

GAO

Report to the Chairman, United States
Securities and Exchange Commission

November 2010

FINANCIAL AUDIT

Securities and Exchange Commission's Financial Statements for Fiscal Years 2010 and 2009



G A O

Accountability * Integrity * Reliability



Highlights of [GAO-11-202](#), a report to the Chairman, U.S. Securities and Exchange Commission

Why GAO Did This Study

Pursuant to the Accountability of Tax Dollars Act of 2002, the United States Securities and Exchange Commission (SEC) is required to prepare and submit to Congress and the Office of Management and Budget audited financial statements. GAO, under its audit authority, audited SEC's financial statements to determine whether (1) the financial statements are fairly stated, and (2) SEC management maintained effective internal control over financial reporting. GAO also tested SEC's compliance with selected provisions of significant laws and regulations. In accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act, GAO also reported on SEC's assessment of its internal control over financial reporting.

What GAO Recommends

GAO will be separately reporting to SEC on additional details concerning the deficiencies discussed in this report along with recommendations for corrective actions and the status of recommendations from previously reported deficiencies.

View [GAO-11-202](#) or key components. For more information, contact James R. Dalkin at (202) 512-9406 or dalkinj@gao.gov.

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Securities and Exchange Commission's Financial Statements for Fiscal Years 2010 and 2009

What GAO Found

In GAO's opinion, SEC's fiscal years 2010 and 2009 financial statements are fairly presented in all material respects. However, in GAO's opinion, SEC did not maintain effective internal control over financial reporting as of September 30, 2010, due to material weaknesses involving SEC's internal control over information systems and its financial reporting and accounting processes. GAO's opinion on SEC's internal control over financial reporting is consistent with SEC's assessment of its internal control over financial reporting. GAO found no reportable instances of noncompliance with the provisions of laws and regulations it tested.

Since SEC began preparing financial statements in 2004, it has struggled with maintaining effective internal control over financial reporting. SEC has taken actions to address previously reported deficiencies. For example, it took sufficient actions during fiscal year 2010 such that its controls over its fund balance with Treasury and its risk assessment processes are no longer considered significant deficiencies. Notwithstanding this progress, as of September 30, 2010, GAO identified continuing deficiencies over SEC's information security, financial reporting process, budgetary resources, and registrant deposits, combined with newly identified deficiencies in the areas of information systems, disgorgements and penalties and required supplementary information. These deficiencies were judged to represent two material weaknesses in internal control that have reduced assurance that data processed by its information systems are reliable and appropriately protected and have resulted in errors and misstatements in SEC's financial reporting during the fiscal year. SEC made the necessary adjustments and was able to prepare financial statements that were fairly stated in all material respects by fiscal year end.

These material weaknesses are likely to continue to exist until SEC's accounting system is either significantly enhanced or replaced, key accounting activity in other systems is fully integrated with the accounting system at the transaction level, information security controls are significantly strengthened, and appropriate resources are dedicated to maintaining effective internal controls.

In commenting on a draft of this report, SEC stated that, as part of its strategy for remediating the material weaknesses, SEC has initiated actions to replace its core financial system by migrating to a federal government shared service provider in fiscal year 2012.

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Abbreviations

FMFIA	Federal Managers' Financial Integrity Act
OMB	Office of Management and Budget
SEC	United States Securities and Exchange Commission
SRO	Self-Regulatory Organization

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G A O

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

November 15, 2010

The Honorable Mary Schapiro
Chairman
United States Securities and Exchange Commission

Dear Ms. Schapiro:

The accompanying report presents the results of our audits of the financial statements of the United States Securities and Exchange Commission (SEC) as of, and for the fiscal years ending, September 30, 2010, and 2009. The Accountability of Tax Dollars Act of 2002 requires that SEC prepare and submit audited financial statements to Congress and the Office of Management and Budget (OMB). We agreed, under our audit authority, to audit SEC's financial statements. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) further requires that, effective for fiscal year 2010, SEC submit a report to Congress describing management's responsibility for internal control over financial reporting and attesting to the effectiveness of such internal control during the fiscal year; the SEC Chairman and Chief Financial Officer attest to SEC's report; and GAO submit a report to Congress attesting to the internal control assessment made by SEC.¹ Accordingly, this report also responds to our requirement under the Dodd-Frank Act.

This report contains our (1) unqualified opinions on SEC's financial statements, (2) opinion that SEC's internal control over financial reporting was not effective as of September 30, 2010,² and (3) conclusion that we found no reportable noncompliance with laws and regulations we tested.

We are sending copies of this report to the Chairmen and Ranking Members of the Senate Committee on Banking, Housing, and Urban Affairs; the Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Financial Services; and the House

¹ Dodd-Frank Act, Pub. Law No. 111-203, §§ 963(a), (b)(2), 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. §§ 78d-8(a), (b)(2)).

² Section 963(b)(1) of the Dodd-Frank Act also requires, effective for fiscal year 2011, GAO to assess the effectiveness of SEC's internal control over financial reporting and SEC's assessment of the same. Our audit satisfies these requirements beginning this fiscal year. See 15 U.S.C. § 78d-8(b)(1), which codifies this requirement.

Committee on Oversight and Government Reform. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested parties. In addition, this report will be available at no charge on our Web site at <http://www.gao.gov>.

If you have questions about this report, or if I can be of further assistance, please contact me at (202) 512-9406 or dalkinj@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James R. Dalkin
Director
Financial Management and Assurance



United States Government Accountability Office
Washington, DC 20548

To the Chairman of the United States Securities and Exchange Commission

In our audits of the United States Securities and Exchange Commission (SEC) for fiscal years 2010 and 2009, we found

- the financial statements as of and for the fiscal years ended September 30, 2010, and 2009, including the accompanying notes, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- SEC did not maintain, in all material respects, effective internal control over financial reporting as of September 30, 2010; and
- no reportable noncompliance with laws and regulations we tested.

Since SEC began preparing financial statements in 2004, it has struggled with maintaining effective internal control over financial reporting. As of September 30, 2010, we identified two material weaknesses¹ in internal control over financial reporting related to SEC's information systems and its financial reporting and accounting processes. These material weaknesses, which are discussed in more detail later in this report, comprise many of the deficiencies we reported in previous years as well as newly identified deficiencies.

SEC took actions during fiscal year 2010 to address previously reported deficiencies. For example, SEC took sufficient actions to improve controls over its fund balance with Treasury, including dedicating staff to perform monthly reconciliations and resolve differences with Treasury on a timely basis, such that we no longer consider this area to be a deficiency in internal control. In addition, SEC, with significant contractor support, made sufficient progress in improving its risk assessment processes pertaining to SEC's financial reporting control environment such that we no longer consider the remaining issues in this area to be a deficiency in internal control. SEC also took actions in fiscal year 2010 toward improving control processes related to other previously reported deficiencies. However, notwithstanding these efforts, the material weaknesses we identified this year, which in part, represent continuing

¹ A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

deficiencies, give rise to significant management challenges that have (1) reduced assurance that data processed by SEC's information systems are reliable and appropriately protected; and (2) resulted in errors and misstatements in SEC's financial reporting that were not prevented or detected in a timely manner. These material weaknesses are likely to continue to exist until SEC's accounting system is either significantly enhanced or replaced, key financial reporting applications are fully integrated with the accounting system at the transaction level, information security controls are significantly strengthened, and appropriate resources are dedicated to maintaining effective internal controls.

The following sections discuss in more detail (1) these conclusions, (2) our conclusions on Management's Discussion and Analysis and required supplementary and other accompanying information, (3) our audit objectives, scope, and methodology, and (4) agency comments and our evaluation.

Opinion on Financial Statements

SEC's financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, SEC's assets, liabilities, and net position as of September 30, 2010, and September 30, 2009; and net costs, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended.

Opinion on Internal Control

Because of two material weaknesses in internal control discussed below, SEC did not maintain, in all material respects, effective internal control over financial reporting as of September 30, 2010, and thus did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements would be prevented or detected and corrected on a timely basis. Our opinion is based on criteria established under 31 U.S.C. 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA). Our opinion is consistent with SEC's evaluation of, and attestation on, the effectiveness of its internal

controls during fiscal year 2010, which identified and reported similar material weaknesses in internal control over financial reporting.²

We identified pervasive information system control deficiencies, some of which are continuing deficiencies reported in prior audits, that span across SEC's general support system and all key applications that support SEC's financial reporting. As a result of these system deficiencies, SEC is not able to rely on its information system controls to provide reasonable assurance that (1) the financial statements are fairly stated in accordance with U.S. generally accepted accounting principles, (2) financial information management relies on to support day-to-day decision making is current, complete, and accurate, and (3) proprietary information processed by these automated systems is appropriately safeguarded. In fiscal year 2009, we reported information security as a significant deficiency³ and included it as a component of the material weakness in financial reporting.⁴ However, while SEC took some actions to address its information security deficiencies, continuing security deficiencies as well as newly identified deficiencies in information security controls and other system controls were serious enough, that they collectively represent a material weakness in information systems given their pervasive impact on financial reporting.

During fiscal year 2010, we also identified five areas of deficiencies in internal control concerning SEC's financial reporting and accounting processes. We reported on many of these deficiencies in fiscal year 2009, and at various times in prior audits dating back to fiscal year 2004. These continuing deficiencies and the newly identified deficiencies this year

² The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. Law No. 111-203, §§ 963(a), (b)(2), 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. §§ 78d-8(a), (b)(2)), requires that, effective for fiscal year 2010, SEC submit a report to Congress describing management's responsibility for internal control over financial reporting and attesting to the effectiveness of such internal control during the fiscal year; the SEC Chairman and Chief Financial Officer attest to SEC's report; and GAO submit a report to Congress attesting to the internal control assessment made by SEC. SEC conducted an evaluation of its internal controls in accordance with the Office of Management and Budget's Circular No. A-123, *Management's Responsibility for Internal Control*, based on criteria established under FMFIA.

³ A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

⁴ GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2009 and 2008*, [GAO-10-250](#) (Washington, D.C.: Nov. 16, 2009).

indicate that SEC's monitoring process was not always effective in identifying and correcting internal control issues in a timely manner. The collective nature of these significant control deficiencies are such that a reasonable possibility exists that a material misstatement of SEC's financial statements would not be prevented, or detected and corrected on a timely basis. Consequently, these control deficiencies collectively represent a material weakness in SEC's internal control over financial reporting and accounting processes. The five areas of deficiencies that collectively comprise a material weakness over financial reporting and accounting processes concern internal control over

- SEC's financial reporting process, resulting in significant errors in financial reporting that were not always detected and corrected on a timely basis;
- accounting for budgetary resources, resulting in obligations and deobligations that were not always recorded timely or accurately, and obligations that were not valid;
- registrant deposit transactions, resulting in SEC misstating filing fee revenue and the related registrant deposit account liability amounts in the proper period;
- accounting for disgorgement and penalties,⁵ resulting in SEC misstating related accounts receivable, liability, and collections amounts in the proper period; and
- reporting required supplementary information, resulting in SEC omitting the required information in its draft fiscal year 2010 financial report.

For significant errors and issues that were identified, SEC made necessary adjustments to the financial statements, the notes accompanying the financial statements, and other required supplementary information, as appropriate, and was therefore able to prepare financial statements that were fairly stated in all material respects for fiscal years 2010 and 2009. However, the material weaknesses in SEC's internal control over

⁵A disgorgement is the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible. A penalty is a monetary payment from a violator of securities law that SEC obtains pursuant to statutory authority. A penalty is fundamentally a punitive measure, although penalties occasionally can be used to compensate harmed investors.

information systems and over financial reporting and accounting processes may adversely affect information used by SEC's management that is based, in whole or in part, on information that is inaccurate because of these weaknesses. In addition, unaudited financial information reported by SEC may also contain misstatements resulting from these weaknesses. We considered the material weaknesses identified above in determining the nature, timing, and extent of our audit procedures on SEC's fiscal year 2010 financial statements. We caution that misstatements may occur and not be detected by our tests and that such testing may not be sufficient for other purposes.

These material weaknesses are discussed in more detail in appendix I to this report. We will be reporting additional details concerning these material weaknesses separately to SEC management, along with recommendations for corrective actions. We also identified other deficiencies in SEC's system of internal control that we do not consider to be material weaknesses or significant deficiencies but which merit SEC management's attention and correction. We have communicated these matters to SEC management informally and as appropriate, will be reporting them in writing to SEC separately.

Compliance with Laws and Regulations

Our tests of SEC's compliance with selected provisions of laws and regulations for fiscal year 2010 disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards. The objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

SEC's Management's Discussion and Analysis, required supplementary information, and other accompanying information contain a wide range of information, some of which is not directly related to the financial statements. We did not audit and we do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with SEC officials. On the basis of this limited work, we found no material inconsistencies with the financial statements, U.S. generally accepted accounting principles, or Office of Management and Budget Circular No. A-136, Financial Reporting Requirements.

Objectives, Scope, and Methodology

SEC management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles; (2) establishing and maintaining effective internal control over financial reporting, and evaluating its effectiveness; and (3) complying with applicable laws and regulations. SEC management evaluated the effectiveness of SEC's internal control over financial reporting as of September 30, 2010, based on the criteria established under FMFIA. Effective for fiscal year 2010, SEC is also responsible for attesting to the effectiveness of its internal control during the fiscal year.⁶ SEC management's assertion, based on its evaluation, is included in its Management's Discussion and Analysis included in this report.

We are responsible for planning and performing the audit to obtain reasonable assurance and provide our opinion about whether (1) SEC's financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; and (2) SEC management maintained, in all material respects, effective internal control over financial reporting as of September 30, 2010. We are also responsible for (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and (2) performing limited procedures with respect to certain other information accompanying the financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by SEC management;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of SEC and its operations, including its internal control over financial reporting;
- considered SEC's process for evaluating and reporting on internal control over financial reporting that SEC is required to perform by FMFIA;

⁶ Dodd-Frank Act, Pub. Law No. 111-203, §§ 963(a), (b)(2), 124 Stat. 1376, 1910 (July 21, 2010)(*codified at* 15 U.S.C. §§ 78d-8(a), (b)(2)).

-
- assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;
 - evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
 - tested relevant internal control over financial reporting;
 - tested compliance with selected provisions of the following laws and regulations: the Securities Exchange Act of 1934, as amended; the Securities Act of 1933, as amended; the Antideficiency Act; laws governing the pay and allowance system for SEC employees; the Debt Collection Improvement Act; the Prompt Payment Act; the Federal Employees' Retirement System Act of 1986; Financial Services and General Government Appropriations Act, 2010; and the Dodd-Frank Wall Street Reform and Consumer Protection Act; and
 - performed such other procedures as we considered necessary in the circumstances.

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with the laws governing the use of budgetary authority and other laws and regulations that could have a direct and material effect on the financial statements.

We did not evaluate all internal control relevant to operating objectives as broadly established under FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on the effectiveness of internal control over financial reporting and may not be sufficient for other purposes. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness. Because of inherent limitations, internal control may not prevent or detect and correct misstatements due to error or fraud, losses, or noncompliance. We also caution that projecting any

evaluation of effectiveness to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We did not test compliance with all laws and regulations applicable to SEC. We limited our tests of compliance to selected provisions of laws and regulations that have a direct and material effect on the financial statements for the fiscal year ended September 30, 2010. We caution that other deficiencies in internal control may exist and not be detected by our tests and that our testing may not be sufficient for other purposes.

We performed our audit in accordance with U.S. generally accepted government auditing standards. We believe our audit provides a reasonable basis for our opinions and other conclusions.

SEC Comments and Our Evaluation

In commenting on a draft of this report, SEC's Chairman said she was pleased to receive an unqualified opinion on SEC's financial statements. The Chairman stated that SEC plans to address the material weaknesses in information systems and in financial reporting and accounting processes through improvements in its core financial system, which SEC believes will both enhance security and significantly reduce manual processes. According to the Chairman, SEC has already initiated actions to replace the agency's core financial system by migrating to a federal government shared service provider in order to put in place better protections for financial data and to enhance its financial reporting processes through further automation. SEC plans to shift to the new environment in fiscal year 2012. The complete text of SEC's response is reprinted in appendix II.

