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Briefing Report to the Chairman,
Subcommittee on Oversight and
Investigations, Committee on Energy and
Commerce, House of Representatives

August 1986

SEC ENFORCEMENT PROGRAM:

Information on Productivity Statements and Cases Closed Without Action



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August 26, 1986

The Honorable John D. Dingell
Chairman, Subcommittee on Oversight
and Investigations
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

In response to your request, the General Accounting Office (GAO) has been evaluating various aspects of the Securities and Exchange Commission's enforcement program. While the securities markets have continued to grow in size and complexity in the past few years, the Commission's staff has been stable or declining, causing many in the Congress and in the securities industry to worry that the program's effectiveness may suffer. Last year we issued a report to you summarizing some statistics on that program (GAO/GGD-85-28, March 25, 1985).

As discussed with Subcommittee representatives, this briefing report contains our observations about recent statements made by the Commission concerning enforcement program productivity. We concluded that numbers used by the Commission to demonstrate increased productivity in its enforcement program are not statistically valid because they treat all cases equally without regard to their complexity. The numbers cited by SEC do not conform to the Bureau of Labor Statistics' productivity measurement criteria of homogeneity which require that an output measure consist of units that are relatively the same with respect to labor requirements. We recommend that if measures of program productivity are needed for management purposes, the Commission should consult with experts at the Bureau of Labor Statistics to devise a system that considers complexity of cases. (See app. I.) Our report also presents some figures on reasons why the Commission has closed cases without taking any enforcement actions. (See app. II.) The objectives, scope, and methodology of our work are contained in appendix III, and the Commission's comments on the report and our response are included in appendix IV.

In passing the Securities Exchange Act of 1934, the Congress assumed that some degree of market oversight and enforcement activity was necessary in order to assure the market's integrity. You and some of your colleagues in the Congress have expressed concern that if the resources devoted to this effort decline, especially in light of a growing market, enforcement effort might also decline, and therefore less assurance will exist about the integrity of the market. Similar concerns have been expressed by some persons practicing law in the securities area and some state securities officials.

The Commission has defended the program by citing certain statistics to show increased productivity and, therefore, maintenance of an adequate level of enforcement effort. It did so in testimony and in commenting on our earlier report.

In fact, as experts we have contacted point out, it is difficult at best to prove a direct causal relationship between a given level of effort by the Commission and the overall level of violative conduct in the market. One problem is that an ultimate objective of the enforcement program is to discourage undesirable behavior, and no good way has been devised to measure either the total amount of such behavior or the effect of the Commission's actions on it. Therefore, while it does not necessarily follow that a smaller Commission staff leads to an increase in bad conduct, neither does it necessarily follow that the increase in the number of enforcement actions cited by the Commission preserves a given level of market integrity.


Nevertheless, the concern remains that without some compensating factor, a reduced or stabilized level of staff resources in the face of a growing market could lead to a reduction in the overall level of enforcement activities and, hence, to a reduced assurance of market integrity. Moreover, since deterrence is one major goal of the enforcement program, the perception that the Commission has reduced its effort would be undesirable.

The Commission has undertaken certain initiatives to enhance the enforcement process in order to maintain adequate activity, and we are analyzing these initiatives which we will report on later.

In its comments on a draft of this report, the Commission confirmed the lack of homogeneity in enforcement cases and did not dispute our technical analysis. However, the Commission stated that it believes its use of caseload and enforcement action data is appropriate for measuring productivity. While we believe that the number of enforcement actions can serve as a gross indicator of Commission activity, they are of limited use in measuring productivity because of variations in case complexity and resource requirements.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time we will send copies to interested parties and make copies available to others upon request. If you have questions or need more information, please contact Craig Simmons at (202) 275-8678.

Sincerely yours,



William J. Anderson
Assistant Comptroller General

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ABBREVIATIONS

BLS	Bureau of Labor Statistics
CATS	Case Activity Tracking System
GAO	General Accounting Office
SEC	Securities and Exchange Commission

TECHNICAL ANALYSIS OF SEC
PRODUCTIVITY STATISTICS

In order to demonstrate its continued ability to police growing markets with fewer staff, SEC has maintained that it has increased the productivity of its enforcement program. In testimony given before House of Representatives and Senate Subcommittees,¹ SEC noted that it had achieved a 57-percent increase in the number of enforcement actions² brought between fiscal years 1981 and 1984 and that this represented one of the highest levels of activity in years. Commenting on a 1985 GAO report, SEC stated that the number of enforcement actions³ had risen from 1981 to 1983 and indicated that the number of actions per staff year had risen in 1984 to its highest level in 7 years (see table I.1).

