building housing the NERO collapsed. Some documents could be reconstructed, but the loss slowed the pace of investigations and hampered staff in litigation. This event demonstrated a need to improve the methods by which we store and manage case files in all enforcement cases. (Also reported in 2001 and 2002)	ENF and OIT retained a contractor who has completed a concept of operations, an alternative study, cost-benefit analysis and task order to obtain proposals from contractors for a system to safeguard evidentiary material against loss. In addition, presentations have and are being made to the ITCPC and OMB.	Pending
ENF	In July 2002, GAO recommended that the Commission (1) develop procedures that ensure information in the Disgorgement Payments Tracking System is accurate and current, (2) ensure disgorgement is addressed in strategic and annual performance plans, (3) assess the feasibility of contracting for certain collection functions, and (4) issue collection guidelines to the staff.	Only one recommendation is open from last year--assess the feasibility of contracting for certain collection functions. Such assessment was undertaken and reported to the Commission in an Information Memorandum dated Nov. 11, 2002. Staff concluded among other things that the Commission needed additional statutory authority to contract out collections and made this recommendation in one of the Sarbanes-Oxley reports. Such legislation was introduced and is pending in Congress. In addition, ENF has hired two additional attorneys for collection activities and intends to make offers to two paralegals as well.	Completed

WEAKNESSES IDENTIFIED IN 2003 MANAGEMENT CONTROL CERTIFICATIONS

Organization	Weakness	Corrective Action Planned or Completed	Status
ENF	<p>In July 2003, GAO recommended that SEC take the necessary steps to implement the action plan to replace the Disgorgement Payments Tracking System by (1) meeting the FY2003 milestone for implementing phase I of the plan, (2) setting a milestone for completing the requirements analysis for phase II of the plan, and (3) establishing and meeting the implementation date for phase II.</p>	<p>ENF met the fiscal 2003 goal of phase I of the plan, replacing the DPTS system. Work continues to assure that the data in the replacement system is accurate, timely and properly reported. Phase II will be a comprehensive upgrade of ENF's current case tracking system. One of the goals of the new system is to integrate a number of databases devoted to tracking collections. The requirements phase of this project is scheduled to begin in FY 2004. As phase II nears completion, ENF will be able to establish additional milestones.</p>	Partially Complete
ENF	<p>Former Chairman Pitt's 2002 Federal Manager's Financial Integrity Act report to the President and Congress identified the following material weakness: "The SEC needs to ascertain its regulatory and financial accountability and reporting authorities and responsibilities for disgorgement funds and whether these funds should be treated as accounts receivable and recorded and monitored in the Commission's financial systems. Until this decision is made, SEC cannot ascertain appropriate internal controls to establish over these funds."</p>	<p>SEC officials have concluded that only disgorgements and penalties due to be paid to the SEC should be recorded as SEC accounts receivables. The Commission's FY2003 reports to the Treasury Department reflect this determination. Information on disgorgements to be paid to court receivers will be included in the SEC annual audited financial report; SEC officials are deliberating on the correct presentation of this data.</p>	Complete
OGC	<p>The ability to track workload data and locate historical documents needs continual oversight to ensure all workload is counted, that trends in activities are identified, and that actions of a similar nature can be identified to avoid duplication of effort.</p>	<p>OGC is working with OIT to develop software that will be used by all OGC staff to track their individual projects/cases and to provide management with the ability to develop reports on all aspects of workload activity. New system expected to be in place by summer of FY 2004.</p>	Pending
OEA	<p>Periodic management reports that facilitate the comparison of paper-based travel logs to the electronic records housed in the Travel Manager system are currently not produced.</p>	<p>The Administrative Contact will be given access to Travel Manager and will attempt to produce periodic management reports that enable the office to reconcile the two reporting systems. If those cannot be produced, all FY2003 records will be reviewed.</p>	Pending