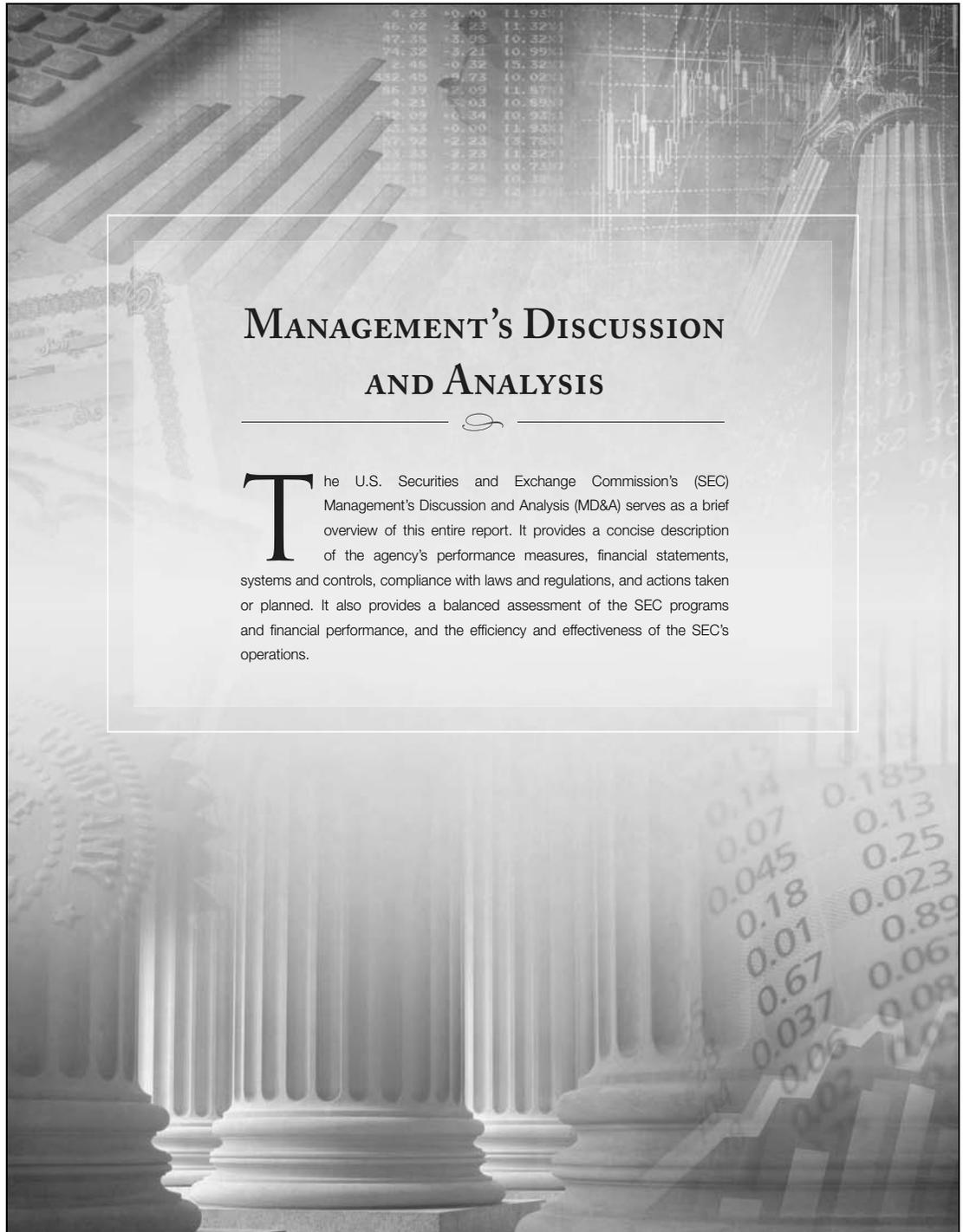
Sincerely yours,



James R. Dalkin
Director
Financial Management and Assurance

November 12, 2010

Management's Discussion and Analysis



Vision, Mission, Values, and Goals

Vision

The SEC strives to promote a market environment that is worthy of the public's trust and characterized by transparency and integrity.

Mission

The mission of the SEC is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.

Values

Integrity	Teamwork
Accountability	Fairness
Effectiveness	Commitment to Excellence

In FY 2010, the Commission approved a new strategic plan covering FY 2010 - FY 2015. The plan sets out the agency's mission, vision, values, and strategic goals through FY 2015. The plan also details the outcomes the agency is seeking to achieve, the strategies and initiatives that will be undertaken to accomplish those outcomes, and the performance measures that will be used to gauge the agency's progress. The plan can be accessed on the SEC's website at www.sec.gov/about/secstratplan1015f.pdf.

Strategic Goals and Outcomes

Goal 1: Foster and enforce compliance with the federal securities laws

Outcome 1.1: The SEC fosters compliance with the federal securities laws.

Outcome 1.2: The SEC promptly detects violations of the federal securities laws.

Outcome 1.3: The SEC prosecutes violations of federal securities laws and holds violators accountable.

Goal 2: Establish an effective regulatory environment

Outcome 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.

Outcome 2.2: The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.

Outcome 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.

Goal 3: Facilitate access to the information investors need to make informed investment decisions

Outcome 3.1: Investors have access to high-quality disclosure materials that are useful to investment decision making.

Outcome 3.2: Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.

Goal 4: Enhance the Commission's performance through effective alignment and management of human, information, and financial capital

Outcome 4.1: The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.

Outcome 4.2: The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.

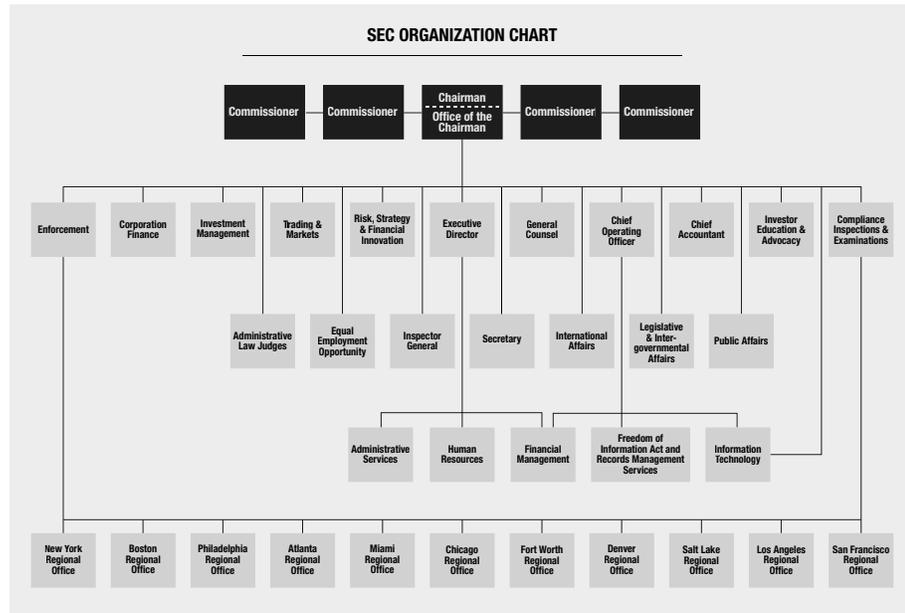
Outcome 4.3: Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment.

Outcome 4.4: Resource decisions and operations reflect sound financial and risk management principles.

Organizational Structure and Resources

The SEC is an independent federal agency established pursuant to the Securities Exchange Act of 1934 (Exchange Act). It is headed by a bipartisan five-member Commission, comprised of the Chairman and four Commissioners, who are appointed by the President and confirmed by the Senate (see *Appendix A: Chairman and Commissioners*). The Chairman serves as the Chief Executive Officer (CEO). The SEC is organized into five main divisions: Enforcement; Corporation Finance; Investment Management; Trading and Markets; and Risk, Strategy, and Financial Innovation. The SEC's headquarters are in Washington, D.C., and it has 11 regional offices located throughout the country. In Fiscal Year (FY) 2010, the SEC received budget authority of \$1,571 million consisting of current-year offsetting collections in the amount of \$1,095 million, \$452 million for the SEC Investor Protection Fund, and \$24 million in funds carried over from prior fiscal years. In FY 2010, the agency employed 3,748 Full-time Equivalents (FTE), including 3,664 permanent and 84 temporary FTEs.

CHART 1.1



Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

The SEC organizes its divisions and offices under the 10 major programs outlined below in *Table 1.1, SEC Programs and Program Descriptions*.

**TABLE 1.1
SEC PROGRAMS AND PROGRAM DESCRIPTIONS**

Program	Divisions and Offices	Program Descriptions
Enforcement	Division of Enforcement and enforcement staff within the SEC's regional offices	This program investigates and brings civil charges in federal district court or in administrative proceedings based on violations of the federal securities laws. An integral part of the program's function is to seek penalties and the disgorgement of ill-gotten gains in order to return funds to harmed investors.
Compliance Inspections and Examinations	Office of Compliance Inspections and Examinations staff within the SEC's regional offices	This program conducts the SEC's examinations of registrants such as investment advisers, investment companies, broker-dealers, self-regulatory organizations, credit rating agencies, transfer agents, and clearing agencies.
Corporation Finance	Division of Corporation Finance	This program performs functions to assure that investors have access to materially complete and accurate information, and to deter fraud and misrepresentation in the public offering, trading, voting, and tendering of securities.
Trading and Markets	Division of Trading and Markets	This program conducts activities to establish and maintain standards for fair, orderly and efficient markets, while fostering investor protection and confidence in the markets.
Investment Management	Division of Investment Management	This program seeks to minimize the financial risks to investors from fraud, mismanagement, self-dealing, and misleading or incomplete disclosure in the investment company and investment adviser segments of the financial services industry.
Risk, Strategy, and Financial Innovation	Division of Risk, Strategy, and Financial Innovation	This program's responsibilities cover three broad areas: risk and economic analysis, strategic research, and financial innovation. Its activities relate to policymaking, rulemaking, examination and enforcement matters agency-wide.
General Counsel	Office of the General Counsel	OGC serves as the chief legal officer of the Commission and provides independent legal analysis and advice to the Chairman, Commissioners, and operating divisions on all aspects of the Commission's activities. The General Counsel also defends the Commission in federal district courts, represents the Commission in all appellate matters and <i>amicus curiae</i> filings, and oversees the SEC's bankruptcy program.

(Continued on next page)

Management's Discussion and Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

TABLE 1.1 Continued from previous page

Program	Divisions and Offices	Program Descriptions
Other Program Offices	<ul style="list-style-type: none"> Office of Chief Accountant; Office of Investor Education and Advocacy; Office of International Affairs; and Office of Administrative Law Judges 	<p>These offices are responsible for:</p> <ul style="list-style-type: none"> serving as the chief advisor on all accounting and auditing policy and overseeing private sector standards setting; serving investors who contact the SEC, ensuring that retail investors' perspectives inform the Commission's regulatory policies and disclosure programs; and improving investors' financial literacy; advancing international regulatory and enforcement cooperation, promoting converged high regulatory standards worldwide, and facilitating technical assistance programs in foreign countries; and adjudicating allegations of securities law violations.
Agency Direction and Administrative Support	<ul style="list-style-type: none"> The Chairman and Commission; Office of Legislative and Intergovernmental Affairs; Office of Public Affairs; Office of the Secretary; Office of the Chief Operating Officer; Office of Information Technology; Office of Freedom of Information Act and Records Management Services; Office of Financial Management; Office of the Executive Director; Office of Human Resources; Office of Administrative Services; and Office of Equal Employment Opportunity 	<p>The Chairman is responsible for overseeing all aspects of agency operations, and the Chairman and Commissioners are responsible for the review and approval of enforcement cases and formal orders of investigation and the development, consideration, and execution of policies and rules. The other offices in Agency Direction and Administrative Support are responsible for:</p> <ul style="list-style-type: none"> working with Members of Congress on issues that affect the Commission; coordinating the SEC's communications with the media, the general public, and foreign visitors; reviewing all documents issued by the Commission, and preparing and maintaining records of Commission actions; maximizing the use of SEC resources by overseeing the strategic planning, information technology program, financial management, records management, human resources, and administrative functions of the agency; and ensuring that the SEC is an equal opportunity employer in full compliance with all federal EEO laws.
Inspector General	Office of the Inspector General	OIG is an independent office that conducts audits of programs and operations of the SEC and investigations into allegations of misconduct by staff or contractors. The mission of OIG is to detect fraud, waste, and abuse and to promote integrity, economy, efficiency, and effectiveness in the SEC's programs and operations.

As shown in the *Statement of Net Cost*, on page 83, the SEC presents its net costs of operations by the programs outlined above, consistent with the presentation used by the agency in submitting its budget requests. A detailed discussion of program achievements and program contributions to accomplishing the mission of the SEC can be found in the *Performance Section*.

FY 2010 Year in Review

Opening: Continuing the Path of Reform

Over the past year, the SEC continued its efforts to reform its operations and focus on its core mission of protecting investors. During that time, it also began preparing to implement the mandates of the newly-enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

The agency continued its internal reform efforts by completing the restructuring of its enforcement division and launching a reorganization of its inspection unit with the intention of more aggressively and effectively spotting violations and pursuing fraud. The agency also continued to recruit individuals with a range of skill-sets, increase staff training, upgrade its technology, and foster a culture of collaboration among the various divisions and offices.

On the rule-making front, the SEC adopted regulations designed to better protect investors from fraud and abusive practices, assure investors have access to timely and accurate information, including with regard to corporate governance at the companies in which they invest.

The agency's new structures and approaches were tested by the events of May 6, when a volatile market sent the Dow Jones down more than 500 points in a matter of minutes – and back up almost as rapidly. In response, Chairman Schapiro immediately brought together representatives of the exchanges and self-regulatory organizations to identify measures that could reduce the risk of another similar disruption. Within weeks, the SEC had approved new rules that pause trading when stock prices experience steep, rapid movements. Additionally, the SEC – together with the Commodity Futures Trading Commission (CFTC) – launched an extensive review that ultimately determined the cause and exacerbating factors of that day's market volatility.

Finally, when Dodd-Frank became law, the SEC was ready with a detailed internal agenda, cross-agency working groups, and a comprehensive strategy for facilitating public input as the agency develops the rules required by the new law.

In short, the SEC continued to work toward becoming a more responsive and effective agency, committed to protecting investors and restoring confidence in the markets.

Internal Reforms

In the past 12 months, the agency has continued its efforts to improve its operational capacity – working to transform the culture, breaking down silos, investing in human and technological capital, and adopting new procedures that broadly encourage individual initiative and improve agency performance.

Consistent with its increasingly collaborative culture, the agency created interdisciplinary groups that worked together on a host of specific issues – including life settlements and the development of a consolidated audit trail.

The agency increased funding for training that allows agency staff to build skills and keep current with accelerating legal, technical and financial changes. New hires are being selected for their industry knowledge and their varied backgrounds, bringing new expertise into the agency and a sharper focus on emerging products and areas in need of specialized oversight.

The SEC also has begun a long-term effort to improve its technology, beginning with a system designed to better track, store, and compare tips, complaints, and referrals. Another key area of investment has been in workflow and document management systems that are already improving the management of enforcement cases and the consistency of inspections and examinations. These systems are all being built on the same software platform so that information can be easily researched and shared across organizational lines.

Reinvigorating the Enforcement Program

In 2010, the Division of Enforcement completed its comprehensive internal review and subsequent structural reforms – the most significant in four decades. As a result of the restructuring, the division has redeployed hundreds of experienced attorneys to front-line investigations and created nationwide specialized units to concentrate on high-priority areas of enforcement. The units will focus on Asset Management (hedge funds and investment advisers), Market Abuse (large-scale insider trading and market manipulation), Structured and New Products (various derivative products),

Foreign Corrupt Practices Act violations, and Municipal Securities and Public Pensions. They will rely on enhanced training, industry experience and skills, and targeted investigative approaches to better detect links and patterns suggesting wrongdoing. Each of the units is in the process of hiring additional professionals with specialized experience to assist in investigative and enforcement efforts.

In addition, the Division established an Office of Market Intelligence to serve as a central office for handling tips, complaints, and referrals. This office will enable enforcement staff to provide a coherent and coordinated response to the huge volume of potential leads the agency receives every day. OMI also will house the new whistleblower office created by Dodd-Frank.

OMI will also benefit from the agency-wide technology initiative. The first phase of the initiative successfully consolidated the multiple, dispersed repositories for tips and complaints into a single, searchable database. In the second phase, the agency will deploy a new intake and resolution system that will allow the agency to capture more – and more valuable – information. And in the third phase, the agency will add risk analytics tools that help to efficiently identify high-value tips and to search for trends and patterns across the database.

Enforcement Cases

Despite the demands involved in making these important changes, the Division's enforcement efforts continued to bring excellent results. The numbers do not tell the whole story, but the Division obtained \$2.8 billion in penalties and disgorgement; barred numerous wrongdoers from engaging in improper business practices in the future; required companies to institute internal controls to prevent future harm from such practices; and obtained other remedies that send a strong deterrent message.

Key Enforcement Cases

In FY 2010, the SEC brought 681 enforcement cases covering a broad spectrum of financial wrongdoing. What follows is a selection of some of those enforcement actions.

Financial Crisis

In the aftermath of the financial crisis, the SEC filed many cases involving mortgage-related securities and mortgage-related products linked to the crisis. In three such cases, involving Countrywide, American Home Mortgage and Evergreen, the SEC filed charges in FY 2009. In 2010, the SEC continued to pursue cases related to the financial crisis, including:

Goldman Sachs. In April 2010, in an action led by the agency's Structured and New Products Unit, the Commission charged Goldman Sachs and one of its vice presidents with defrauding investors by misstating and omitting key facts regarding a financial product tied to subprime mortgages. Goldman Sachs failed to disclose to investors that Paulson & Co., a major hedge fund player, had taken a significant role in assembling a synthetic collateralized debt obligation tied to the performance of subprime residential mortgage-backed securities, and had taken a short position against it. Goldman Sachs settled with the SEC in July, paying \$550 million in penalties and disgorgement and agreeing to reform its business practices.

Citigroup. In July 2010, Citigroup and two senior executives agreed to settle charges that it had misled investors about the company's exposure to subprime mortgage-related assets, making misleading statements in earnings calls and public filings about the extent of its holdings of assets backed by subprime mortgages. Between July and mid-October 2007, Citigroup represented that subprime exposure in its investment banking unit was \$13 billion or less when, in fact, it was more than \$50 billion.

New Century. In July 2010, three former officers of New Century Financial Corporation agreed to pay more than \$1.5 million in disgorgement, interest and fines to settle charges that they defrauded investors. In December 2009, the SEC alleged that Brad A. Morrice, the former CEO and co-founder; Patti M. Dodge, the former chief financial officer (CFO); and David N. Kenneally, the former controller had falsely assured New Century investors that all was well, while failing to disclose key negative information known to them, including a dramatic increase in loan defaults, loan repurchases and loan repurchase requests. New Century had been, at one point, one of the largest subprime mortgage lenders in the nation.

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ICP Asset Management. In June 2010, the SEC charged New York-based ICP Asset Management, its president, Thomas Priore, and two affiliated firms with defrauding four multi-billion-dollar collateralized debt obligations (CDOs) by engaging in fraudulent practices and misrepresentations that caused the CDOs to lose tens of millions of dollars. Priore and his companies also improperly obtained tens of millions of dollars in advisory fees and undisclosed profits at the expense of their clients and investors.

Taylor, Bean & Whitaker. In June 2010, the SEC charged the former chairman and majority owner of what was once the nation's largest non-depository mortgage lender with orchestrating a large-scale securities fraud scheme and attempting to scam the U.S. Treasury's Troubled Asset Relief Program (TARP). The SEC alleged that Lee B. Farkas, through his company, Taylor, Bean & Whitaker Mortgage Corp., sold more than \$1.5 billion worth of fabricated or impaired mortgage loans and securities to Colonial Bank. Farkas also was responsible for a bogus equity investment that caused Colonial Bank to misrepresent that it had satisfied a prerequisite necessary to qualify for TARP funds.