¹Subcommittee on Telecommunications, Consumer Protection, and Finance, House Committee on Energy and Commerce, March 21, 1985, and the Subcommittee on Securities, Senate Committee on Banking, Housing and Urban Affairs, April 17, 1985.

²Generally, the Commission uses two types of enforcement actions against those who violate securities laws. One type is a civil injunctive action in a U.S. District court which prohibits existing or imminent violations of law and sometimes provides other equitable relief. A second type is an administrative proceeding before an administrative law judge which may provide other types of remedies such as a suspension or bar from further business in the securities industry.

³Statistics on SEC's Enforcement Program (GAO/GGD-85-28, March 25, 1985). The figures used by SEC are not adjusted. They reflect unweighted figures reported in SEC budget documents and annual reports.

Table I.1
Enforcement Actions Per Staff Year

	<u>1977</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>
Total actions ^a	308	257	189	177	187	242	245	293
Staff years	633.1	667.1	694.1	678.1	640.0	597.6	610.1	599.7
Actions per staff year	.49	.39	.27	.26	.29	.40	.40	.49

^aExcludes criminal and civil contempt proceedings.

Source: SEC's official response to the GAO report entitled Statistics on SEC's Enforcement Program (GAO/GGD-85-28, March 25, 1985), p. 43.

SEC concluded that "these increases in productivity mitigate decreases in enforcement resources that may have occurred over the period, especially from 1981 to 1984."⁴ However, since those figures are not based on an accepted method of productivity analysis, their usefulness in evaluating SEC's actual performance is limited.

PROBLEMS WITH SEC PRODUCTIVITY STATEMENTS

Productivity is broadly defined as the efficiency with which resources are utilized to produce a final output. One way to express productivity is to determine the relationship between output, such as enforcement actions, and one type of input, such as labor (staff time). However, certain standards⁵ exist which must be observed when making such calculations, and according to a BLS representative, the most important is the standard of homogeneity.

⁴Ibid., pp. 42-43.

⁵See the Department of Labor's Bureau of Labor Statistic's "Technical Note: Federal Productivity Concepts and Index Construction" in Productivity Measurement Systems Within the Federal Government: A State of the Practice Review (Office of Personnel Management: Washington, D.C., July 1980). This note is included as an appendix in the Office of Personnel Management report.

The homogeneity standard, as the name implies, is concerned with the similarity of output products in different time periods. Unless the homogeneity standard is observed, simple output products would count as much as complex ones in determining an organization's total output. As a consequence, if the mix of types of output products changes over a period of time, proper comparisons of productivity cannot be made without certain mathematical adjustments to the output data.

A basic problem with the SEC's productivity claims is that they do not comply with the homogeneity standard. Enforcement actions are the result of case investigations that vary widely in their resource and time demands. In this regard, SEC's fiscal year 1986 Budget Estimate states

". . . the resources needed to conduct an investigation or enforcement action varies [sic] with the complexity of facts, the underlying legal issues, the number of investors and defendants involved, the availability of needed evidence, the degree of cooperation provided by the subjects of the investigation, and the willingness of the defendants and respondents to enter into settlements that avoid protracted litigation. These factors affect the ratio of resources expended to the benefits that may be obtained in a particular case."

The homogeneity standard requires that the output measure consist of units which are relatively the same, or homogeneous, with respect to labor requirements. Differences in outputs which in turn require different levels of labor inputs must be taken into account in order to be meaningful for productivity measures. This might be done by using a weighting system that adjusts for case complexity or some other measure of "worth" of output to adjust for differences in labor requirements.

SEC Enforcement Cases Are Not Homogeneous

Cases vary in their complexity which, in turn, affects both staff time and the kinds or amounts of activities conducted to investigate and prosecute them. In general, unless outputs are homogeneous over the period of measurement or the mix of heterogeneous cases is unchanged over the period of measurement, attempts at measuring labor productivity changes require an analysis that rigorously adjusts output data for changes in mix.

In order to illustrate the lack of homogeneity in the enforcement cases, we selected a group of all 133 cases (see app. III) for which enforcement actions were initiated in fiscal

year 1984 and completed by December 1985.⁶ From this group we prepared an analysis to illustrate variations in the staff time expended, differences in the kinds or amounts of case activities, and the effects of changing program priorities to illustrate differences in types of cases and resources that have been devoted to their resolution.