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Organization	Weakness	Corrective Action Planned or Completed	Status
OFIS	<p>There is no authentication of individuals or companies that request access codes to the EDGAR system thru the Form ID process. There is a risk that false filings may be submitted.</p> <p>There is no unique identifier for each filer to ensure that the individual requesting access codes has not been issued codes previously. There is a risk that multiple CIKs and access codes for the same individual could be created and result in integrity issues.</p>	<p>The IOC has approved the first of a two-part project to enable an Automated On-line Form ID process. The first part, scheduled for implementation in early 2004, will allow filers to complete the Form ID on-line and submit it to OFIS. The second part will have a certificate authority to authenticate these electronic Form IDs. In both parts, filers will use a "pass phrase" that they have created to authenticate themselves.</p>	Pending
OFIS	<p>The Records Management program needs to implement a Records Management Application to effectively manage the huge problem of handing e-mail messages, word processing documents and other electronic records that, by law, are official records that must be saved and archived.</p>	<p>OFIS and OIT are working together to develop standardized, consolidated indexes and to implement a Records Management Application with auto-indexing in conjunction with a Document Management System.</p>	Pending
OFIS	<p>Modern information technology necessitates mandating the electronic filing of the remaining heavy volume paper filings. Potential weaknesses include untimely disclosure of information to investors and technological solutions needed to support the electronic filing of paper filings are undertermined because of lack of resources and coordination between the operating divisions. (Also reported in 2001 and 2002)</p>	<p>OIG and CF are currently examining the process of mandating Form D filings and compiling information to present to the ITCPC. Upon approval from the ITCPC, OFIS will collaborate with CF to prepare and present a programming change request to the EDGAR Requirements Subcommittee.</p>	Pending
OIT	<p>ADP security controls should be enhanced, strengthened, and communicated to all SEC staff. Security administration processes should be standardized and formalized. Compliance with OMB Circular A-130 requirements for ADP security administration and system certification is needed. (Material weakness reported previously in Chairman's FMFIA letters)</p>	<p>During the year, OIT adopted additional policies. SEC general support systems and financial applications will be accredited in the 2nd quarter of fiscal 2004.</p>	Pending

WEAKNESSES IDENTIFIED IN 2003 MANAGEMENT CONTROL CERTIFICATIONS

Organization	Weakness	Corrective Action Planned or Completed	Status
OIT	Better management of ADP resources is needed. Weaknesses relate to contracting for systems development, information resources planning, and ADP security. (Also reported in 1995, 1996, 1997, 1998, 1999, 2000, 2001, and 2002, and in the IG's semiannual reports)	OIT closed 33 pending IG recommendations in 2003. Additional recommendations will be closed in FY 2004. Also, OIT, the IOC and OED are reviewing agency-wide IT policies drafted last year and pushing them thru the approval process.	Pending
NERO (BDO)	Weakness in controls over the expenditure of funds to hire expert witnesses.	Management reiterated to litigation and enforcement staff the need to seek approval from a committee consisting of the District Administrator, Associate District Administrator and District Trial Counsel for all expert witness expenditures. Written procedures were distributed.	Complete
CRO	CRO's video camera security system needs upgrading. FWDO has a copier that is continuously breaking down and has a high monthly maintenance cost.	The new video recording machine has been designated as a budget item for FY2004. Once purchased, it will be installed. A new copier for FWDO was included as a budget item in FY2004.	Pending

WEAKNESSES IDENTIFIED IN 2003 MANAGEMENT CONTROL CERTIFICATIONS

Organization	Weakness	Corrective Action Planned or Completed	Status
ALJ	None identified.	N/A	N/A
CF	None identified.	N/A	N/A
ED	None identified.	N/A	N/A
IM	None identified.	N/A	N/A
MR	None identified.	N/A	N/A
OAPM	None identified.	N/A	N/A
OCA	None identified.	N/A	N/A
OLA	None identified.	N/A	N/A
OCIE	None identified.	N/A	N/A
OEA	None identified.	N/A	N/A
OFM	None identified.	N/A	N/A
OIA	None identified.	N/A	N/A
OIG	None identified.	N/A	N/A
OIEA	None identified.	N/A	N/A
OPA	None identified.	N/A	N/A
MRO	None identified.	N/A	N/A
PRO	None identified.	N/A	N/A
SERO	None identified.	N/A	N/A
Secretary	None identified.	N/A	N/A

RESULTS OF FINANCIAL MANAGEMENT SYSTEMS REVIEWS
CONDUCTED FOR FY2003 CERTIFICATION

Org.	System	Weakness	System Improvements Planned
OFM	Agency Accounting System (Momentum)	None identified.	Upgrade to more current version within the next 2 years. SEC will have financial statements audited for FY2004, at which time the system will be extensively reviewed for financial compliance.
OFM	Host Paid Travel	None identified.	Possible upgrade or rewrite of system.
OFM	Fee Subsystem (Momentum-EDGAR)	None identified.	Upgrade within the next 2 years.
OFM	Travel Manager	None identified.	Upgrade with an on-line interface with accounting system.
OAPM	Mail Management	None identified.	Acquire a new commercial postal payments system that tracks overall accountability for mail costs at the program level.
OAPM	Property Management System (TRAQ)	None identified.	None identified.
OED	STATS	At this time, reports cannot be tailored to meet specific needs.	Update application to improve the reporting function.
ENF	Transmittal Tracking System	None identified	None planned
ENF	CATS2000	The Disbursement and Penalties Tracking System was replaced with an upgrade to CATS 2000. The data input phase is continuing. Therefore, the data available at the end of fiscal year 2003 and currently do not adequately meeting the financial management system objectives in Circular A-127.	Complete system modifications to accommodate tracking tracking moneys ordered, collected and distributed.