Morgan Keegan. In April 2010, the SEC brought administrative proceedings against Morgan Keegan & Company, Morgan Asset Management and two employees for allegedly overstating the value of securities backed by subprime mortgages. The SEC alleged that Morgan Keegan failed to employ reasonable procedures to internally price the portfolio securities in five funds and sold shares to investors based on the inflated prices.

Brookstreet Securities. In December 2009, CEO Stanley C. Brooks and Brookstreet Securities were charged with fraud for allegedly systematically selling approximately \$300 million worth of risky and illiquid collateralized mortgage obligations (CMOs) to more than 1,000 seniors and retirees with conservative investment goals. Additionally, in a failed last-ditch effort to stave off bankruptcy, Brooks directed the unauthorized sale of CMOs from Brookstreet customers' cash-only accounts, causing substantial investor losses.

Return of Monies to Harmed Investors

FY 2010 also saw several SEC-ordered distributions to shareholders harmed by misleading statements and material omissions regarding defendants' exposures to subprime mortgages

and other investments. The agency also returned approximately \$2.2 billion dollars to investors as a result of SEC enforcement actions.

State Street Bank and Trust. In February 2010, State Street Bank and Trust agreed to distribute more than \$300 million to investors who lost money during the subprime market meltdown. The distribution resulted from State Street's settlement of SEC charges that it misled investors about their exposure to subprime investments while selectively disclosing more complete information to favored investors.

Reserve Primary Fund. In January 2010, the Reserve Primary Fund completed the distribution of \$3.4 billion in assets to investors who held shares of the fund when its net asset value fell below \$1 per share in September 2008. In May 2009, the SEC brought charges against entities and individuals who operated the Reserve Fund for failing to provide material facts regarding exposure of the fund to Lehman Brothers, whose bankruptcy left the fund unable to meet investor requests for redemptions. In November 2009, the court adopted the SEC's proposed distribution plan, which resulted in investors recovering more than 98 cents on the dollar.

Pay-to-Play

Another enforcement focus was on "pay-to-play" arrangements, in which lucrative financial management deals are struck between municipalities and firms who reward the well-connected individuals who arrange those deals with cash, campaign contributions or other favors. Contracts based on connections – rather than competence – potentially harm both taxpayers and the beneficiaries of these funds, through higher fees and lower performance.

Quadrangle. In April 2010, Quadrangle Group LLC and Quadrangle GP Investors II, L.P. settled charges that they had participated in a kickback scheme to obtain a \$100 million investment from the New York State Common Retirement Fund, the state's largest public pension fund. The investment came only after a then-executive at Quadrangle arranged for an affiliate to distribute the DVD of a low-budget film that former New York State Deputy Comptroller David Loglisci and his brothers had produced.

The SEC further charged that the Quadrangle executive agreed to pay more than \$1 million in purported "finder" fees to Henry Morris, the top political advisor and chief fundraiser for former New York State Comptroller Alan Hevesi.

Quadrangle agreed to settle the SEC's charges and to pay a \$5 million penalty. The SEC's investigation continues.

JP Morgan. In November 2009, J.P. Morgan Securities Inc. settled charges springing from an unlawful payment scheme that enabled them to win business involving municipal bond offerings and swap agreement transactions with Jefferson County, Ala. by agreeing to pay a penalty of \$25 million, make a payment of \$50 million to Jefferson County, and forfeit more than \$647 million in claimed termination fees.

The SEC also brought charges against two former managing directors, alleging that Charles LeCroy and Douglas MacFaddin made more than \$8 million in undisclosed payments to close friends of certain Jefferson County commissioners.

Auditors

Investors rely on accurate financial information to make critical financial decisions. By focusing on the auditors who sign off on companies' reporting, the SEC helps deter Enron-type accounting fraud that might cost investors billions.

Ernst & Young LLP. In December 2009, Ernst & Young LLP, independent auditor of Chicago-based Bally Total Fitness, paid \$8.5 million to settle charges that it knew or should have known about Bally's fraudulent financial accounting and disclosures. In addition, six current and former Ernst & Young partners settled with the SEC. The SEC found that Ernst & Young issued false and misleading audit opinions stating that Bally's 2001 to 2003 financial statements were presented in conformity with generally accepted accounting principles and that Ernest & Young's audits were conducted in accordance with Generally Accepted Auditing Standards.

Insider Trading

The SEC continues to focus on insider trading – both by individuals and by large-scale institutional traders – through its new Market Abuse Unit.

Galleon. In October 2009, the SEC charged billionaire Raj Rajaratnam and his New York-based hedge fund advisory firm Galleon Management LP with engaging in an insider trading scheme that generated more than \$33 million in illicit gains. The SEC also charged six others involved in the scheme, including senior executives at IBM, Intel, and McKinsey & Company.

In November, the SEC broadened its case, charging 13 additional individuals and entities, including three hedge fund managers, three professional traders at New York-based Schottenfeld Group, and a senior executive at Atheros Communications, a California-based developer of networking technologies. This is the largest hedge fund insider trading investigation to date.

Cutillo. In November 2009, the SEC charged Arthur J. Cutillo and Jason Goldfarb with trading inside information in exchange for kickbacks, as well as six Wall Street traders and a proprietary trading firm who were also involved in a \$20 million insider trading scheme.

The SEC alleged that Cutillo, an attorney in the New York office of law firm Ropes & Gray LLP, had access to confidential information about at least four major proposed corporate transactions in which his firm's clients participated.

Offering Frauds/Ponzi Schemes

The SEC's efforts to hold accountable perpetrators of offering frauds and Ponzi schemes – aided by the adoption of significant post-Madoff reforms and the establishment of the Asset Management Unit – continue to uncover numerous large-scale frauds.

Meredon Mining. In June 2010, the SEC charged four Canadian men and two others living in Florida with perpetrating a \$300 million international Ponzi scheme on investors in a purportedly successful gold mining operation. The SEC alleged that Milowe Allen Brost and Gary Allen Sorenson, of Calgary, were the primary architects and beneficiaries of a scheme that persuaded more than 3,000 investors across the U.S. and Canada to invest their savings, retirement funds and even home equity, in shell companies owned or controlled by Brost or Sorenson.

Foreign Corrupt Practices Act

The SEC continues to prosecute companies that make illegal payments to win business overseas. A renewed focus on these practices in recent years, coupled with the efforts of the FCPA Unit, continues to yield significant settlements.

ENI. In July 2010, the SEC charged an Italian company, ENI, S.p.A. and its former Dutch subsidiary, Snamprogetti Netherlands B.V., with violations of the Foreign Corrupt

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Practices Act for providing cash-filled briefcases and vehicles to Nigerian government officials in an effort to win lucrative construction contracts. ENI agreed to pay \$125 million to settle the SEC's charges, and Snamprogetti paid an additional \$240 million penalty to settle separate criminal proceedings announced by the U.S. Department of Justice. According to the SEC's complaint, senior executives at Snamprogetti and the other joint venture companies authorized the hiring of two agents who funneled more than \$180 million in bribes to Nigerian government officials to obtain several contracts to build liquefied natural gas facilities in Nigeria.

Daimler. In March 2010, Daimler AG agreed to pay \$91.4 million in disgorgement to settle charges that it engaged in a repeated and systematic practice of paying bribes to foreign government officials to secure business in Asia, Africa, Eastern Europe, and the Middle East. Daimler also agreed to pay \$93.6 million in fines to settle charges in separate criminal proceedings by the U.S. Department of Justice.

Financial Fraud

Financial fraud can cost investors billions in lost equity. Both companies and corporate officers are accountable to shareholders for timely and, especially, honest reporting.

Dell. In July 2010, the SEC charged Dell Inc. with failing to disclose material information to investors and using fraudulent accounting to make it falsely appear that the company was consistently meeting Wall Street earnings targets and reducing its operating expenses. Among others, Dell Chairman and CEO Michael Dell, former CEO Kevin Rollins, and former CFO James Schneider were charged by the SEC for their roles in the disclosure violations. Dell Inc. agreed to pay a \$100 million penalty to settle the SEC's charges. Michael Dell and Rollins each agreed to pay a \$4 million penalty, and Schneider agreed to pay \$3 million, to settle the SEC's charges against them.

Municipal Securities and Public Pensions

As the financial health of municipalities and its effect on the securities they issue become a matter of greater concern, the SEC has focused on ensuring that investors are aware of factors which could affect the ability of municipalities to meet their financial obligations.

New Jersey. In August 2010, in an investigation handled by the Municipal Securities and Public Pensions Unit, New Jersey became the first state ever charged by the SEC for violations of federal securities laws, when it was charged with failing to disclose that it was underfunding the state's two largest pension plans, to investors in billions of dollars worth of municipal bonds. As a result, investors were not provided adequate information to evaluate the state's ability to fund the pensions or to assess their impact on the state's financial condition. New Jersey agreed to settle the case without admitting or denying the SEC's findings.

Strengthening Examinations and Oversight

Like the Enforcement Division, the Office of Compliance Inspections and Examinations (OCIE) engaged in a comprehensive self-examination to improve its examination program in critical areas of strategy, structure, people, processes, and technology.

During FY 2010, OCIE established a new, national governance structure designed to break down silos and increase consistency among regional offices, and to improve collaboration with other divisions. For the first time, leaders from across the country began working together to develop an integrated strategy and implement enhanced policies, procedures, and tools to drive consistency and effectiveness across the national exam program.

Staffing strategies are changing, as well. Instead of creating fixed examination teams that remain together over time, OCIE will now customize teams for each examination, matching the strengths of individual examiners to the unique challenges offered by the entity being examined. And managers are spending more time in the field, leading their teams on-site.

Vastly outnumbered by the entities it is charged with overseeing, OCIE also is increasingly utilizing a risk-based inspection strategy that relies on a variety of data points to determine which entities pose the greater risk to investors. To this end, OCIE has created a centralized Risk Assessment and Surveillance Unit, which is working with the agency's recently-created Division of Risk, Strategy, and Financial Innovation to develop new risk assessment tools that will allow OCIE to engage in more sophisticated risk assessment and earlier action. Finally, OCIE is placing greater emphasis on hiring staff with strong industry experience, as well as training and

certifying examiners. In support of these functions, OCIE is deploying a new suite of technology tools to more fully equip examiners in the field.

Investor-Focused Rulemaking

In 2010, the SEC continued to engage in one of the most active investor-focused regulatory agendas in the agency's history. The rules reflect the agency's efforts to create a more secure marketplace, assure that investors have the timely and accurate information they need, and support effective and responsive governance.

A More Secure Marketplace

One key SEC focus has been on creating tools and procedures that help protect investors from fraud and manipulation, and which enhance the ability of the SEC to investigate when malfeasance is suspected. To make the markets safer for investors, the SEC proposed or adopted the following rules:

- **Custody Controls.** The SEC adopted a rule designed to provide greater protections to investors who entrust their assets to investment advisers. The rule requires that independent public accountants confirm – in the course of a surprise exam – the existence and value of the assets a client has placed in an investment adviser account, and to review custody controls in situations where the possibility for misappropriation of client assets is most acute. These rules will diminish the ability of dishonest advisers to distribute false account statements purporting to document assets that do not exist, or for the adviser to misappropriate assets under their control.
- **Consolidated Audit Trail.** The SEC proposed a rule that would require self-regulatory organizations to establish a consolidated audit trail system which will allow regulators to track information about orders received and executed across the securities markets. Currently, there is no single database of comprehensive and readily accessible data regarding orders and executions across markets. If adopted, for the first time ever, this data could be tracked across multiple markets, products and participants in real time, allowing more rapid reconstruction of trading activity and to better analysis of both suspicious trading behavior and unusual market events.

- **Short Selling/Fails-to-Deliver.** The SEC adopted a rule designed to limit the downward price pressure applied by short-selling to a stock that has dropped more than 10 percent in one day, promoting market stability and preserving investor confidence. This rule also enables long sellers to stand in the front of the line once the 10 percent benchmark is breached and to sell their shares before any short sellers. In addition, the SEC addressed the potentially harmful effects of abusive "naked" short selling, adopting rules that require that fails-to-deliver resulting from short sales be closed out immediately after they occur. Since this rule was adopted, the number of failures to deliver securities has dropped significantly.

- **Sponsored Access.** The SEC proposed a new rule that would effectively prohibit broker-dealers from providing customers with "unfiltered" or "naked" access to an exchange or ATS. The rule would require those with market access to put in place risk management controls and supervisory procedures, in order to minimize the chances that a client with unfiltered access will enter erroneous orders, fail to comply with various regulatory requirements, or breach a credit or capital limit.

- **Money Market Funds.** In the wake of the financial crisis, the SEC adopted rules strengthening the oversight and resiliency of money market funds by requiring, among other things, higher credit quality, greater liquidity, shorter maturities, stress testing and the disclosure of the funds' actual "mark-to-market" net asset value.

- **Pay-to-Play.** The SEC adopted rules prohibiting an investment adviser from providing advisory services for compensation within two years after contributing to the campaigns of elected officials in a position to influence selection of managers for public funds. The rules also restricted the bundling by an adviser of contributions from others. The rules will help prevent "pay-to-play" arrangements and assure investors and taxpayers that advisers to public accounts – such as public employee pension funds – are selected on merit, rather than political favor.

Better Information

Another important principle is that all investors should have access to timely and accurate information. To facilitate better disclosure, the SEC took the following actions:

- **Municipal Securities Disclosure.** The SEC adopted rules improving the quality and timeliness of the disclosure of material events related to municipal securities. These events, which could affect the risk and value of a municipal security, include such occurrences as payment defaults, rating changes and tender offers. The rules will allow investors to make more knowledgeable decisions about municipal securities.
- **Form ADV Part 2.** The SEC updated the principal investment adviser disclosure document, Form ADV Part 2, to improve the quality of the information investors receive regarding their advisers' conflicts, compensation strategy, business activities and disciplinary history. The new form will offer detailed, relevant information in plain English, on both advisory firms and individual advisers. The brochure will provide improved and expanded information in a more user-friendly format describing advisers' qualifications, investment strategies and business practices in plain English.
- **12b-1 Fees.** The SEC proposed rules that would create a new and more equitable framework governing the way in which mutual funds are marketed and sold to investors. The rules would limit the amount of asset-based sales charges that individual investors pay and would improve the information provided to investors regarding fees deducted from mutual funds to compensate those who sell the funds.
- **Target Date Funds.** The SEC proposed rules to help clarify the meaning of a date in a target date fund's name and to enhance the information in target date fund advertising and marketing materials. Information would be provided in chart, table, or graph format in order to enhance investor understanding of a fund's asset mix and how the mix is expected to change as the investor's retirement approaches and thereafter.
- **Asset-Backed Securities.** The SEC proposed new rules that would significantly improve the disclosure and offering process for asset-backed securities. The new rules would require reporting of detailed data on each loan in the pool

both at the time of securitization and on an ongoing basis. In addition, the rule would require that a computer program be filed with the SEC that demonstrated the effect of the "waterfall" – how loan payments and losses are distributed among different tranches of the security. The rule also would assure that investors have enough time to utilize this enhanced information by imposing a minimum offering period. For expedited "off the shelf" offerings, sponsors would be required to retain some interest in the securities, better aligning interests of sponsors and investors by keeping "skin in the game." Since the SEC proposed its rule, Congress passed Dodd-Frank, which also imposes an asset-backed securities risk retention requirement to be adopted by financial regulators.

- **Dark Pools.** The growth of private trading systems known as dark pools – in which participants can execute trades without displaying public quotations – threatens to create a two-tiered market, in which only privileged investors have full price and liquidity information. The SEC proposed rules to generally require that information about an investor's interest in buying or selling a stock be made publicly available, instead of available only to a select group operating within a dark pool.

- **Market Structure Concept Release.** U.S. equity markets are changing significantly as trading speed accelerates, alternative trading centers emerge and liquidity and pricing information disperses across many exchanges. In light of these changes, the SEC launched a broad review of equities market structure, issuing a concept release seeking public comment on issues such as high-frequency trading, co-locating trading terminals, and markets that do not publicly display price quotations. In conducting this review, which was launched several months ahead of the May 6 disruptions, the Commission has sought to learn how all types of, and all sizes of, individual investors are faring in the current market structure.

Corporate Governance

The SEC is committed to supporting effective corporate governance that benefits both shareholders and companies. It is working to see that proxy and disclosure rules give market participants access to the full, timely, and accurate information they need.

• **Proxy Enhancements.** The SEC adopted rules that allow shareholders to better evaluate the leadership of public companies by requiring companies to provide more meaningful and detailed information about the leadership structure of boards, the qualifications of board nominees, potential conflicts of interest faced by compensation consultants, and the relationship between a company's overall compensation policies and risk taking. In place for just a single proxy season so far, this regulation has substantially increased the quality of many filings, giving investors much greater insight into the talents and qualifications of the men and women who run their companies.

• **Proxy Access.** The SEC adopted rules designed to facilitate the ability of shareholders to exercise their traditional rights under state law to nominate and elect members to company boards of directors. Under the rules, shareholders will be eligible to have their nominees included in a company's proxy materials if they meet certain requirements, including owning at least 3 percent of the company's shares continuously for at least the prior three years.

• **Voting Infrastructure Concept Release.** Every year, more than 600 billion shares are voted at more than 13,000 shareholder meetings. The proxy is the principal means through which shareholders and public companies communicate around these elections. Yet it has been 30 years since the Commission has conducted a thorough review of this infrastructure. In light of the vast changes in the intervening decades, the SEC issued a concept release related to the state of proxy infrastructure and how it might be improved. The goal is to hear whether the U.S. proxy system as a whole operates with the accuracy, reliability, transparency, accountability, and integrity that shareholders and issuers expect.

May 6 Market Disruption

On May 6, 2010, the Dow Jones Industrial Average dropped more than 500 points in under five minutes of trading. It then dramatically reversed itself, recovering most of the loss in the following five minutes. These gyrations deprived investors of essential price discovery function, and brought uncertainty to investors counting on safe and stable markets.

With the markets unsettled, the SEC moved immediately to search for causes and to prevent a similar situation from occurring again. Within hours, cross-functional SEC teams

were collaborating with exchange representatives, the Financial Industry Regulatory Authority (FINRA) and CFTC, discussing a coordinated response.