Differences in time spent
demonstrate heterogeneity

Table I.2 illustrates the wide variation in the time charged to enforcement cases. Within the group of 133 cases, staff time varied from 0 hours⁷ to 9,507 hours. Of the 83 cases with less than 1,000 hours expended, 18 had less than 94 hours charged, 36 had between 124 and 486 hours charged, and the remaining 29 had between 520 and 924 hours charged to the investigation. Hours devoted to the four largest cases ranged from 5,442 to 9,507.

Table I.2
DIFFERENCES IN TIME SPENT
(INPUT) AFFECT HOMOGENEITY

	Staff hours					Total
	Col. 1 0 - 999	Col. 2 1000 - 1999	Col. 3 2000 - 2999	Col. 4 3000 - 3999	Col. 5 4000 - over	
Number of cases	83	29	11	6	4	133
Number of enforcement actions	186	143	40	13	35	415
Total hours spent	30,478	42,803	26,149	20,584	26,413	146,427

⁶Included in this universe is one case for which 31 enforcement actions were initiated and completed in our time period with 1,586 hours charged. Although the case is still open, SEC officials told us that no further enforcement actions are contemplated and only nominal additional time will be charged to close the case.

⁷The SEC Case Tracking System (CATS) quarterly report showed that no hours were charged to one case number in which a permanent injunction was obtained against a company.

Differences in the number of enforcement actions obtained in relation to the time spent on each case also illustrate differences among cases. In the aggregate, for example, while only a 17-percent difference in hours spent exists between column 1 and column 3 cases, column 1 cases produced 365 percent more enforcement actions. Further, of 49 cases in which one enforcement action was obtained, time spent varied considerably on a case-by-case basis. For example, in five cases, 1,924, 1,547, 2,145, and 3,968 hours were spent, respectively. Unless these cases were all of the same complexity, the use of enforcement actions as a measure of output does not provide meaningful indicators of productivity change. In view of the resources applied to these cases, it seems reasonable to presume that they differed in their complexity.

Differences in case activities
affect homogeneity

Differences in processes that must be followed to successfully bring enforcement cases affect the time devoted to them and thus the homogeneity required for productivity measurement. A closer examination of several closed cases from our universe, judgmentally chosen to ensure a mix of staff hours spent, reveals differences in basic types of case activity. For example, table I.3 suggests that cases which involve collecting evidence through the subpoena process are likely to consume greater staff hours than those cases that result in enforcement action without subpoenas. While case 3 consumed 145 staff hours and resulted in five enforcement actions, case 8 consumed 2,221 staff hours and also resulted in five actions. Case 8 experienced greater activity (see activity columns) and therefore consumed greater staff time before closing. If differences in cases are not accounted for through a weighting process or some other measurement device, it is impossible to determine if increases in enforcement actions result from actual productivity improvements or simply from a change in case mix, i.e., a shift to less time-consuming cases.

Table 1.3
DIFFERENCES IN TECHNIQUES
USED DURING AN INVESTIGATION

<u>Case</u>	<u>Staff hours</u>	<u>Days open</u>	<u>No. of enf. actions</u>	<u>Selected case activity</u>				<u>Total activity</u>
				<u>No. of action memos</u>	<u>No. of informal requests</u>	<u>No. of questionnaires</u>	<u>No. of subpoenas</u>	
1	1	229	1	1	0	0	0	1
2	8	132	1	1	0	0	0	1
3	145	119	5	2	0	0	0	2
4	196	434	3	0	0	0	7	7
5	426	170	2	2	0	0	7	9
6	469	203	2	1	3	0	0	4
7	486	134	3	5	0	0	5	10
8	2221	1121	5	3	39	50	13	105
9	2325	932	4	3	7	2	54	66
10	3074	649	2	7	1	0	36	44
11	5442	957	16	5	11	7	179	202

Type of violation investigated
affects homogeneity

Depending upon its perception of industry problems from year to year, SEC can change the emphasis on which types of violations are pursued. While this flexibility is important, it produces differences in inputs which, if not weighted appropriately, can affect productivity figures. For example, in fiscal year 1984, SEC directed a special effort against those who failed to comply with Section 16 of the 1934 Exchange Act

which imposes certain filing requirements on individuals.⁸ SEC officials felt it important to bring action against a large number of individuals in order to capture the attention of potential nonfilers to encourage future compliance with the law. One case was opened in which enforcement actions were initiated against 31 different individuals or entities. SEC staff charged time to the one case so it is impossible to determine the amount of time devoted to each separate action. In the previous fiscal year no such actions were initiated.