Within two weeks, the staffs of the SEC and CFTC released a preliminary report on the events of May 6. In addition, the SEC posted for comment proposed rules that would require – for the first time – that FINRA and the exchanges impose a uniform circuit-breaker system to halt trading for certain securities if their price moved 10 percent in a five minute period. These pauses are designed to give market participants time to provide liquidity and for the affected security to attract new trading interest, so that trading can resume in a fair and orderly fashion.

By June, slightly more than six weeks after the event, FINRA and the exchanges began putting in place a pilot circuit breaker program for S&P 500 stocks. In September, the program was expanded to include stocks listed in the Russell 1000 and to cover several hundred exchange-traded funds, or ETFs.

Also in September, the SEC approved new rules submitted by the exchanges and FINRA clarifying the process for breaking clearly erroneous trades. On May 6, nearly 20,000 trades were invalidated – but only for those stocks that traded 60 percent or more away from their price at 2:40 PM, a benchmark that was set after the fact. The new rule reduces investor uncertainty by more fully defining the conditions under which the exchanges and FINRA may cancel erroneous trades.

In September, the Commission also posted for comment proposed exchange rules that would effectively eliminate the practice by market makers of submitting “stub” quotes to exchanges when they do not want to participate in the markets. Stub quotes are priced far away from the prevailing market price (e.g., a buy order at a penny or a sell order at \$100,000) and are not intended to be executed; however, the extraordinary volatility on May 6 caused a large number of stub quotes to be executed, thereby generating a substantial portion of the trades that needed to be broken.

At the end of September, the staffs of the SEC and CFTC released a report of their findings regarding the events of May 6. The report describes what occurred that afternoon as the result of “two liquidity crises – one at the broad index level in the E-mini S&P futures contract, the other with respect to individual stocks.” The report details how a large trade in the E-Mini S&P futures contract led to a loss of liquidity in that

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instrument and how a similar loss of liquidity occurred in the equity markets, as many providers of liquidity curtailed their activity or temporarily withdrew, leading to some trades being executed at absurdly low or high prices.

Wall Street Reform

On July 21, President Obama signed into law Dodd-Frank, the most significant piece of financial reform legislation since the 1930s. Dodd-Frank gives the SEC significant new investor protection responsibilities and provides new tools with which to carry out agency responsibilities, old and new.

Over the two years following the bill-signing, the SEC will be responsible for more than 100 new rulemakings, 20 reports and five new offices to be created within the agency. While this is a significant task, the SEC continues to fulfill both its mandates under the Act and its pre-existing responsibilities.

The SEC began planning for the demands of the new legislation months before passage. Internal processes and cross-disciplinary working groups – planned before the bill's signing for each of the major rulemakings and studies – came on-line immediately after the bill's signing, and continue to drive the process. Rule writing divisions and offices meet weekly to review the status of rulemakings and studies, and to plan for the upcoming weeks. SEC staff also meet regularly with other financial regulators charged with bringing Dodd-Frank to life. The SEC's Office of International Affairs meets weekly with rulewriting staff to ensure appropriate coordination with foreign regulators.

One key goal during Dodd-Frank rulemaking is to maximize the opportunity for public comment against a background of complete transparency.

The SEC opened a series of e-mail boxes less than a week after President Obama signed the Act, to encourage public comment even before the various rules were proposed and the official comment periods began.

As the rulemakings progress, the SEC is making an effort not only to meet with every party who expresses interest, but also to reach out to stakeholders whose interests are affected but whose views do not appear to be fully represented. The SEC is also holding public roundtables and hearings on selected topics.

In the interest of full transparency, the SEC is posting on its website both the transcripts of these roundtables, and the written comments it receives. Additionally, the SEC is posting descriptions of any rule-related meetings between staff and outside parties – including participants, agendas and materials distributed.

The Act will result in a number of important SEC actions including:

Over-the-Counter Derivatives. Dodd-Frank provides a comprehensive framework for the regulation of the over-the-counter derivatives market – bringing daylight into an opaque market that contributed to the economic crisis of recent years. In directing the SEC and CFTC to create a comprehensive regulatory framework where none currently exists, Dodd-Frank imposes a number of substantial tasks. The SEC and CFTC must distinguish between swaps and security-based swaps, and decide how to regulate mixed swaps that are security-based swaps with a commodity component. The agencies also must work together to define other key terms. They are writing rules that address, among other issues, mandatory clearing, the end-user exception to mandatory clearing and transactional information transparency.

The SEC and CFTC are also charged with designating and defining new classes of market participants. And they must register and oversee these market participants.

Executive Compensation. In 2011, the SEC will finalize a number of corporate governance rules, with a particular focus on executive compensation. Dodd-Frank requires that shareholders have advisory say-on-pay votes on executive compensation – non-binding up-or-down votes on executive pay packages – at all companies at least once every three years. Shareholders will also vote on the frequency of the say-on-pay vote, and will have a similar “say” on golden parachutes.

Companies will be required to calculate and disclose the median total compensation of all employees, and the ratio of CEO compensation to that figure. Companies will also be required to disclose the relationship between senior executives' compensation and the company's financial performance, as well as whether employees or directors are permitted to hedge against a decrease in value of equity securities granted as part of their compensation.

In addition, the SEC is creating standards under which listed companies will be required to develop "clawback" policies for reclaiming incentive-based compensation from current and former executive officers after a material financial restatement.

The SEC will also adopt rules requiring stock exchanges to set forth listing standards for compensation committees including independence requirements. In addition, the Commission will adopt disclosure requirements addressing compensation consultant conflicts of interest.

Fiduciary Duty. Currently, registered investment advisers are held to what is known as a "fiduciary" standard of conduct, meaning they must put their clients' interests before their own, and avoid or reveal any conflicts of interest. Registered broker-dealers, however, are held to a "suitability" standard, that does not necessarily require the broker-dealer to disclose all conflicts or put investors' needs first. This distinction is lost on many investors, who do not realize that they can be treated differently based on who is advising them. Dodd-Frank requires that the SEC conduct a study of the effectiveness of existing disparate standards of conduct.

After completion of the study, the legislation also gives the SEC authority to write rules that would impose a harmonized fiduciary standard on broker-dealers and investment advisers providing personalized investment advice and recommendations about securities to retail customers (and other customers as determined by the SEC). The Act requires that this standard be "no less stringent" than the standard applicable to investment advisers and further gives the SEC the ability to better harmonize the regulatory requirements applicable to broker-dealers and investment advisers.

Private Fund Adviser Registration. Dodd-Frank requires advisers to most private funds – including hedge funds – with assets under management of more than \$150 million to register with the SEC. The Act eliminates the so-called "15 client" provision which allows advisers to avoid registration while managing substantial amounts of assets on behalf of a large number of ultimate investors. It also authorizes the Commission to require advisers to maintain records of – and file reports regarding – the private funds they advise. The large number of unregistered private fund advisers presented significant potential for fraud and questionable practices. In addition, the lack of a comprehensive database for private funds has made it virtually impossible to monitor them for systemic risk.

Asset-backed Securities. Dodd-Frank requires the SEC to issue rules designed to improve the asset-backed securitization process.

Dodd-Frank requires the SEC to work with fellow regulators to adopt rules requiring certain parties who put together securitizations to retain an economic interest in a material portion of the credit risk in assets transferred or sold in connection with securitizations. Dodd-Frank includes this provision – known as "risk retention" or "skin in the game" – in order to align the economic interests of securitizers with those of investors in asset-backed securities.

The SEC also expects to finalize rules in 2011 requiring that securitizers provide enhanced disclosure about representations and warranties, as well as fulfilled and unfulfilled asset repurchase requests. These rules will allow investors to identify asset originators with clear underwriting deficiencies. Dodd-Frank also requires the SEC to issue rules requiring any issuer of an asset-backed security to perform a review of the assets underlying the security and to disclose the nature of this analysis.

The legislation also directs the SEC to promulgate rules requiring asset-level or loan-level data about the underlying assets, if individual loan data are necessary for investors to independently perform due diligence. Dodd-Frank requires specific types of data to be disclosed, many of which were included in the SEC's 2010 proposals to revise Regulation AB.

Finally, Dodd-Frank requires the SEC to adopt rules to address material conflicts of interest in connection with securitizations. Specifically, Dodd-Frank mandates rules to prohibit underwriters, placement agents, initial purchasers or sponsors of an asset-backed security (or their affiliates or subsidiaries) from engaging in any transaction within one year of the date of the first closing of the sale of an asset-backed security that would constitute a material conflict of interest with respect to any investor in a transaction arising out of such activity.

Credit Rating Agencies. The Act builds on existing SEC authority to designate Nationally Recognized Statistical Rating Organizations (NRSROs), requiring the Commission to adopt rules designed both to improve the accuracy of individual ratings, and to give investors greater insight into the

MANAGEMENT'S DISCUSSION AND ANALYSIS

factors behind those ratings. New regulations will address potential conflicts of interest with respect to NRSRO sales and marketing practices. They will also require annual reports on internal controls designed to eliminate bias in favor of issuer/clients; prescribe "look-back" analyses when an analyst leaves an organization – searching for patterns of bias; and grant the SEC authority to impose fines and penalties.

New rules will also require that NRSROs disclose performance statistics, reveal their rating methodologies and disclose – in an easily accessible format – the data and assumptions underlying credit ratings. In addition, new regulations will establish an analyst training and testing regime and consistent application of rating symbols and definitions, creating a clarity of communication that allows investors to easily understand rating agency opinions, regardless of their source, and to compare performance of one agency against another.

Financial Highlights

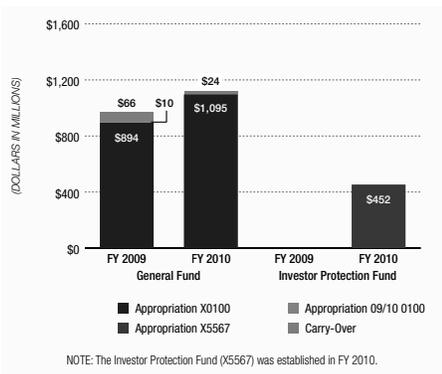
This section provides key financial information for FY 2010. It summarizes the SEC's efforts to manage resources efficiently and responsibly while accomplishing the agency's mission.

In FY 2010, the SEC's total budgetary authority equaled \$1,571 million, a 62 percent increase over the FY 2009 level of \$970 million. The largest contributor of the increase is the establishment of Investor Protection Fund authorized in Dodd-Frank. The funding authority in FY 2010 included \$1,095 million in offsetting collections (X0100), \$452 million for the Investor Protection Fund (X5567), and \$24 million in carry-over of unobligated balances and recoveries from prior-year obligations. In FY 2009, the funding included \$894 million in offsetting collections (X0100), \$10 million in a supplemental appropriation (09/10 0100) issued by Congress to use for investigating securities fraud, and \$66 million in carry-over of unobligated balances and recoveries from prior-year obligations. This is illustrated in *Chart 1.2, Spending Authority by Source*.

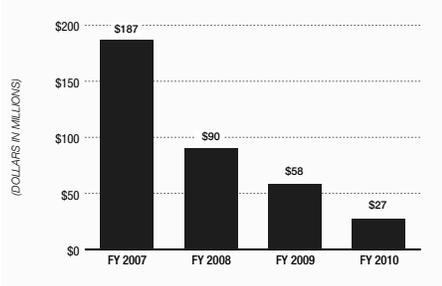
The SEC employed a total of 3,748 FTE in FY 2010. This represents an increase of 106 FTE over FY 2009. The increase in FTE from FY 2009 to FY 2010 is due to the increase in funding and the agency's focus on hiring new staff with the requisite skills and experience to further the SEC's mission.

The SEC has steadily reduced the "Unobligated Balance Brought Forward, October 1" line of the Statement of Budgetary Resources, as illustrated in *Chart 1.3, Unobligated Balance, Brought Forward*. In FY 2010, of the \$27 million brought forward, \$7.8 million was related to a \$10 million supplemental appropriation for investigations of securities fraud.

**CHART 1.2
SPENDING AUTHORITY BY SOURCE**

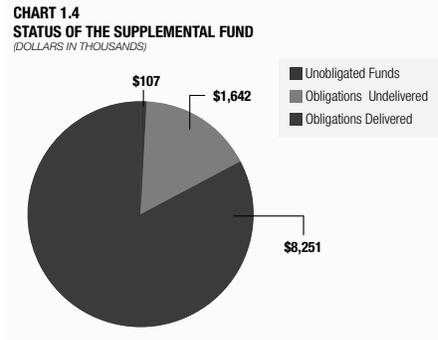


**CHART 1.3
UNOBLIGATED BALANCE, BROUGHT FORWARD**

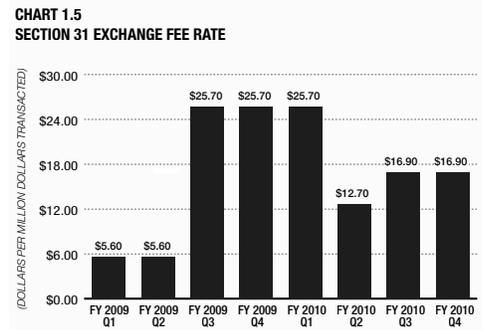


MANAGEMENT'S DISCUSSION AND ANALYSIS

Of the \$10 million supplemental appropriation, \$107 thousand remains unobligated as of September 30, 2010. This supplemental appropriation is also reflected on the "Unexpended Appropriations - Other Funds" line of the Balance Sheet. The status of funds for the supplemental appropriation is illustrated in *Chart 1.4, Status of the Supplemental Fund*.



The Commission adjusts the rates (dollars per million dollars transacted) for Section 31 transaction fees periodically in accordance with the Investor and Capital Markets Fee Relief Act of 2002. As shown in *Chart 1.5, Section 31 Exchange Fee Rate*, the first half of FY 2009, the Section 31 Fee rate was \$5.60. It was subsequently increased to \$25.70 for the second half of FY 2009 through the first quarter of FY 2010. The rate was then reduced to \$12.70 on January 15, 2010, and then increased to \$16.90 on April 1, 2010.

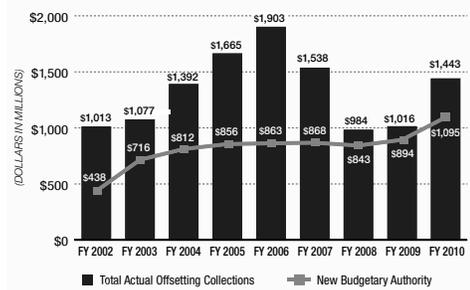


The overall securities transactions volume subject to Section 31 Fees was nearly unchanged between FY 2009 and FY 2010. However, the monthly volume fluctuations applied to the varying fee rates produced average weighted fee rates of \$14.34 and \$18.33 for FY 2009 and FY 2010, respectively. As a result, there was approximately a 26 percent increase in Section 31 Fee revenues.

Chart 1.6, *Offsetting Collections vs. New Budgetary Authority*¹, presents the budget authority and offsetting collections related to transactions fees and filing fees from FYs 2002 through 2010. The sum of the offsetting collections targets for Section 31 Fees and filing fees in FY 2010 was \$1,495 million. The actual offsetting collections for FY 2010 was \$1,443 million.

In FY 2010, there was a \$273 million decrease to the accounts receivable balance. The decrease was primarily due to a \$155 million increase in the Allowance for Loss on Accounts Receivable for disgorgement and penalties. Secondly, receivables for Section 31 Fees declined by \$60 million, comprised of \$48 million due to fee rate changes, and \$12 million due to adjustments from prior year fees owed in FY 2009 that were paid in FY 2010. Finally, there was a \$58 million decrease in gross disgorgement and penalties receivables.

CHART 1.6
OFFSETTING COLLECTIONS VS. NEW BUDGETARY AUTHORITY
SECTION 31 FEES AND FILING FEES

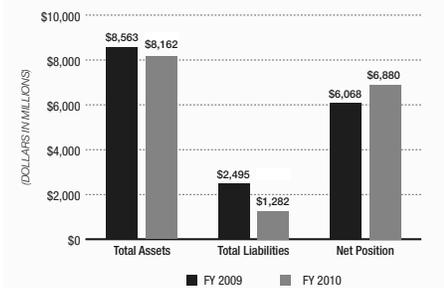


As of September 30, 2010, Total Assets decreased by \$401 million compared to the September 30, 2009 balance, as illustrated in *Chart 1.7, Assets, Liabilities, and Net Position*. This decrease is primarily due to a \$1,035 million decline in Investments, stemming from the SEC's continued efforts to accelerate distributions to harmed investors. This decline was offset by a \$906 million increase in Fund Balance with Treasury (FBWT), due largely to \$452 million in funding for the new Investor Protection Fund authorized by Dodd-Frank and an increase of \$348 million in filing fees and Section 31 fees.

The decrease of \$1,213 million in Total Liabilities is mostly due to distributions to harmed investors and a lower accounts receivable balance.

The SEC does not record on its financial statements any asset amounts that another government entity such as a court, or a non-governmental entity, such as a receiver, has collected or will collect and will subsequently disburse.

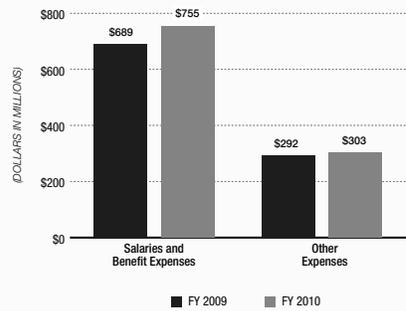
CHART 1.7
ASSETS, LIABILITIES, AND NET POSITION



¹ The above chart only reflects offsetting collections related to fees collected on Section 31 securities transactions and Section 6(b), 13(e), 14(g), and 24f-2 filings and does not include reimbursable type collections and refunds as reported on the "Offsetting Collections" line of the Statement of Budgetary Resources.

The "Total Program Costs" line on the Statement of Net Cost and the "Gross Outlays" line on the Statement of Budgetary Resources increased primarily as a result of increases in salaries and benefits. In FY 2010, the SEC incurred costs resulting from an increase in staffing levels and cost of living adjustments. The increase in the SEC's salary and benefits related costs is evidenced in *Chart 1.8, Expense Comparison*.

**CHART 1.8
EXPENSE COMPARISON**



Limitations of the Financial Statements

The principal financial statements included in this report have been prepared by SEC Management to report the financial position and results of operations of the SEC, pursuant to the requirements of 31 U.S. Code Section 3515(b). While the statements have been prepared from the books and records of the SEC in accordance with GAAP for federal entities and the

formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the understanding that they are for a component of the U.S. Government, a sovereign entity.

Performance Highlights

This section provides key performance information for FY 2010. It outlines the SEC’s strategic and performance planning framework and progress toward reaching planned performance targets. Additionally, this section includes a list of performance indicators that provide useful information for understanding the agency’s activities.

Strategic and Performance Planning Framework

The FY 2010 strategic and performance planning framework is based on the SEC’s new strategic plan covering FY 2010 – FY 2015, available at www.sec.gov/about/secstratplan1015f.pdf. This updated plan addresses the agency’s mission, vision, values, and revised strategic goals. The plan further details the outcomes the agency is seeking to achieve, the strategies and initiatives that will be undertaken to accomplish those outcomes, and the performance measures that will be used to gauge the agency’s progress.

The SEC’s goals and priorities in the Strategic Plan are influenced by a number of external environmental factors, including the demands of fulfilling the agency mission in complex and

global financial markets and changes in legislation affecting the agency. During the past two years, this environment has changed dramatically. While the Strategic Plan attempts to anticipate various ways in which markets, regulated industries, and legislative underpinnings may transform over time, no plan can anticipate all possible scenarios. Because the accompanying performance measures were significantly revised in the FY 2010 – FY 2015 strategic plan, there is limited prior year performance information provided in this report.

The SEC’s work is structured around four strategic goals and 12 outcomes that gauge the SEC’s performance within each strategic goal.

TABLE 1.2

Strategic Goals with Resources Invested	Outcomes
Foster and enforce compliance with the federal securities laws Cost: \$641.7 million	The SEC fosters compliance with the federal securities laws.
	The SEC promptly detects violations of the federal securities laws.
	The SEC prosecutes violations of federal securities laws and holds violators accountable.
Establish an effective regulatory environment Cost: \$106.1 million	The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and prevents abusive practices by registrants, financial intermediaries, and other market participants.
	The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.
	The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.
Facilitate access to the information investors need to make informed investment decisions Cost: \$183.1 million	Investors have access to high-quality disclosure materials that are useful to investment decision making.
	Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.
Enhance the Commission’s performance through effective alignment and management of human, information, and financial capital Cost: \$127.5 million	The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.
	The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.
	Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment. Resource decisions and operations reflect sound financial and risk management principles.

Performance Measures Overview

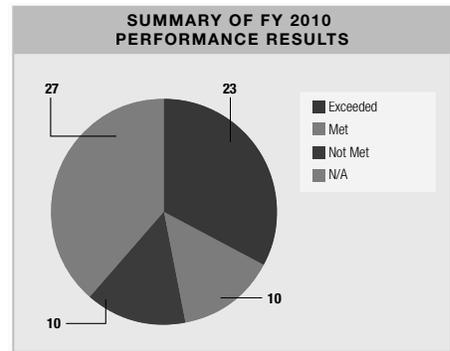
To assess the SEC's performance results against the Strategic Plan's established targets, a results rating methodology is used to assign one of the following three performance ratings for a given result:

Below Target	On Target	Above Target
Not Met	Met	Exceeded

The new strategic plan identified 51 performance measures. Several of these performance measures track multiple performance targets, and *Chart 1.9, Summary of FY 2010 Performance Results* shows the performance results for each of the 70 performance targets. Twenty-seven of these targets have not yet been established or FY 2010 data is not available (categorized as not applicable (N/A)). As the agency refines its processes for collecting the information, targets will be established and data will be reported.

Performance indicators, outlined in *Table 1.4, Performance Indicators Results Summary*, do not include planned targets because it would be inappropriate for the agency to conduct certain activities with an eye towards meeting predetermined targets. Therefore, results for performance indicators are not included in *Chart 1.9, Summary of FY 2010 Performance Results*.

CHART 1.9



Performance Results Summary

The SEC has established various performance measures for assessing program performance against strategic goals and planned outcomes. For each performance measure, one or more performance targets have been established. *Table 1.3, Performance Measures Results Summary* provides a summary of actual performance results during FY 2009 and FY 2010 for each performance measure, and *Table 1.4, Performance Indicators Results Summary* provides a summary of indicators by outcome within each strategic goal. A detailed discussion of the agency's program achievements and performance results is located in the *Performance Section*.

TABLE 1.3

PERFORMANCE MEASURES RESULTS SUMMARY				
GOAL 1: Foster and Enforce Compliance with the Federal Securities Laws				
OUTCOME 1.1: The SEC fosters compliance with the federal securities laws.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 1: Number of new investor education materials designed specifically to help investors protect themselves from fraud	N/A	N/A	16	N/A
MEASURE 2: Number of industry outreach and education programs targeted to areas identified as raising particular compliance risks	N/A	N/A	6	N/A
MEASURE 3: Percentage of firms receiving deficiency letters that take corrective action in response to all exam findings	94%	95%	90%	Not Met
MEASURE 4: Percentage of attendees at CCO outreach that rated the program as "Useful" or "Extremely Useful" in their compliance efforts	84%	92%	77%	Not Met
OUTCOME 1.2: The SEC promptly detects violations of the federal securities laws.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 5: Percentage of cause and special exams (sweeps) conducted as a result of risk assessment process that includes multi-divisional input	N/A	N/A	N/A	N/A
MEASURE 6: Percentage of advisers deemed "high risk" examined during the year	22%	33%	N/A	N/A
MEASURE 7: Percentage of registrant population examined during the year:				
Investment advisers	10%	9%	9%	Met
Investment companies	29%	15%	10%	Not Met
Broker-dealers (exams by SEC and SROs)	54%	55%	44%	Not Met
MEASURE 8: Percentage of non-sweep and non-cause exams that are concluded within 120 days	65%	75%	48%	Not Met
OUTCOME 1.3: The SEC prosecutes violation of federal securities laws and holds violators accountable.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 9: Percentage of enforcement actions successfully resolved	92%	90%	92%	Exceeded
MEASURE 10: Percentage of first enforcement actions filed within two years	70%	65%	67%	Exceeded
MEASURE 11: Percentage of debts where either a payment has been made or a collection activity has been initiated within six months of the due date of the debt	90%	92%	86%	Not Met
MEASURE 12: Percentage of Fair Fund and disgorgement fund plans that distributed the final tranche of funds to injured investors within 24 months of the order appointing the fund administrator	N/A	N/A	N/A	N/A
MEASURE 13: Percentage of Fair Fund and disgorgement fund plans approved by final order within the prior fiscal year which had a first tranche of funds distributed under those plans within 12 months of such approval date	N/A	60%	N/A	N/A

N/A – Signifies data does not currently exist or targets were not established

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MANAGEMENT'S DISCUSSION AND ANALYSIS

TABLE 1.3 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 2: Establish an Effective Regulatory Environment				
OUTCOME 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting, and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 1: Survey on quality of disclosure	N/A	N/A	N/A	N/A
MEASURE 2: Number of consultations; joint events, reports, or initiatives; and joint examinations and other mutual supervisory efforts with SROs and other federal, state, and non-U.S. regulators	N/A	N/A	N/A	N/A
MEASURE 3: Number of non-U.S. regulators trained	N/A	1,905	1,997	Exceeded
OUTCOME 2.2: The U.S. capital markets operate in a fair, efficient, transparent, and competitive manner, fostering capital formation and useful innovation.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 4: Percentage of transaction dollars settled on time each year	99%	99%	99%	Met
MEASURE 5: Average institutional transaction costs for exchange listed stocks on a monthly basis	N/A	N/A	N/A	N/A
MEASURE 6: Percentage of market outages at SROs and electronic communications networks (ECNs) that are corrected within targeted timeframes:				
Within 2 hours	87%	60%	74%	Exceeded
Within 4 hours	98%	75%	85%	Exceeded
Within 24 hours	98%	96%	100%	Exceeded
OUTCOME 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 7: Length of time to respond to written requests for no-action letters, exemptive applications, and written interpretive requests				
Trading and Markets – No-action letters, exemptive applications, and written interpretive requests (combined figure)	70%	85%	91%	Exceeded
Investment Management – No-action letters and interpretive requests	100%	75%	100%	Exceeded
Investment Management – Exemptive applications	95%	80%	100%	Exceeded
Corporation Finance – No-action letters and interpretive requests	85%	90%	97%	Exceeded
Corporation Finance – Shareholder proposals	100%	100%	100%	Met
MEASURE 8: Survey on whether SEC rules and regulations are clearly understandable	N/A	N/A	N/A	N/A
MEASURE 9: Time to complete SEC review of SRO rules that are subject to SEC approval				
Within 35 days	N/A	40%	73%	Exceeded
Within 45 days	N/A	80%	99%	Exceeded

N/A – Signifies data does not currently exist or targets were not established

(Continued on next page)

TABLE 1.3 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 3: Facilitate Access to the Information Investors Need to Make Informed Investment Decisions				
OUTCOME 3.1: Investors have access to high-quality disclosure materials that are useful to investment decision making.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 1: Percentage of public companies and investment companies with disclosures reviewed each year				
Corporations	40%	34%	44%	Exceeded
Investment company portfolios	35%	33%	35%	Exceeded
MEASURE 2: Time to issue initial comments on Securities Act filings	25.3 days	<30 days	24.1 days	Met
MEASURE 3: Percentage of investment company disclosure reviews for which initial comments are completed within timeliness goals				
Initial registration statements	95%	85%	93%	Exceeded
Post-effective amendments	97%	90%	94%	Exceeded
Preliminary proxy statements	99%	99%	99%	Met
MEASURE 4: Point of sale "click-through rate"	N/A	N/A	N/A	N/A
MEASURE 5: Access to broker-dealer and investment adviser background checks				
BrokerCheck System	N/A	N/A	N/A	N/A
IAPD System	N/A	N/A	N/A	N/A
MEASURE 6: Investor demand for disclosures on municipal securities	N/A	N/A	N/A	N/A
MEASURE 7: Satisfaction index for disclosure process	N/A	N/A	N/A	N/A
OUTCOME 3.2: Agency rulemaking and investor education programs are informed by an understanding of the wide range of investor needs.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 8: Number of investors reached, and number of in-person events with specifically targeted communities and organizations				
Number of investors reached (in millions)	N/A	17.3	17.8	Exceeded
Number of in-person events	N/A	25	42	Exceeded
MEASURE 9: Number of investor educational initiatives organized and produced	N/A	8	9	Exceeded
MEASURE 10: Timeliness of responses to investor contacts				
Closed within 7 days	70%	80%	72%	Not Met
Closed within 30 days	90%	90%	93%	Exceeded
MEASURE 11: Percentage of rules impacting investors that are presented in alternate user-friendly formats	N/A	100%	100%	Met
MEASURE 12: Customer satisfaction with usefulness of investor educational programs and materials	N/A	N/A	N/A	N/A

N/A – Signifies data does not currently exist or targets were not established

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TABLE 1.3 Continued from previous page

PERFORMANCE MEASURES RESULTS SUMMARY (continued)				
GOAL 4: Enhance the Commission's Performance Through Effective Alignment and Management of Human, Information, and Financial Capital				
OUTCOME 4.1: The SEC maintains a work environment that attracts, engages, and retains a technically proficient and diverse workforce that can excel and meet the dynamic challenges of market oversight.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 1: Survey of employee engagement	N/A	65%	58%	Not Met
MEASURE 2: Best Places to Work ranking	Ranked #11	Ranked #5	Ranked #24	Not Met
MEASURE 3: Turnover	3.70%	<8%	5%	Met
MEASURE 4: Expanding staff expertise	N/A	N/A	N/A	N/A
MEASURE 5: Size of competency gaps	N/A	10%	N/A	N/A
MEASURE 6: Number of diversity-related partnerships/alliances	N/A	1	2	Exceeded
MEASURE 7: Survey feedback on the quality of the SEC's performance management program	N/A	65%	N/A	N/A
OUTCOME 4.2: The SEC retains a diverse team of world-class leaders who provide motivation and strategic direction to the SEC workforce.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 8: Quality of hire	N/A	75%	N/A	N/A
MEASURE 9: Leadership competency gaps	N/A	10%	N/A	N/A
MEASURE 10: Satisfaction with Leadership Development Program (5-point scale)	N/A	4	4.46	Exceeded
OUTCOME 4.3: Information within and available to the SEC becomes a Commission-wide shared resource, appropriately protected, that enables a collaborative and knowledge-based working environment.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 11: Percentage of SEC data sources accessible through a virtual data warehouse, and milestones achieved towards the creation of a robust information management program	N/A	N/A	N/A	N/A
MEASURE 12: Deployment of document management and workflow tools	N/A	Enforcement and Examinations	Enforcement and Examinations	Met
MEASURE 13: Time to process evidentiary material for enforcement investigations	N/A	N/A	N/A	N/A
MEASURE 14: System availability				
Systems availability	N/A	99%	99.97%	Exceeded
Percentage fail over within 4 hours	N/A	100%	N/A	N/A
Systems virtualized	N/A	N/A	22%	N/A
OUTCOME 4.4: Resource decisions and operations reflect sound financial and risk management principles.	FY 2009 Actual	FY 2010 Target	FY 2010 Actual	FY 2010 Results
MEASURE 15: Milestones achieved towards establishment of a robust data management program	N/A	Administrative data and reporting requirements identified	N/A	N/A
MEASURE 16: Financial Systems Integration	N/A	17%	N/A	N/A
MEASURE 17: Financial Audit Results				
Unqualified opinion	Yes	Yes	Yes	Met
Material weaknesses	1	0	2	Not Met
Significant deficiency	6	0	0	Met

N/A – Signifies data does not currently exist or targets were not established

TABLE 1.4

PERFORMANCE INDICATORS RESULTS SUMMARY		
GOAL 1: Foster and Enforce Compliance with the Federal Securities Laws		
OUTCOME 1.1: The SEC fosters compliance with the federal securities laws.	FY 2009 Actual	FY 2010 Actual
INDICATOR 1: Percentage of actions identified as "high impact" which have resulted in significant corrective industry reaction	N/A	100%
INDICATOR 2: Annual increases or decreases in the number of CCOs attending CCO outreach programs	N/A	N/A
OUTCOME 1.2: The SEC promptly detects violations of the federal securities laws.	FY 2009 Actual	FY 2010 Actual
INDICATOR 3: Percentage of exams that identify deficiencies, and the percentage that result in a "significant finding"		
Percentage identify deficiencies	N/A	72%
Percentage that result in a "significant finding"	N/A	42%
INDICATOR 4: Number of investigations or cause exams from tips:		
Number of investigations	N/A	303
Number of cause exams	N/A	N/A
OUTCOME 1.3: The SEC prosecutes violations of federal securities laws and holds violators accountable.	FY 2009 Actual	FY 2010 Actual
INDICATOR 5: SEC investigations referred to SROs or other state, federal, and foreign authorities for enforcement	N/A	492
INDICATOR 6: Percent of all enforcement investigations deemed "high impact"	N/A	3.26%
INDICATOR 7: Percent of investigations that come from internally-generated referrals or prospects	N/A	21.9%
INDICATOR 8: Criminal investigations relating to SEC investigations	N/A	139
INDICATOR 9: Disbursement and penalties ordered and the amounts collected by the SEC:		
Ordered amounts (in millions)	\$2,442	\$2,846
Collected amounts (in millions)	\$1,683	\$1,724
INDICATOR 10: Requests from foreign authorities for SEC assistance and SEC requests for assistance from foreign authorities		
Number of requests from foreign authorities	408	457
Number of SEC requests	774	605
GOAL 2: Establish an Effective Regulatory Environment		
OUTCOME 2.1: The SEC establishes and maintains a regulatory environment that promotes high-quality disclosure, financial reporting and governance, and that prevents abusive practices by registrants, financial intermediaries, and other market participants.	FY 2009 Actual	FY 2010 Actual
INDICATOR 1: Average cost of capital in U.S. relative to the rest of the world	N/A	10.99%
OUTCOME 2.2: The U.S. capital markets operate in a fair, efficient, transparent and competitive manner, fostering capital formation and useful innovation.	FY 2009 Actual	FY 2010 Actual
INDICATOR 2: Average quoted spread for exchange listed stocks on a monthly basis (in cents)	N/A	2.52
INDICATOR 3: Average effective spread for exchange listed stocks on a monthly basis (in cents)	N/A	2.65
INDICATOR 4: Speed of execution (in seconds)	N/A	1.77
INDICATOR 5: Average quoted size of exchange listed stocks on a monthly basis	N/A	N/A
INDICATOR 6: Average daily volatility of exchange listed stocks on a monthly basis	N/A	1.18%
OUTCOME 2.3: The SEC adopts and administers rules and regulations that enable market participants to understand clearly their obligations under the securities laws.	FY 2009 Actual	FY 2010 Actual
INDICATOR 7: Percentage of SRO rule filings that are submitted for immediate effectiveness	N/A	69%

N/A – Signifies data does not currently exist for existing or newly added measures

Management Assurances

The SEC is firmly committed to building and maintaining strong internal controls. Internal control is an integral component of effective agency management, providing reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with laws and regulations. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires agencies to annually assess and report on internal controls that protect the integrity of federal programs and on the conformance of financial management systems with certain requirements.

Guidance for implementing the FMFIA is provided through OMB Circular No. A-123. In addition to requiring agencies to provide an assurance statement on the effectiveness of programmatic internal controls and financial system conformance, the Circular requires agencies to provide an assurance statement on the effectiveness of internal control over financial reporting.

In addition, Section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203), signed into law on July 21, 2010, describes the responsibility of SEC management to establish and maintain adequate internal controls and procedures for financial reporting. Dodd-Frank requires an annual financial controls audit, an assessment of the effectiveness of internal control, and an attestation by the Chairman and Chief Financial Officer.

The following Assurance Statement is issued in accordance with the FMFIA, OMB Circular No. A-123 and Section 963 of Dodd-Frank.