According to SEC staff, developing a case for a delinquent filing action in this project was relatively straightforward. SEC knew before opening the case that the required form was not filed. Staff did not request a formal order of investigation from the Commission and also did not issue subpoenas. SEC was able to obtain consent decrees in 25 of these enforcement actions rather quickly. For the remaining six actions, SEC entered into protracted settlement negotiations in five of them and litigated one. According to SEC staff, the litigated action consumed most of the approximately 1,500 hours devoted to the project.

This special project resulted in an increase of 31 enforcement actions initiated (10.5 percent) in fiscal year 1984 (see table I.1). Because the actions represent a first-time influx of these cases that were relatively easy to bring, the unweighted figures can distort productivity measurement. To provide further illustration, we looked at each fiscal year 1984 case, including the special project mentioned above, that required approximately 1,500 hours before an action was initiated. As table I.4 indicates, the three other cases produced five enforcement actions whereas the special project produced 31 actions.

⁸Generally, Section 16(a) requires that every person who is the beneficial owner of more than 10 percent of any class of equity security or who is the director or an officer of the issuer of such security file a statement with the SEC indicating the amount of ownership. This filing is required to be made within 10 days after the close of each calendar month thereafter if there is a change in ownership.

Table I.4
COMPARISON OF ACTIONS RESULTING FROM CASES
CONSUMING SIMILAR STAFF HOURS

<u>Case</u>	<u>Program area</u>	<u>Type of enforcement action</u>	<u>Hours</u>	<u>Number of enforcement actions</u>
1	Broker Dealer - Other	Administrative proceeding	1,578	3
2	Offering violation	Civil injunction	1,547	1
3	Offering violation	Civil injunction	1,546	1
4	Special project for delinquent filings (Forms 4)	Civil injunction	1,586	31

CONCLUSION

Because of variation in the subject, investigative technique, and, therefore, the amounts of time spent on each enforcement investigation, the figures SEC has used to demonstrate improvements in the productivity of its enforcement program do not conform to the standards necessary for validating the program's actual productivity. Therefore, such figures cannot be used to sustain an argument that a desired level of enforcement activity has been maintained by increases in productivity.

RECOMMENDATION

We recommend that if the Chairman, SEC, wants to use productivity measurement to determine the sufficiency of the enforcement program resources, he should, in consultation with the Bureau of Labor Statistics of the Department of Labor, develop a measurement approach that would conform with the homogeneity criteria. In deciding if a new measurement system should be adopted, SEC should consider the cost in relation to the new system's ability to provide accurate data for use in analyzing and appraising the need for additional resources during the budget process.

CLOSING REASONS AND TIME SPENT FOR
CASES CLOSED WITHOUT ENFORCEMENT ACTION

This appendix highlights the reasons SEC enforcement cases were closed without enforcement action in fiscal years 1981, 1983, and 1985 and also shows the length of time these cases remained open before being closed. Table II.1 depicts the number of times certain reasons were given for closing cases. A total of 545 cases were closed without enforcement action during these 3 fiscal years, including 238 cases in 1981, 165 cases in 1983, and 142 cases in 1985.

Many cases (45 percent or 246 of the 545 reviewed) had more than one reason given for closing, so the total number of reasons exceeds the total number of cases reviewed. The standard form used by SEC to close a case (from which we obtained the closing reasons) provided no indication of their relative importance. However, we have identified the five most frequently cited reasons for each fiscal year in table II.2. Insufficient evidence was the reason most often cited for each year. For the 3 years combined, this reason is used in 48 percent of all cases reviewed, and it also appears as the sole closing reason for approximately 29 percent of the 545 cases.

Eight similar individual closing reasons (reasons 1 through 8) are grouped under the general heading "Referrals or other Action" in table II.1. In these situations, SEC has declined to prosecute potential securities offenses because action was pursued elsewhere. This group constitutes 36 percent or 335 of the 924 reasons cited for closing cases in the 3 fiscal years.

Two tables were constructed to illustrate the length of time cases remained open without enforcement action. Table II.3 illustrates the number of cases within specific age groups, and table II.4 shows the average number of calendar days these cases remained open in each fiscal year. Data from these 3 fiscal years shows that the number of cases closed without action decreased. Further, the length of time they remained open decreased between 1981 and 1983 but increased slightly in 1985.