Annual Assurance Statement

Assurance Statement Under FMFIA: The management of the SEC is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act of 1982. In accordance with OMB Circular No. A-123, the SEC conducted its annual assessment of the effectiveness of internal control. The results of this assessment identified two material weaknesses: one in information systems and a second in the agency's financial reporting and accounting processes; this latter material weakness is the combination of five deficiencies in financial reporting, budgetary resources, filing fees, disgorgement and penalty transactions, and required supplementary information. Because of these material weaknesses, the SEC is able to provide a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA. Details to support this qualified statement of assurance appear in the section titled *Material Weaknesses in Internal Control*.

Assurance Statement On Internal Controls Over Financial Reporting: In accordance with Appendix A of OMB Circular No. A-123, the SEC conducted an assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations. Based on the results of this assessment, the SEC identified two material weaknesses: one in information systems and a second in the agency's financial reporting and accounting processes; this latter material weakness is the combination of five deficiencies in financial reporting, budgetary resources, filing fees, disgorgement and penalty transactions, and required supplementary information. Because of these material weaknesses, SEC management concludes that the agency's internal controls over financial reporting were not effective as of September 30, 2010.



Mary Schapiro
Chairman
November 15, 2010



Kenneth A. Johnson
Chief Financial Officer
November 15, 2010

Management's Responsibility for Internal Control

The Federal Managers' Financial Integrity Act requires that the head of the agency, based on the agency's internal evaluation, provide an annual Statement of Assurance on whether the agency has met the requirements of FMFIA. OMB Circular No. A-123, *Management's Responsibility for Internal Control*, implements the FMFIA and defines management's responsibility for internal control in federal agencies.

Section 2 of the FMFIA requires agencies to establish internal control and financial systems that provide reasonable assurance that the following objectives are achieved:

- Effective and efficient operations,
- Compliance with applicable laws and regulations, and
- Reliability of financial reporting.

Section 4 of the FMFIA requires that agencies annually evaluate and report on whether financial management systems conform to government-wide requirements. The SEC evaluated its financial management systems for the fiscal year ending September 30, 2010, in accordance with the Federal Financial Management Improvement Act of 1996 (FFMIA) and OMB Circular No. A-127, *Financial Management Systems*, as applicable.

Appendix A of OMB Circular No. A-123 requires the agency head to provide a separate assurance statement on the effectiveness of internal control over financial reporting (ICFR), in addition to the overall FMFIA assurance statement. The 2010 Annual Assurance Statement for FMFIA and ICFR is provided on the preceding page. This report also provides a Summary of Financial Statement Audits and Management Assurances under the section entitled *Other Accompanying Information*, as required by OMB Circular No. A-136, *Financial Reporting Requirements*.

As part of the overall FMFIA assurance process, SEC management assessed internal control at the entity level, as well as at the process, transaction, and application level. To assess the effectiveness of entity-level control, SEC management used the Government Accountability Office's (GAO) document titled *Internal Control Management and Evaluation Tool* (GAO-01-1008G) to define entity-level control objectives. Then, SEC management identified control activities performed by staff across the SEC that address the control objectives. Information on these entity-level control activities was gathered through meetings with relevant points of contact and feedback in the form of survey responses from SEC supervisors.

The effectiveness of process-level controls was assessed through detailed test procedures related to the agency's financial reporting objectives. As part of this effort, the agency performed a comprehensive risk assessment in which SEC management identified:

- Significant financial reports and materiality;
- Significant line items, accounts, disclosures, and laws and regulations;
- Major classes of transactions;
- Relevant assertions, risks of material misstatement and control objectives;
- Reporting and regulatory requirements; and
- Existing deficiencies and corrective action plans.

From the results of the risk assessment, SEC management documented business processes and control activities designed to mitigate significant financial reporting and compliance risks. These control activities were tested for design and operating effectiveness. The test results served as a basis for management's assessment of the effectiveness of internal control over financial reporting.

In addition, each division director and office head provided an assurance statement identifying any management challenges. These statements were based on information gathered from various sources including, among other things:

- Internal management reviews, self-assessments, and tests of internal controls as described above;
- Management's personal knowledge gained from daily operations;
- Reports from the GAO and the SEC's Office of Inspector General (OIG);
- Reviews of financial management systems under OMB Circular No. A-127, *Financial Management Systems*;
- Annual performance plans and reports pursuant to the Federal Information Security Management Act (FISMA) and OMB Circular No. A-130, *Management of Federal Information Resources*;
- Annual reviews and reports pursuant to the Improper Payments Information Act;

MANAGEMENT'S DISCUSSION AND ANALYSIS

- Reports and other information from Congress or agencies such as OMB, the Office of Personnel Management (OPM), or the General Services Administration (GSA) reflecting the adequacy of internal controls; and
- Additional reviews relating to a division or office's operations, including those discussed in the *Other Reviews* section below.

Each year, the agency's Financial Management Oversight Committee (FMOC) evaluates the assurance statements from directors and office heads, recommendations from OIG, and other supplemental sources of information. Based on this review, the FMOC advises the Chairman as to whether the SEC had any deficiencies in internal control or financial system design significant enough to be reported as a material weakness or non-conformance.

Other Reviews

GAO audited the SEC's financial statements. The objective of GAO's audit was to express an opinion on the financial statements and on internal control over financial reporting and to report on tests of compliance with selected laws and regulations.

The OIG conducted 13 audits and reviews during the fiscal year. The reviews covered 14 of the 33 assessable units (42 percent). Some components had multiple reviews.

Material Weaknesses in Internal Control

Information Systems. For FY 2009, the SEC reported information security as one of six significant deficiencies which collectively represented a material weakness in internal control. Although the SEC undertook corrective actions in FY 2010, the SEC continues to have pervasive information technology and security control deficiencies which span across its general support system and all key applications. New security control deficiencies identified during the SEC FY 2010 assessment include an inconsistent patch management program, informal processes to ensure secure baseline system configurations, gaps in user access controls, and untimely remediation of self-identified information security control deficiencies. Because of these deficiencies, the SEC cannot rely upon automated controls across its financial applications. These security deficiencies are heightened because some of the agency's financial reporting processes

are reliant on databases and spreadsheets, which are inherently less secure.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the SEC's financial statements will not be prevented, or detected and corrected on a timely basis. Information systems are integral to the financial reporting process. Therefore, the SEC has determined that the conditions noted above related to information systems meet the definition of a material weakness since a reasonable possibility exists that a material misstatement would not be prevented, or detected and corrected on a timely basis.

Financial Reporting and Accounting Processes. The SEC's second material weakness stems from the agency's reliance on manual processes for financial reporting and accounting, many of which are necessary because of gaps in the agency's core financial system. In several areas, these manual processes are not operating effectively, because they are prone to error and because the agency's monitoring does not always detect the errors. This material weakness relates to the combination of five deficiencies in the areas of financial reporting, budgetary resources, filing fees, disgorgement and penalty transactions, and required supplementary information.

Financial Reporting. This deficiency is similar in nature to the findings from the FY 2009 financial audit. In FY 2010, the SEC launched efforts to enhance its tracking of investments and formalized processes for evaluating prior period adjustments and capturing contingent liabilities. However, the agency has continuing gaps in the functionality of its core financial system, and therefore many of the agency's financial reporting processes still are manual in nature and reliant on spreadsheets and databases to both initiate transactions and perform key control functions. The FY 2010 assessments of internal controls over financial reporting continued to find errors in the agency's financial reporting processes, including in reviews of calculations and reconciliations; in the preparation, review and approval of journal voucher adjustments; and in draft financial statement notes. The SEC also identified the need for additional external validation points within its spreadsheets and databases to ensure that manual compensating controls are operating effectively.

Budgetary Resources. This area was found to be a significant deficiency in FY 2009, and in response the SEC corrected posting models and developed new policies and procedures related to posting obligations, creating miscellaneous obligating documents, and processing miscellaneous deobligations. However, the agency's FY 2010 assessment of internal controls over financial reporting found continuing problems, specifically in the design and operation of controls to:

- Record obligations and adjustments to obligations accurately and on a timely basis, upon contract execution;
- Ensure completeness of recorded obligations between the core financial reporting and sub-ledger systems;
- Certify funds availability prior to the period of performance;
- Ensure that open obligations identified by the divisions and offices as no longer needed are timely de-obligated by the contracting officer per the close-out procedures contained in Federal Acquisition Regulation.

The conditions described above increase the likelihood that obligation and adjustment transactions and balances could be misstated and not detected by SEC management in a timely manner.

Registrant Deposits and Filing Fees. In FY 2009, the SEC reported a significant deficiency over registrant deposits and filing fees, because the SEC was not ensuring that revenues were recorded on a timely basis and because the agency had a backlog of inactive accounts for which the balances should be returned to registrants in accordance with SEC regulations. In FY 2010, the SEC hired an outside vendor to assist with the process of returning these funds, and the agency is currently in the process of adding staff positions dedicated to the review of current filings and dormant registrant deposit accounts. However, as of September 30, 2010, the agency did not yet have sufficient control activities in place to routinely review, research, and monitor registrant deposit account activity to determine if amounts should be refunded or recognized as revenue.

Disgorgement and Penalty Transactions. The SEC collects disgorgement and penalty amounts from violators of securities law for subsequent distribution to harmed investors. As part of the FY 2010 audit, the agency was found to have insufficient control procedures to ensure that receivables and payments related to disgorgements and penalties are recorded in the proper accounting period. For example, the agency's external auditor noted that checks received on September 30 were not recorded in the general ledger until the following day and therefore were not recognized in FY 2010 for year-end reporting. The SEC failed to record on a timely basis disgorgement receivables that were initially payable to a court but then were changed to be payable to the Treasury General Fund through a subsequent court order. Although all funds identified for transfer to the Treasury General Fund were properly and accurately transferred as of September 30, 2010, some amounts collected on behalf of the U.S. Treasury during the fiscal year were not transferred in a timely manner.

Required Supplementary Information. OMB Circular No. A-136 requires that agencies produce required supplementary information (RSI) in their financial statements, to disaggregate budgetary information for each major budget account. The agency's external auditors found that the SEC had not included RSI, particularly with respect to the new Investor Protection Fund, in its draft financial statements. The SEC must ensure that its processes for preparing financial statements and notes properly reflect the requirements of OMB guidance.

Corrective Action Plans

The core of the SEC's strategy for remediating these material weaknesses is to launch a major new initiative to replace the agency's core financial system, by migrating to a federal government Shared Service Provider (SSP). This effort will help address the agency's material weakness in information systems reported for FY 2010 by moving the agency's financial and secondary mixed financial systems into a strong, proven security environment. In addition, through this initiative, the SEC will aim to eliminate many of its manual processes that rely on Microsoft Access databases and spreadsheets and consolidate them within the new SSP environment. The SEC has issued a Letter of Intent with the Enterprise Ser-

MANAGEMENT'S DISCUSSION AND ANALYSIS

vices Center (ESC) at the Department of Transportation to develop detailed requirements for the system, and is planning to migrate to the new environment in FY 2012. The agency also has strengthened its management team by hiring a new Chief Operating Officer, Chief Information Officer, and Chief Financial Officer, as well as seeking to appoint a new Chief Accounting Officer.

While the SSP initiative is in progress, during FY 2011, the SEC will continue to implement improvements in its information security environment. For example, the agency will improve its monitoring capability over system configuration changes, so that all changes to system requirements, design, and scripts are evaluated by a Configuration Control Board on the basis of cost, benefits, and risk to the agency. Future system upgrades will be documented to show both the impact on security and evidence of approval by the Board. The agency also will work to certify the technical team managing the core financial application as Capability Maturity Model Integration (CMMI) Level 3, to ensure that the system is managed to strict configuration management standards. During the first quarter of FY 2011, the Office of Information Technology (OIT) will update patches all across the agency's financial systems and workstations and will enable Secure Sockets Layer (SSL) communication protocol to ensure sensitive EDGAR data is transmitted using a secure, approved communications method. OIT also will work to resolve outstanding security weaknesses in its systems identified by management through its certifications and accreditations.

Major improvements in the SEC's financial reporting processes will be affected through the SSP initiative described above. During FY 2011 before the agency migrates to the SSP environment, the SEC will reduce the number of manual processes by tracking investments at the detail level within the financial system and building an automated interface with the Bureau of Public Debt for handling investments. In addition, the agency will seek in the short term to bolster the databases and spreadsheets still in use, for example by incorporating the use of independent, external data sources wherever possible as validation tools.

The agency's controls over budgetary resources will be significantly enhanced through integration of procurement and financial systems, which the agency aims to achieve as part of the migration to a federal Shared Services Provider. In addition, in FY 2011 the SEC will continue to refine its business

processes in this area, including by further enhancing the processes by which the agency records miscellaneous obligating documents and deobligates unliquidated amounts from prior year contracts.

In FY 2011, the SEC will continue its efforts to resolve the backlog of filing fees in need of verification and inactive deposit accounts that must be returned to registrants. In addition, the agency will work to re-engineer this business process and plan for a new automated solution to replace Fee Momentum. With continued remediation efforts, the SEC intends to ensure that registrant filings and deposits are matched on a timely basis, record revenues in the period earned, and eliminate the backlog of dormant registrant deposit accounts.

Effective October 2010, the SEC modernized the cash receipt process by electronically scanning checks upon receipt. The scanned checks are recorded in the general ledger through an automated interface. The SEC will establish a process for recording deposits in transit to ensure all checks received are recognized in the proper accounting period. In addition, the SEC is working to enhance processes for timely recognition of disgorgement and penalty receivables deemed payable to the Treasury General Fund. In FY 2011, the SEC will make any adjustments necessary to ensure these enhanced processes and controls are operating effectively.

The SEC's draft financial reporting results did not include required supplementary information, however, SEC ultimately prepared the required supplementary information for the September 30, 2010 financial reporting. In addition, the SEC will focus on performing a detailed review of OMB Circular No. A-136 and other relevant guidance to ensure that such requirements are properly reflected in the agency's financial statements.

Status of Prior Year Internal Control over Financial Reporting Issues

The SEC's FY 2009 financial audit identified a material weakness in internal controls over financial reporting, that resulted from the combination of six significant deficiencies:

- Information Security,
- Financial Reporting,
- Budgetary Resources,

- Registrant Deposits,
- Risk Assessment and Monitoring, and
- Fund Balance with Treasury.

The first area, information security was reassessed as a material weakness in information systems for FY 2010. Prior year significant deficiencies related to financial reporting, budgetary resources, and registrant deposits remain and, combined with deficiencies related to disgorgement and penalty transactions and required supplementary information, together remain a material weakness. The agency initiated efforts to address last year's audit findings, and successfully remediated two of the six significant deficiencies disclosed in the FY 2009 PAR, related to risk assessment and monitoring and the SEC's FBWT. The agency's efforts to remediate these two areas is described further below.

Risk Assessment and Monitoring Process

As mentioned above, the SEC's external auditor cited deficiencies in internal control monitoring as a contributing factor to the agency's second material weakness related to financial reporting and accounting processes. However, the SEC's efforts to improve its risk assessment process during FY 2010 resulted in the remediation of this significant deficiency. The SEC, with the assistance of contractor support, implemented a top-down, risk-based approach for FY 2010 and thereafter to:

- Identify all key elements of the SEC's financial reporting control environment and evaluate all significant financial reporting and compliance risks, including those related to its information systems and external service providers;
- Document internal controls designed to mitigate financial reporting risks, including client control considerations identified in service organization SAS 70 reports;
- Document the evaluation of design effectiveness of key internal controls and monitor the effectiveness of internal controls throughout the year;
- Perform test work to assess the operational effectiveness of internal controls;
- Develop corrective action plans for internal controls not properly designed or operating effectively;

- Assess the magnitude of internal control deficiencies and determined impact on the Statement of Assurance under FMFIA

OFM will continue to perform a robust internal control assessment in FY 2011, and plans to implement improvements that will help to effectively manage, track, monitor, and test key risks and controls over financial reporting throughout the year.

Fund Balance with Treasury

In FY 2010, the SEC successfully resolved its previous significant deficiency over the reconciliations of its FBWT. Whereas previously this monthly reconciliation was an ancillary duty for OFM staff, the SEC created a new Treasury Operations Branch within the Office of Financial Management with personnel dedicated to this function. SEC staff re-engineered the reconciliation processes to be fully compliant with the Treasury Financial Manual, developed new standard operating procedures, and automated the reconciliations to reduce input errors and streamline the effort. The agency also fully resolved the backlog of differences with Treasury records and is now compliant with the policy to resolve variances within 60 days.

Financial Management System Conformance

The FFMA requires that each agency shall implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. The purpose of the FFMA is to advance federal financial management by ensuring that financial management systems provide accurate, reliable, and timely financial management information. Although the SEC is exempt from the requirement to determine substantial compliance with FFMA, the agency assesses its financial management systems annually for conformance with the requirements of OMB Circular No. A-127 and other federal financial system requirements.

The SEC's process for assessing its financial management systems is in compliance with the January 9, 2009 revision of OMB Circular No. A-127 and included the use of an FFMA risk model which ranks risks from nominal to significant. Based on the results of the review, the SEC concluded that its risk rating is moderate. After reviewing the criteria in OMB

Circular No. A-127 for agencies with moderate risk, the SEC determined its financial core and mixed systems are not in substantial compliance with Section 803(a) of the FFMA requirements. This decision was based on the presence of material weaknesses in FY 2009 and FY 2010 and of persistent deficiencies in areas related to the SEC financial and secondary mixed systems.

Summary of Current Financial System and Future Strategies

The SEC's primary objective for its financial and secondary mixed systems is to remediate the FY 2010 material weaknesses and other internal control deficiencies identified by management and external auditors. In addition, the agency aims to establish an integrated financial management environment; build a single data model for transaction processing and reporting; standardize business and technology processes, and prevent future internal control problems.