TABLE II.1
VARIOUS REASONS GIVEN FOR CLOSING
CASES WITHOUT ACTION BY SEC ENFORCEMENT PROGRAM AND THEIR
FREQUENCY OF USE DURING FISCAL YEARS 1981, 1983, and 1985

<u>Closing reasons</u>	<u>Frequency of use</u>			
	<u>Fiscal years</u>			<u>Total</u>
	<u>1981</u>	<u>1983</u>	<u>1985</u>	
<u>Referrals or other action</u>				
1. Corrective action taken by subject	43	37	20	100
2. Action taken by another enforcement body ^a	28	21	17	66
3. Referred to or assisted U. S. Attorney/Department of Justice for criminal action ^c	20 ^b	16 ^b	18 ^b	54 ^b
3.1 Action pending ^d	4	6	4	14
3.2 Action taken	5	5	10	20
3.3 Action not taken	11	5	4	20
4. Referred to or assisted another enforcement body ^a	22	8	10	40
5. Merged with another case	19	11	2	32
6. Enforcement proceeding not pursued due to pending/concluded private litigation	10	10	8	28
7. Referred to or action taken by another SEC office	3 ^b	3 ^b	5 ^b	11 ^b
7.1 Action pending ^d	0	1	3	4
7.2 Action taken	0	2	0	2
7.3 Action not taken	3	0	2	5
8. Remedies sought or obtained in a separate investigation ^e	0	1	3	4
<u>All other reasons</u>				
9. Insufficient evidence	113	81	66	260
10. Age of violation	31	13	17	61
11. Size of investigation	18 ^b	24 ^b	17 ^b	59 ^b
11.1 Small number of investors	11	6	5	22
11.2 Small amount of money	4	14	8	26
11.3 Single registered representative	1	1	2	4
11.4 Small number of shares/transactions	2	3	2	7

<u>Closing reasons</u>	<u>Frequency of use</u>			
	<u>Fiscal years</u>			
	<u>1981</u>	<u>1983</u>	<u>1985</u>	<u>Total</u>
<u>All other reasons (cont'd.)</u>				
12. Resource constraints and other workload demands	22	12	10	44
13. Subject no longer in securities industry	9	14	7	30
14. Other extenuating circumstances ^f	9	4	10	23
15. Bankruptcy/receivership of subject	6	5	9	20
16. Commission declined request for formal order of investigation or recommendation for enforcement action	11	2	4	17
17. Defendant/witness disappeared or died	7	6	3	16
18. No evidence that investors were financially harmed	6	3	4	13
19. Company/individual no longer conducting business	5	2	4	11
20. No prior/subsequent violation by subject	5	2	2	9
21. Staff withdrew request for formal order of investigation or recommendation for enforcement action	3	2	4	9
22. Low priority	4	1	4	9
23. Defendant in prison	3	0	0	3
24. U.S. District Court dismissed case or ruled in favor of subject	0	1	1	2
25. O'Brien decision ^g	0	0	1	1

<u>Closing reasons</u>	<u>Frequency of use</u>			
	<u>Fiscal years</u>			
	<u>1981</u>	<u>1983</u>	<u>1985</u>	<u>Total</u>
<u>All other reasons (cont'd.)</u>				
26. Switzerland denied SEC access per treaty on Mutual Assistance in Criminal Matters ^h	0	0	1	1
27. Report submitted to Congress	0	1	0	1
Total ⁱ	397	280	247	924

- Notes:
- a. "Another enforcement body" refers to self-regulatory organizations such as the National Association of Securities Dealers and the New York Stock Exchange and state securities regulatory bodies as well as state and local prosecutorial authorities.
 - b. These reflect the totals of the subcategories within this main closing reason.
 - c. "Referred to or assisted U.S.A. or DOJ for criminal action" means that SEC granted justice officials access to its investigative case file for the purpose of assessing the case's criminal potential or SEC staff provided other assistance in developing the case.
 - d. The subcategory "action pending" was used when the Enforcement Division's closing report either (1) identified the matter as pending or (2) did not specify the status of the matter.
 - e. These cases were closed because the subject was pursued in a different investigation or the legal principle or theory in the case was being pursued in another investigation.
 - f. This reason included such factors as the age or ill health of the defendant, the high risk of litigation, the foreign citizenship status of the subject, and the possibility that shareholders would be unnecessarily harmed if enforcement action was initiated.
 - g. In the case, Jerry T. O'Brien, Inc. V. SEC, 704 F.2d 1065 (9th Cir. 1983), the court ruled that an SEC third-party subpoena could not be enforced because SEC failed to give notice of the subpoena to the person under investigation.
 - h. Under the provisions of this treaty between the United States and Switzerland, the Swiss may deny SEC access to certain information if they believe the facts in the case do not establish criminality in both countries.
 - i. Since a case may have more than one reason for closing, the number of reasons exceeds the number of cases closed without enforcement action in each fiscal year.

TABLE II.2
MOST OFTEN CITED REASONS FOR
CLOSING A CASE WITHOUT ENFORCEMENT ACTION

	<u>Frequency of use</u>	<u>Percent of reasons cited^a</u>	<u>Percent of cases^b</u>
<u>1981 Reasons</u>			
Insufficient evidence	113	28.5	47.5
Corrective action taken by subject	43	10.8	18.1
Age of violation	31	7.8	13.0
Action taken by another enforcement body	28	7.1	11.8
Referred to or assisted another enforcement body	22	5.5	9.2
Resource constraints and other workload demands	22	5.5	9.2
<u>1983 Reasons</u>			
Insufficient evidence	81	28.9	49.1
Corrective action taken by subject	37	13.2	22.4
Size of investigation	24	8.6	14.6
Action taken by another enforcement body	21	7.5	12.7
Referred to or assisted U.S. Attorney or Department of Justice	16	5.7	9.7

APPENDIX II

APPENDIX II

<u>1985 Reasons</u>	<u>Frequency of use</u>	<u>Percent of reasons cited^a</u>	<u>Percent of cases^b</u>
Insufficient evidence	66	26.7	46.5
Corrective action taken by subject	20	8.1	14.1
Referred to or assisted U. S. Attorney or Department of Justice	18	7.3	12.7
Size of investigation	17	6.9	12.0
Action taken by another enforcement body	17	6.9	12.0
Age of violation	17	6.9	12.0

^aThis column reflects the percent each reason was used as a percentage of all reasons cited for each fiscal year.

^bThis column reflects the percentage of cases in which the reason was cited for each fiscal year.

TABLE II.3
AGE OF CASES CLOSED WITHOUT
ENFORCEMENT ACTION

<u>Age of cases</u>	<u>Fiscal year</u>					
	<u>1981</u>		<u>1983</u>		<u>1985</u>	
	<u>No.</u>	<u>Percent</u>	<u>No.</u>	<u>Percent</u>	<u>No.</u>	<u>Percent</u>
Less than 1 year	42	17.65	53	32.12	32	22.54
1 year but less than 2 years	65	27.31	47	28.48	55	38.73
2 years but less than 3 years	51	21.43	31	18.79	37	26.06
3 years but less than 4 years	27	11.34	21	12.73	8	5.63
4 years but less than 5 years	25	10.50	7	4.24	3	2.11
5 years or more	<u>28</u>	<u>11.77</u>	<u>6</u>	<u>3.64</u>	<u>7</u>	<u>4.93</u>
Total cases closed without enforcement action	238	100.00	165	100.00	142	100.00

TABLE II.4
AVERAGE AGE AND RANGE OF CASES CLOSED
WITHOUT ENFORCEMENT ACTION

<u>Fiscal year</u>	<u>Calendar days</u>			
	<u>Range</u>	<u>Average</u>	<u>Middle 50 percent range</u>	<u>Middle 50 percent average^a</u>
1981	108 - 3575	968	461 - 1362	844
1983	36 - 3308	721	323 - 1000	596
1985	34 - 5235	745	428 - 935	639

^aThis represents a subuniverse of the middle 50 percent of the staff time spent on each case closed without action in each year and provides an additional perspective by eliminating the extreme low and high numbers of days cases remained open.

OBJECTIVES, SCOPE, AND
METHODOLOGY

The objectives of this assignment were to illustrate certain weaknesses with using unweighted staff year and enforcement action data as a basis for making productivity statements concerning SEC's enforcement program and to provide information about (1) the reasons cases were closed without enforcement action and (2) the period of time these cases remained opened before being closed for three different fiscal-year periods.

SCOPE AND METHODOLOGY

For this report we examined the difficulties associated with measuring the effectiveness of SEC's enforcement program. Private securities attorneys and former Commission staff that we interviewed agreed that the program's overall effectiveness is difficult to measure because there is no reliable method for estimating the amount of violative conduct the SEC has prevented. This point was also confirmed by reviewing interviews conducted with industry experts for an earlier report on the enforcement program, Statistics on SEC's Enforcement Program (GAO/GGD-85-28, March 25, 1985).

In evaluating the productivity issue, we focused on homogeneity problems that exist with using unweighted enforcement action numbers and staff time figures when calculating productivity for SEC's enforcement program. Our productivity experts and those with the Department of Labor's Bureau of Labor Statistics (BLS) consider homogeneity to be of critical importance to productivity measurement.