The SEC's current financial management system environment is characterized by an underutilized core financial system; silo applications providing key financial management functionality; external data marts with embedded business logic used for reporting; and processes that rely extensively on human capital for data entry, cleansing, and reconciliation. The SEC's core financial system, Momentum Version 6.1.5, is used to record all accounting transactions, maintain an agency-wide general ledger, produce financial reports, and produce external reports submitted periodically to Treasury and other Federal entities. The core financial system has automated interfaces with mixed systems such as the Budget Planning and Performance Management System for budget formulation and execution; the Central Contractor Registry for SEC vendor information; FedTraveler for travel orders and vouchers; Fee Momentum for the agency's filing fees; and the Department of the Interior's payroll systems. The agency's financial reporting and processes are dependent upon a number of Microsoft Access databases, such as those related to disgorgements and penalties receivables, financial reporting and analysis, payments to harmed investors, investments with the Bureau of Public Debt, and accounts payable accruals.

The centerpiece of the SEC's strategy for achieving its financial system objectives listed above is to migrate to a core financial system offered by a federal Shared Service Provider. As part of this effort, the agency aims to consolidate mixed systems, eliminate manual processes, integrate with programmatic systems where necessary, and adopt standard business and technology practices. Under this initiative, led by the SEC's Office of Financial Management, the agency will work with an OMB-designated federal Shared Services Provider to deploy the new system in FY 2012.

Federal Information Security Management Act (FISMA)

FISMA requires federal agencies to conduct annual assessments of their information technology security and privacy programs, to develop and implement remediation efforts for identified weaknesses and vulnerabilities, and to report compliance to OMB. As of this writing, the SEC's Inspector General (IG), Chief Information Security Officer, and Privacy Officer are performing a joint review of the agency's compliance with FISMA requirements during 2010, and will submit the report to OMB on November 15, 2010, as required.

During the year, OIT, in conjunction with system owners, completed certification and accreditation activities for 18 reportable systems in FY 2010, including recertifying and reaccrediting systems such as the Momentum core financial system. As a result, the SEC has now certified and accredited a total of 63 reportable systems in accordance with guidance from OMB and the National Institute of Standards and Technology. OIT also completed contingency testing on the majority of the SEC's accredited systems as part of several disaster recovery exercises.

In addition, OIT, in conjunction with system owners, has completed Privacy Impact Assessments (PIA) on 14 systems during FY 2010. As a result, the SEC has completed PIAs for 53 of the agency's 61 required systems.

Financial Statements

FINANCIAL SECTION

This section of the Performance and Accountability Report contains the U.S. Securities and Exchange Commission's (SEC) financial statements, required supplementary information, and related Independent Auditor's Report, as well as other information on the agency's financial management. Information presented here satisfies the reporting requirements of Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as well as the Accountability of Tax Dollars Act of 2002.

The first portion of this section contains the principal financial statements. The statements provide a comparison of Fiscal Year (FY) 2010 and FY 2009 information. The SEC prepares the following required financial statements:

- Balance Sheet – presents, as of a specific time, amounts of future economic benefits owned or managed by the reporting entity exclusive of items subject to stewardship reporting (assets), amounts owed by the entity (liabilities), and amounts which comprise the difference (net position).
- Statement of Net Cost – presents the gross cost incurred by the reporting entity less any exchange revenue earned from its activities. The SEC also prepares a Statement of Net Cost by program to provide cost information at the program level.
- Statement of Changes in Net Position – reports the change in net position during the reporting period. Net position is affected by changes to Cumulative Results of Operations.
- Statement of Budgetary Resources – provides information about how budgetary resources were made available as well as their status at the end of the year.
- Statement of Custodial Activity – reports collection of non-exchange revenue for the Treasury General Fund. The SEC, as the collecting entity, does not recognize these collections as revenue. Rather, the agency accounts for sources and disposition of the collections as custodial activities on this statement.

The SEC does not have stewardship over resources or responsibilities for which supplementary stewardship reporting would be required.

The accompanying *Notes to the Financial Statements* provide a description of significant accounting policies as well as detailed information on select statement lines. These notes and the principal financial statements are audited by the U.S. Government Accountability Office (GAO).

Message from the Chief Financial Officer



I am delighted to join Chairman Schapiro in presenting the SEC's Performance and Accountability Report (PAR) for FY 2010. We hope you find the PAR a useful summary of the SEC's use of resources, operating performance, financial stewardship, and internal control.

Because of its mission, the SEC is a staunch believer in the value of strong internal controls. The agency made significant strides in FY 2010 in its multi-year effort to build a strong, sustainable internal control environment and once again sustained an unqualified audit opinion on its FY 2010 financial statements. In FY 2010, the SEC successfully resolved two of the six significant deficiencies identified in the previous year by GAO. For example, the agency significantly enhanced its risk assessment and monitoring program, undertaking its most comprehensive assessment yet of its internal controls over financial reporting, in accordance with OMB guidance. In the second area, related to the agency's Fund Balance with Treasury, the SEC created a new branch within the Office of Financial Management with dedicated staff who reformed and strengthened this key process.

Despite noteworthy progress, for FY 2010 the SEC identified two material weaknesses in internal controls over financial reporting. The first material weakness is in information systems, because of issues related to patch management, configuration management, user access controls, and security management. The second material weakness relates to financial reporting and accounting processes; it is the combination of deficiencies in financial reporting, budgetary resources, filing fees, disgorgement and penalty transactions, and required supplementary information. A core element of this second material weakness relates to gaps in the functionality of our financial system and a reliance on manually intensive processes that are prone to error.

The centerpiece of our remediation strategy is to shift to a new financial system offered by a federal shared service provider (SSP). Through this initiative, the SEC aims to strengthen the security over the SEC's financial data and to consolidate or integrate financial functions within the new system, minimizing manual processes. The SEC has issued a Letter of Intent with the Enterprise Services Center at the Department of Transportation, and the agency will work in the coming months to develop detailed requirements, in preparation to go live with a new system in FY 2012.

The SEC's other planned remediation efforts in FY 2011 include:

- Improving its monitoring capability over system configuration changes, as overseen by a Configuration Control Board;
- Continuing to resolve outstanding security weaknesses in its systems identified by management through its certifications and accreditations;
- Updating security patches across the agency's systems environment;
- Bolstering user access controls related to key financial applications;
- Working to deploy the capability within the agency's current financial system to track investments at the detail level, and building an interface with the Bureau of Public Debt for handling investments;
- Re-examining the business process, organizational structure, and information systems supporting the agency's handling of disgorgements and penalties;
- Strengthening the agency's process governing the recording of obligations and the identification and deobligation of undelivered orders;

- Adding resources to the agency's filing fees function, to reduce backlogs of filings for which the SEC must determine the proper amounts owed;
- Implementing enhancements to the agency's process for recording cash collections and disgorgement and penalty receivables, to ensure they are accounted for in the proper period; and
- Conducting a detailed review of OMB Circular No. A-136 and other requirements to ensure they are properly reflected in agency financial statements.

The SEC is committed to investing the time and resources to fully resolve these material weaknesses. The public has every right to expect strong internal controls from their government, and that goal remains one of the SEC's top priorities in the coming months.

Sincerely,



Kenneth A. Johnson
Chief Financial Officer
November 15, 2010

Financial Statements

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Balance Sheet

As of September 30, 2010 and 2009

(DOLLARS IN THOUSANDS)

	FY 2010	FY 2009
ASSETS (Notes 2 and 13):		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 6,989,367	\$ 6,083,307
Investments, Net (Note 5)	924,823	1,959,611
Accounts Receivable (Note 6)	—	188
Advances and Prepayments	2,198	2,284
Total Intragovernmental	7,916,388	8,045,390
Cash and Other Monetary Assets (Note 4)	2,815	—
Accounts Receivable, Net (Note 6)	161,143	434,033
Advances and Prepayments	2,381	1,273
Property and Equipment, Net (Note 7)	79,712	82,435
Total Assets	\$ 8,162,439	\$ 8,563,131
LIABILITIES (Notes 8 and 13):		
Intragovernmental:		
Accounts Payable	\$ 5,185	\$ 9,080
Employee Benefits	6,088	5,213
Unfunded FECA and Unemployment Liability	1,719	1,441
Custodial Liability (Note 17)	42,380	4
Liability for Non-Entity Assets	4	1
Other	—	157
Total Intragovernmental	55,376	15,896
Accounts Payable	46,260	34,084
Accrued Payroll and Benefits	31,649	27,131
Accrued Leave	45,629	42,696
Registrant Deposits	44,729	40,898
Actuarial FECA Liability (Note 9)	7,576	6,178
Liability for Disgorgement and Penalties (Note 19)	1,021,466	2,297,741
Contingent Liabilities (Note 12.B)	—	9,500
Other Accrued Liabilities (Note 10)	29,270	20,922
Total Liabilities	1,281,955	2,495,046
Commitments and Contingencies (Note 12)		
NET POSITION (Note 13):		
Unexpended Appropriations—Other Funds	1,749	9,860
Cumulative Results of Operations—Earmarked Funds	6,878,132	6,058,225
Cumulative Results of Operations—Other Funds	603	—
Total Net Position	\$ 6,880,484	\$ 6,068,085
Total Liabilities and Net Position	\$ 8,162,439	\$ 8,563,131

The accompanying notes are an integral part of these financial statements.

Financial Statements

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Net Cost

For the years ended September 30, 2010 and 2009

(DOLLARS IN THOUSANDS)

	FY 2010	FY 2009 (Reclassified)
PROGRAM COSTS (Note 14):		
Enforcement	\$ 355,451	\$ 333,382
Compliance Inspections and Examinations	229,389	212,061
Corporation Finance	131,166	123,782
Trading and Markets	54,107	47,010
Investment Management	47,873	48,295
Risk, Strategy and Financial Innovation	18,143	14,354
General Counsel	39,780	36,948
Other Program Offices	48,603	45,140
Agency Direction and Administrative Support	128,531	115,158
Inspector General	5,380	4,835
Total Program Costs	<u>1,058,423</u>	<u>980,965</u>
Less: Earned Revenue Not Attributed to Programs (Note 15)	1,382,856	1,109,891
Net (Income) Cost from Operations (Note 18)	<u>\$ (324,433)</u>	<u>\$ (128,926)</u>

The accompanying notes are an integral part of these financial statements.

Financial Statements

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Changes in Net Position

For the years ended September 30, 2010 and 2009

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010		
	Earmarked Funds	All Other Funds	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS:			
Beginning Balances	\$ 6,058,225	\$ —	\$ 6,058,225
Budgetary Financing Sources:			
Appropriations Used	—	8,111	8,111
Non-Exchange Revenue	451,910	—	451,910
Other Financing Sources:			
Imputed Financing (Note 11)	36,216	—	36,216
Other	—	(160)	(160)
Total Financing Sources	488,126	7,951	496,077
Net Income (Cost) from Operations	331,781	(7,348)	324,433
Net Change	819,907	603	820,510
Cumulative Results of Operations (Note 13)	6,878,132	603	6,878,735
UNEXPENDED APPROPRIATIONS:			
Beginning Balances	—	9,860	9,860
Budgetary Financing Sources:			
Appropriations Received	—	—	—
Appropriations Used	—	(8,111)	(8,111)
Total Unexpended Appropriations	—	1,749	1,749
Net Position, End of Period	\$ 6,878,132	\$ 2,352	\$ 6,880,484
<hr/>			
<i>(DOLLARS IN THOUSANDS)</i>	FY 2009		
	Earmarked Funds	All Other Funds	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS:			
Beginning Balances	\$ 5,903,289	\$ —	\$ 5,903,289
Budgetary Financing Sources:			
Appropriations Used	—	140	140
Non-Exchange Revenue	—	—	—
Other Financing Sources:			
Imputed Financing (Note 11)	25,955	—	25,955
Other	—	(85)	(85)
Total Financing Sources	25,955	55	26,010
Net Income (Cost) from Operations	128,981	(55)	128,926
Net Change	154,936	—	154,936
Cumulative Results of Operations (Note 13)	6,058,225	—	6,058,225
UNEXPENDED APPROPRIATIONS:			
Beginning Balances	—	—	—
Budgetary Financing Sources:			
Appropriations Received	—	10,000	10,000
Appropriations Used	—	(140)	(140)
Total Unexpended Appropriations	—	9,860	9,860
Net Position, End of Period	\$ 6,058,225	\$ 9,860	\$ 6,068,085

The accompanying notes are an integral part of these financial statements.

Financial Statements

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Budgetary Resources

For the years ended September 30, 2010 and 2009

(DOLLARS IN THOUSANDS)	FY 2010	FY 2009
BUDGETARY RESOURCES:		
Unobligated Balance, Brought Forward, October 1	\$ 26,765	\$ 57,696
Recoveries of Prior Year Unpaid Obligations	18,753	28,982
Budget Authority:		
Appropriation	451,910	10,000
Spending Authority from Offsetting Collections:		
Earned:		
Collected	1,443,347	1,017,763
Change in Receivables from Federal Sources	(188)	143
Change in Unfilled Customer:		
Advance Received	(157)	157
Without Advance from Federal Sources	(98)	1
Subtotal	1,894,814	1,028,064
Temporarily not Available Pursuant to Public Law	(347,694)	(122,101)
Total Budgetary Resources	\$ 1,592,638	\$ 992,641
STATUS OF BUDGETARY RESOURCES:		
Obligations Incurred:		
Direct (Note 16)	\$ 1,103,007	\$ 964,640
Reimbursable (Note 16)	282	1,236
Subtotal	1,103,289	965,876
Unobligated Balance Available:		
Realized and Apportioned for Current Period	17,213	9,968
Unobligated Balance Not Available	472,136	16,797
Total Status of Budgetary Resources	\$ 1,592,638	\$ 992,641
CHANGE IN OBLIGATED BALANCE:		
Obligated Balance, Net:		
Unpaid Obligations, Brought Forward, October 1	\$ 236,399	\$ 250,974
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(311)	(167)
Total Unpaid Obligated Balance, Net	236,088	250,807
Obligations Incurred Net	1,103,289	965,876
Gross Outlays	(1,003,163)	(951,469)
Recoveries of Prior Year Unpaid, Obligations Actual	(18,753)	(28,982)
Change in Uncollected Customer Payments from Federal Sources	286	(144)
Obligated Balance, Net, End of Period:		
Unpaid Obligations	317,772	236,399
Uncollected Customer Payments from Federal Sources	(25)	(311)
Total, Unpaid Obligated Balance, Net, End of Period (Note 12)	\$ 317,747	\$ 236,088
NET OUTLAYS:		
Net Outlays:		
Gross Outlays	\$ 1,003,163	\$ 951,469
Offsetting Collections	(1,443,190)	(1,017,920)
Distributed Offsetting Receipts	194	(702)
Net Outlays/(Collections)	\$ (439,833)	\$ (67,153)

The accompanying notes are an integral part of these financial statements.

Financial Statements

FINANCIAL SECTION

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Custodial Activity

For the years ended September 30, 2010 and 2009

(DOLLARS IN THOUSANDS)

	FY 2010	FY 2009
REVENUE ACTIVITY:		
Sources of Cash Collections:		
Disgorgement and Penalties	\$ 1,116,632	\$ 815,802
Other	1	10
Net Collections	1,116,633	815,812
Accrual Adjustments	42,380	4
Total Custodial Revenue (Note 17)	1,159,013	815,816
DISPOSITION OF COLLECTIONS:		
Amounts Transferred to:		
Department of the Treasury	664,723	815,812
Investor Protection Fund	451,910	—
Amounts Yet to be Transferred	42,380	4
Total Disposition of Collections	1,159,013	815,816
NET CUSTODIAL ACTIVITY	\$ —	\$ —

The accompanying notes are an integral part of these financial statements.

Notes to the Financial Statements

As of September 30, 2010 and 2009

NOTE 1. Summary of Significant Accounting Policies

A. Reporting Entity

The SEC is an independent agency of the U.S. Government established pursuant to the Securities Exchange Act of 1934, charged with regulating this country's capital markets. The SEC's mission is to protect investors; maintain fair, orderly, and efficient securities markets; and facilitate capital formation. The SEC works with Congress, other executive branch agencies, SROs (e.g., stock exchanges and FINRA), accounting and auditing standards setters, state securities regulators, law enforcement officials, and many other organizations in support of the agency's mission.

The agency's programs protect investors and promote the public interest by fostering and enforcing compliance with the federal securities laws; establishing an effective regulatory environment; facilitating access to the information investors need to make informed investment decisions; and enhancing the Commission's performance through effective alignment and management of human, information, and financial capital.

B. Basis of Presentation and Accounting

The accompanying financial statements present the financial position, net cost of operations, changes in net position, budgetary resources, and custodial activities of the SEC's core business activities as required by the Accountability of Tax Dollars Act of 2002. The statements may differ from other financial reports submitted pursuant to OMB directives for the purpose of monitoring and controlling the use of the SEC budgetary resources. The SEC's books and records serve as the source of the information presented in the accompanying financial statements. The agency classified assets, liabilities, revenues, and costs in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those due from or to other federal entities. Intragovernmental earned revenues are collections or accruals due from other federal entities. Intragovernmental costs are payments or accruals due to other federal entities.

The SEC's financial statements have been prepared on the accrual basis of accounting in conformity with generally accepted accounting principles (GAAP) for the federal government. Accordingly, revenues are recognized when earned and expenses are recognized when incurred, without regard to the receipt or payment of cash. These principles differ from budgetary accounting and reporting principles from which the Statement of Budgetary Resources (SBR) is prepared. The differences relate primarily to the capitalization and depreciation of property and equipment, as well as the recognition of other long-term assets and liabilities. The Statement of Custodial Activity is presented on the modified cash basis of accounting. Cash collections and disbursements to Treasury are reported on a cash basis and the change in receivables and related payables are reported on an accrual basis. The statements were also prepared in conformity with OMB Circular No. A-136, *Financial Reporting Requirements*.

C. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates and assumptions include, but are not limited to, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. Estimates are also used in the allocation of costs to the SEC programs presented in the Statement of Net Cost.

D. Changes in Accounting Presentation

The SEC recognizes receivables stemming from judicial and administrative proceedings that order violators of the federal securities laws to pay disgorgement of ill-gotten gains, civil monetary penalties, and pre-judgment and post-judgment interest. Orders can identify whether the resulting proceeds are to be held on behalf of harmed investors or whether they are to be remitted to the Treasury General Fund.