To illustrate the homogeneity problem as it applies to SEC investigations, it was necessary to create a universe of closed cases from which we could determine the staff time spent and identify the activity necessary to obtain enforcement actions. We obtained a computer-generated listing from SEC's Case Activity Tracking System (CATS) of cases for which enforcement actions were initiated in fiscal year 1984. Because some SEC investigations may take longer than 1 year to complete and because it was necessary to determine staff time spent on each case, we allowed additional time for closing the case beyond fiscal year 1984 but only selected those that had been closed by December 6, 1985. We obtained the staff hours charged for each case from CATS Quarterly Reports, and we obtained the number of enforcement actions obtained per case from a separate CATS report. No attempt was made to verify the accuracy of the data from the CATS system.

In order to determine the potential effect of differences in case activity, we obtained the main case file and recorded the frequency that selected investigatory activity occurred in 11 cases for which different amounts of time were expended (see table I.3). Other activity occurred during the investigations which are not evidenced by documents in the main files, such as the analysis of information. However, we believe those activities we recorded provide a basic indication of the steps necessary for collecting and analyzing evidence for investigations.

We reviewed productivity literature and consulted with BLS and our agency technical experts in order to define the homogeneity criteria necessary for productivity measurement. From these discussions, we decided that the nature of the case and action being sought were the most important factors affecting staff time. We therefore decided to focus the analysis on differences in time spent on each case, differences in case activity, and the types of violations investigated as they affect the time spent.

Additional steps were necessary to obtain information about the reasons cases were closed without enforcement action. From the Division of Enforcement's Management Information System, we identified 545 cases closed without enforcement action in three recent fiscal years (1981, 1983, and 1985) and determined the number of calendar days these cases had remained open. The selection of the fiscal years was judgmental and was based on obtaining data for the most recent full fiscal year and two earlier years to allow for comparison. For the 545 investigations, we obtained and reviewed the case closing forms (19A) which provided a synopsis of the cases and the reasons for closing. In establishing the closing reasons, we first reviewed approximately 10 percent of the 545 case closing forms and developed a basic list of 18 closing reasons. Nine additional reasons were added to this basic list during the review of the remaining forms. While a certain amount of judgment was required on our part in categorizing the closings for individual cases, we believe that this process adequately summarizes the reasons cases were closed without enforcement action.

COMMENTS FROM THE
SECURITIES AND EXCHANGE COMMISSION

Note: GAO comments supplementing those on page 2 appear at the end of this appendix.



EXECUTIVE DIRECTOR

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

July 11, 1986

Mr. William J. Anderson
Director
General Government Division
U.S. General Accounting Office
Washington, D.C. 20548

Re: General Accounting Office draft report entitled
"SEC ENFORCEMENT PROGRAM--Information on Productivity
Statements and Cases Closed Without Enforcement Action"

Dear Mr. Anderson:

I am responding, at the invitation of your staff, to the above-captioned draft report.

The draft report concludes that Commission statements regarding enforcement productivity have an inadequate theoretical basis. This conclusion is based on the idea that proper productivity analysis requires that units compared be homogeneous. According to the draft report, Commission cases lack homogeneity because they involve varying violations, amounts of staff time, and amounts and kinds of required activities. The report recommends that, if measuring program productivity is desirable for management purposes, the Commission should devise a better measurement system in consultation with the Bureau of Labor Statistics.

As stated in the report, experts point out the difficulty of proving a direct causal relationship between a specific level of Commission activity and a corresponding level of violative conduct in the market. No acceptable method has been devised to measure with scientific precision either the total amount of illegal activity or the effect on such activity of Commission actions. However, recent press concerning the enforcement program's impact on insider trading cases indicates that the present efforts are effective as deterrents.

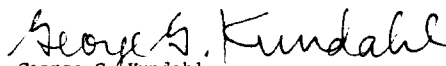
Currently, statistics on enforcement activity are collected through management information systems which support program policy decisions. In selecting matters for investigation, Commission managers consider not only specific characteristics, such as the potential dollar value and number of investors involved, but also intangible factors such as the deterrent value of a particular case.

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- The draft report criticizes the use of individual enforcement "cases" as homogeneous units in SEC enforcement data. However, true homogeneity, as a concept, may not readily be applied to complex matters such as the Commission's enforcement investigations. Nevertheless, basic data concerning the number of cases or enforcement actions do have a role as indicators of Commission efficiency. Over time, the mix of large and small cases, complex and simple ones, averages out, bringing an acceptable level of credibility to aggregate annual caseload statistics. Against this background, knowledgeable commentators agree that the Commission's enforcement efforts, by maintaining or increasing their level, did benefit from productivity enhancements during the period covered by the report. This agreement is achieved on the basis of common sense and without regard to technical requirements of theories of productivity measurement.
- See Comment 1.
- See Comment 2.
- See Comment 3. The report's recommendation observes that "any decision to adopt a new measurement system should balance its cost against its utility..." "Numbers of cases" is a concept that is understood well by managers and used by them in decisions regarding allocation of personnel and other resources. Any substitute manufactured for a marginal improvement in accuracy, would require extensive changes to existing management systems and would be of limited value. Such a substitute also would be difficult and expensive to create and implement.
- We continue to believe that the Commission productivity statements that are the subject of the draft report are accurate. The basis for these statements has stood the test of time. Case load statistics historically have been used to explain and measure this and other agencies' enforcement programs. This historical data has been used by both the Office of Management and Budget and the Congress in reviewing the agency's budget and legislative proposals. In addition, the criteria supporting this information are reported annually to the Bureau of Labor Statistics and used by that agency in overall analyses of government productivity. This acceptance demonstrates the appropriateness and utility of the Commission's present measurement criteria.
- See Comment 4.

Sincerely,


George G. Kundahl
Executive Director

COMMENTS FROM THESECURITIES AND EXCHANGE COMMISSION

The following are GAO's comments on the Securities and Exchange Commission's letter dated July 11, 1986.

GAO COMMENTS

1. We disagree that the mix of cases averages out over time and, therefore, the numbers of enforcement actions over the years can be compared for productivity measurement. Our report demonstrates that a 10 percent increase in the number of enforcement actions in fiscal year 1984 resulted from a first-time influx of cases that were relatively easy to bring. Aggregating figures over time would not necessarily "average out" such an occurrence, particularly when making year-to-year comparisons. Moreover, using numbers of enforcement actions as the predominate indicator of productivity, as SEC did in response to the March 1985 GAO report, ignores other factors that may reflect the work of the enforcement division. For example, in 1981, when the Commission's figures showed that its productivity (based on numbers of enforcement actions) was relatively low, it was reducing a backlog of cases by closing a relatively large number of them without enforcement action. (See p. 18.) While we do not know the merits of closing these particular cases, this activity is a valid use of staff time, and it demonstrates why a weighting scheme based on actual work done is necessary for proper productivity measurement. Finally, the Commission pointed out in answer to questions raised in 1983 oversight hearings that several factors may influence the numbers of enforcement actions brought in any given year. These factors--which may include a change in the mix of cases, increased litigation in pending cases, and others--make it very difficult to compare aggregated figures from one year to the next.

2. We intend to analyze these productivity enhancements the Commission refers to and comment on them in a separate report. The Commission offered no specific information on them in its response to this report.

COMMENTS FROM THE
SECURITIES AND EXCHANGE COMMISSION

3. While the Commission may not believe that a more precise measurement system would be of sufficient value to warrant the cost to create or implement it, we understand that it has developed an automated case tracking system (commonly referred to as CATS) which already collects certain data that could be used for better productivity analysis. These data include the numbers and types of cases and violations charged, the type of enforcement actions obtained, and the staff time charged. We also understand that SEC had envisioned analyzing trends from this system's data once an historical data base was developed. Deciding whether it would be cost-beneficial to implement better productivity measures requires further study. First the Commission must decide if it wants better information. Even though its response indicates that the Commission believes that any "substitute" measuring system would be of limited value as well as difficult and expensive to create and implement, it already has a case tracking system in place that could be used in productivity measurement. Without better data, the Commission's assertions to the Congress about improved productivity will remain largely unproven.

4. While caseload and enforcement action data may have been used by enforcement agencies and managers as indicators of productivity and for resource allocation, use does not prove validity. We made our analysis because key congressional committees have been concerned about the Commission's productivity, notwithstanding the figures presented periodically by the Commission. BLS staff members, whom we worked with during our review, told us that, although they do use figures submitted by the Commission, conceptual weaknesses limit their usefulness. BLS sets the criteria for federal agencies to follow when submitting productivity data, and then BLS processes that data. However, BLS relies on individual agencies to choose which indicators they submit. BLS does not have the authority to specify that data. As a result, BLS acceptance of agency submissions does not necessarily indicate that BLS believes it is the most precise data possible for evaluating productivity.

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