FINANCIAL SECTION

Effective for FY 2010, the Statement of Custodial Activity includes transfers to the newly created Investor Protection Fund and, as a result of revised administrative processes, changes in disgorgements and penalties payable to the Treasury General Fund. Previously, the SEC had presented these receivables as non-custodial assets under the control of the SEC with an equal and offsetting governmental liability on the Balance Sheet. In FY 2010, the SEC presents these receivables as custodial receivables with an equal and offsetting intragovernmental custodial liability to the Treasury. In addition, accrued revenue associated with the generation of these assets are classified as custodial and recognized on the Statement of Custodial Activity.

In FY 2010, the SEC changed its presentation from net cost of operations by goal, to net cost of operations by program. OMB Circular No. A-136, *Financial Reporting Requirements*, defines the term "major program" as describing an agency's mission, strategic goals, functions, activities, services, projects, processes, or any other meaningful grouping. The presentation by program is consistent with the presentation used by the agency in submitting its budget requests.

E. Intra- and Inter-Agency Relationships

The SEC is comprised of a single federal bureau. Therefore, the current organizational structure does not give rise to the need for intra-entity eliminations. Beginning in FY 2011, the Investor Protection Fund will finance the operations of the SEC Office of the Inspector General's employee suggestion program on a reimbursable basis. This will give rise to intra-entity eliminations of the related revenue and expense transactions between the Investor Protection Fund and the SEC's General Salaries and Expenses fund.

F. Fund Accounting Structure

The SEC accounts for financial activities by Treasury Appropriation Fund Symbol (TAFS), summarized as follows:

- **General Funds – Salaries and Expenses** (X0100, 09/10 0100): The TAFS X0100 consists of earmarked funds for use in carrying out the SEC's mission and functions and revenues collected by the SEC in excess of the amounts appropriated. In addition, the SEC received a supplemental appropriation of \$10 million for use in FY 2009 and FY 2010; the supplemental appropriation is accounted for in TAFS 09/10 0100 and is not earmarked (refer to Note 1.G. *Earmarked Funds*, Note 3. *Fund Balance with*

Treasury, and Note 13. Earmarked, Other, Disgorgement and Penalties, and Non-Entity Funds).

Other Funds:

- **Deposit and Suspense Funds** (F3875, X6561, and X6563): These TAFS hold disgorgement, penalties, and interest collected and held on behalf of harmed investors, registrant monies held temporarily until earned by the SEC, and collections awaiting disposition or reclassification. At the end of FY 2010, the SEC discontinued the use of the Budget Clearing Account (F3875).
- **Miscellaneous Receipt Accounts** (1099 and 3220): These TAFS hold non-entity receipts and accounts receivable from custodial activities that the SEC cannot deposit into funds under its control. These accounts include receipts, pursuant to certain SEC enforcement actions, that will be sent to the Treasury General Fund.

The SEC does not have lending or borrowing authority, except as discussed in Note 12. *Commitments and Contingencies*. The SEC has custodial responsibilities, as disclosed in Note 17. *Custodial Revenues*.

The Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, signed into law on July 21, 2010, established the need for two new additional TAFS in the SEC fund accounting structure: the Securities and Exchange Commission Investor Protection Fund (Investor Protection Fund) and the Securities and Exchange Commission Reserve Fund (Reserve Fund).

- **Investor Protection Fund** (Special Fund X5567): This TAFS provides earmarked funding for a whistleblower award program, through which persons can receive award payments from the Fund if they provide original information to the SEC that leads to successful enforcement by the SEC of a judicial or administrative action in which monetary sanctions exceeding \$1 million are imposed. In addition, the Fund will be used to finance the operations of the SEC Office of the Inspector General's employee suggestion program. The suggestion program is intended for the receipt of suggestions from SEC employees for improvements in the work efficiency, effectiveness, productivity, and use of the resources at the SEC, as well as allegations from SEC employees of waste, abuse, misconduct, or mismanagement within the SEC.

The Investor Protection Fund is financed by transferring a portion of monetary sanctions collected by the SEC in judicial or administrative actions brought by the SEC under the securities laws that are not added to the disgorgement fund or other funds under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or amounts in such funds that are determined not to be distributed to injured investors. These funds are considered financing sources. No sanction collected by the Commission can be transferred to the Fund if its balance exceeds \$300 million. The SEC may request the Secretary of the Treasury to invest Investor Protection Fund amounts in Treasury obligations. Refer to *Note 1.J. Investments* for additional details.

- **Reserve Fund:** This TAFS enables the SEC to obligate amounts, not to exceed a total of \$100 million in one fiscal year, as the SEC determines necessary to carry out its functions. Effective on October 1, 2011, a portion of the SEC registration fee collections, not to exceed \$50 million in one fiscal year, shall be deposited in the Reserve Fund. The balance of the fund cannot exceed \$100 million. The SEC will establish the TAFS in FY 2011 in anticipation of beginning Reserve Fund operations in FY 2012. In addition, the SEC is required to notify Congress when obligating amounts from the Reserve Fund.

G. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. The SEC collects earmarked funds and is required to use these funds for designated activities, benefits or purposes and to account for them separately from the government's general revenues. Some of the SEC's earmarked funds are offsetting collections which are deposited into TAFS X0100, Salaries and Expenses. Also, all funds held in the TAFS X5567, Investor Protection Fund, are considered earmarked as detailed in *Note 13. Earmarked, Other, Disgorgement and Penalties, and Non-Entity Funds*.

H. Entity/Non-Entity Assets

Assets that an agency is authorized to use in its operations are entity assets. Assets that an agency holds on behalf of another federal agency or a third party and are not available for the agency's use are non-entity assets. The SEC's non-entity assets include the following: (i) disgorgement, penalties, and interest collected or to be collected and held or invested

by the SEC; (ii) accounts receivable with respect to Freedom of Information Act ("FOIA") fees; and (iii) excess filing fees remitted by registrants (registrant deposits).

I. Fund Balance with Treasury

Fund Balance with Treasury (FBWT) includes certain funds held on behalf of third parties. These include registrant deposits and uninvested disgorgement funds. FBWT also includes undisbursed account balances with Treasury, balances in excess of appropriated amounts that are unavailable to the SEC, and the Investor Protection Fund. The SEC conducts all of its banking activity in accordance with directives issued by Treasury's Financial Management Service (FMS). The SEC deposits all revenue and receipts in commercial bank accounts maintained by the FMS, or wires them directly to a Federal Reserve Bank. Treasury processes all disbursements made by the SEC. The Federal Reserve Bank transfers all monies maintained in commercial bank accounts on the business day following the day of deposit.

J. Investments

The SEC has the authority to invest disgorgement funds and amounts in the Investor Protection Fund in Treasury securities, whenever practicable. Disgorgement funds may also include civil penalties collected under the "Fair Fund" provision of the Sarbanes-Oxley Act of 2002. As the funds are collected, the SEC holds them in a deposit fund account and may invest them in overnight and short-term market-based Treasury bills through a facility provided by the Bureau of the Public Debt (BPD), pending their distribution to investors. The SEC adds interest earned to the funds, and these funds are subject to taxation under Treasury Regulation Section 1.468B-2. Additional details regarding SEC investments are provided in *Note 5. Investments, Net*.

As of September 30, 2010, there are no investments made from the Investor Protection Fund. The SEC is working with BPD to invest these funds in FY 2011. As the funds are collected, the SEC will hold them in a special receipt fund account and may invest them in overnight and short-term market-based Treasury bills through a facility provided by the BPD, pending their distribution. The interest earned on the investments is a component of the balance of the Fund and available to be used for expenses of the Investor Protection Fund.

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K. Accounts Receivable and Allowance for Uncollectible Accounts

Both SEC's entity and non-entity accounts receivable consist primarily of amounts due from the public. Entity accounts receivable are amounts that the SEC will retain upon collection. These generally include claims arising from: (i) securities transaction fees, (ii) filing fees paid by registrants, (iii) goods or services that the SEC has provided to another federal agency pursuant to an inter-agency agreement, (iv) host reimbursement of employee travel, and (v) employee-related debt. Entity accounts receivable represent a small volume of the SEC's business activities because agency fee legislation generally requires payment of filing fees at the time of filing, and securities transaction fees are payable to the SEC twice a year: in March for the period September through December, and in September for the period January through August. Accordingly, the year-end accounts receivable accrual generally represents fees payable to the SEC for activity during the month of September.

Non-entity accounts receivable are amounts that the SEC will not retain upon collection. These mainly include disgorgement, penalties, and interest assessments. The SEC recognizes these accounts receivable when an order of the Commission or a court designates it to collect the assessed disgorgement, penalties, and interest. The SEC does not recognize interest as accounts receivable, unless specified by the court or an administrative order.

The SEC is also party to court orders directing violators of federal securities laws to pay the court or a receiver to collect the disgorgement, penalties, and interest assessed against them. These orders are not recognized as accounts receivable by the SEC because the debts are payable to another party. However, these debts are subject to change based on, for example, future orders issued by the presiding court that could result in the SEC recognizing a receivable. In the cases where the court order or other legally binding instrument requires the debtor to remit funds to the SEC, a receivable is recorded.

The SEC uses a three-tiered methodology to calculate the allowance for loss on its disgorgement and penalty accounts receivable balances. The first tier involves making an individual collection assessment of the cases constituting the top 90 percent of the disgorgement and penalty accounts receivable portfolio. The second and third tiers are composed of cases

in the bottom 10 percent that are equal to or less than 30 days old and over 30 days old, respectively. For the second and third tiers, the SEC applies an allowance rate based on historical collection data analysis.

The SEC bases the allowance for uncollectible amounts and the related provision for estimated losses for filing fees and other accounts receivable on analysis of historical collection data. No allowance for uncollectible amounts or related provision for estimated losses have been established for securities transaction fees payable by SROs, as these gross accounts receivable are deemed to represent their net realizable value based on historical experience.

L. Advances and Prepayments

The SEC may prepay amounts in anticipation of receiving future benefits such as training and supplemental health benefits for the SEC employees. The agency expenses these payments when the goods are received or services are performed.

M. Property and Equipment, Net

The SEC's property and equipment consist of software, general-purpose equipment used by the agency, capital improvements made to buildings leased by the SEC for office space, and internal-use software development costs for projects in development. The SEC reports property and equipment purchases and additions at cost. The agency expenses property and equipment acquisitions that do not meet the capitalization criteria, normal repairs, and maintenance when received or incurred by the SEC.

The SEC depreciates property and equipment over their estimated useful lives using the straight-line method of depreciation. The agency removes property and equipment from its asset accounts in the period of disposal, retirement, or removal from service. The SEC recognizes the difference between the book value and the proceeds in the same period that the asset is removed.

N. Liabilities

The SEC records liabilities for amounts that are likely to be paid as a result of events that have occurred as of the relevant Balance Sheet dates. The SEC's liabilities consist of routine operating accounts payable, accrued payroll and benefits, registrant deposit accounts that have not been returned to

registrants, liabilities for disgorgement and penalties, legal liabilities, and custodial liabilities for amounts held on behalf of Treasury.

A liability for disgorgement and penalties arises when an order is issued for the SEC to collect disgorgement, penalties, and interest from securities law violators. When the Commission or court issues such an order, the SEC establishes an accounts receivable due to the SEC with an offsetting liability. The SEC reports all disgorgement and penalty assets and offsetting liabilities as non-entity items on the Balance Sheet. Previously, all disgorgement and penalty receivables and their offsetting liabilities were held in an SEC deposit account as governmental and non-custodial until distributed to harmed investors or transferred to the Treasury General Fund. As of September 30, 2010, the SEC only recognizes these assets and liabilities as governmental and non-custodial if they are payable to the SEC. If the court order stipulates that collections are to be transferred to the Treasury General Fund, the disgorgement and penalty assets are classified as custodial and the offsetting liabilities are classified as custodial and intragovernmental.

Prior to the enactment of Dodd-Frank on July 21, 2010, collections not distributed to harmed investors were transferred to the Treasury General Fund. After the enactment of Dodd-Frank, collections not distributed to harmed investors could be transferred to either the Investor Protection Fund or the Treasury General Fund. Collections not distributed to harmed investors are transferred to the Investor Protection Fund if the Fund's balance does not exceed \$300 million.

The SEC recognizes liabilities covered by three types of resources: realized budgetary resources, unrealized budgetary resources that become available without further congressional action and amounts that do not require the use of current budgetary resources. Realized budgetary resources include obligated balances that fund existing liabilities and unobligated balances as of the relevant Balance Sheet dates. Unrealized budgetary resources represent fee collections in excess of amounts appropriated for current fiscal year spending. The SEC uses these resources to cover liabilities when appropriation language makes these unrealized budgetary resources available in the fiscal year without further congressional action. Amounts that do not require the use of current budgetary resources are liabilities that will be funded in future years, such as annual leave.

O. Employee Retirement Systems and Benefits

The SEC's employees may participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they started working for the federal government. Pursuant to Public Law 99-335, FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees who are rehired after a break in service of more than one year and who had five years of federal civilian service prior to 1987 are eligible to participate in the CSRS offset retirement system or may elect to join FERS.

The SEC does not report CSRS or FERS assets or accumulated plan benefits that may be applicable to its employees in its financial statements. The U.S. Office of Personnel Management (OPM) reports them. Although the SEC reports no liability for future payments to employees under these programs, the federal government is liable for future payments to employees through the various agencies administering these programs. The SEC does not fund post-retirement benefits such as the Federal Employees Health Benefit Program and the Federal Employees Group Life Insurance Program. The SEC is also not required to fully fund CSRS pension liabilities. Instead, the financial statements of the SEC recognize an imputed financing source and corresponding expense that represent the SEC's share of the cost to the federal government of providing pension, post-retirement health, and life insurance benefits to all eligible SEC employees. All employees are eligible to contribute to a Thrift Savings Plan (TSP). For those employees participating in FERS, the TSP is automatically established, and the SEC makes a mandatory one percent contribution to this plan. In addition, the SEC matches contributions ranging from one to four percent for FERS-eligible employees who contribute to their TSP. The SEC contributes a matching amount to the Social Security Administration under the Federal Insurance Contributions Act, which fully covers FERS participating employees. Employees participating in CSRS do not receive matching contributions to their TSP.

P. Injury and Post-employment Compensation

The Federal Employees' Compensation Act (FECA), administered by the U.S. Department of Labor (DOL), addresses all claims brought by SEC employees for on-the-job injuries. The DOL bills the SEC annually as its claims are paid, and the SEC in turn accrues a liability to recognize the future payments.

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Refer to Note 9, *Actuarial FECA Liability* for additional details. Payment on these bills is deferred for two years to allow for funding through the budget process. Similarly, employees that the SEC terminates without cause may receive unemployment compensation benefits under the unemployment insurance program also administered by the DOL, which bills each agency quarterly for paid claims.

Q. Annual, Sick, and Other Leave

The SEC accrues annual leave and compensatory time as earned and reduces the accrual when leave is taken. The balances in the accrued leave accounts reflect current leave balances and pay rates. No portion of this liability has been obligated. Future financing sources provide funding to the extent that current or prior year funding is not available to pay for leave earned but not taken. The SEC expenses sick leave and other types of non-vested leave as used.

R. Revenue and Other Financing Sources

The SEC's revenue and financing sources include exchange revenues, which are generated from arm's-length transactions, and non-exchange revenues, which arise from the government's ability to demand payment. The SEC's exchange revenue mainly consists of collections from securities transaction fees. The SEC's non-exchange revenue consists of amounts collected in enforcement proceedings from violators of securities laws, as described below.

The SEC's funding is primarily through the collection of securities transaction fees from SROs and securities registration, tender offer, merger, and other fees from registrants. The fee rates are established by the SEC in accordance with federal law and are applied to volumes of activity reported by SROs or to filings submitted by registrants. When received, the SEC records these fees as exchange revenue. The SEC is permitted by law to include these amounts in its obligational authority or to offset its expenditures and liabilities upon collection, up to authorized limits. The SEC records all amounts remitted by registrants in excess of the fees for specific filings as liabilities in deposit accounts until earned by the SEC from registrant filings or returned to the registrant pursuant to the SEC's regulation, which calls for the return of registrant deposits when an account is dormant for at least 180 days.

The SEC also receives collections from proceedings that result in the assessment of disgorgement, penalties, and interest against violators of federal securities laws. When the SEC

collects these funds, it transfers the funds to a SEC deposit account at Treasury. The funds may be later returned to injured investors, transferred to the Investor Protection Fund, or transferred to the Treasury General Fund. Non-exchange revenue is recognized by the SEC when the funds are transferred to the Investor Protection Fund or the Treasury General Fund. Non-exchange funds transferred to the Treasury General Fund are reported in the Statement of Custodial Activity. The SEC does not record amounts collected and held by another government entity, such as a court registry, or a non-government entity, such as a receiver. Funds transferred to the Investor Protection Fund are recognized as non-exchange revenue by the Investor Protection Fund.

The Investor Protection Fund will provide financing for payments to whistleblowers under Section 21F of the Exchange Act and for the SEC Office of the Inspector General's suggestion program. The Investor Protection Fund is financed by transferring a portion of monetary sanctions collected by the SEC in judicial or administrative actions brought by the SEC under the securities laws that are not added to disgorgement fund or other funds under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or amounts in such funds that are determined not to be distributed to injured investors. No sanction collected by the Commission can be transferred to the Fund if its balance exceeds \$300 million. The balance of the Investor Protection Fund as of September 30, 2010 is \$451.9 million. The SEC may request the Secretary of the Treasury to invest Investor Protection Fund amounts in Treasury obligations.

S. Budgets and Budgetary Accounting

The SEC is subject to certain restrictions on its use of statutory fees. The SEC deposits all fee revenues in a designated account at Treasury. However, the SEC may use funds from this account only as authorized by Congress and made available by OMB apportionment, upon issuance of a Treasury warrant. Revenue collected in excess of appropriated amounts is restricted from use by the SEC.

The SEC can use fees other than the restricted excess fees from its operations, subject to annual congressional limitations, which were \$1,095 million and \$894.4 million for the budgets for FY 2010 and FY 2009, respectively. In addition, Congress made available approximately \$16.1 million and \$65.6 million

from prior year balances for FY 2010 and FY 2009, respectively. Funds appropriated that the SEC does not use in a given fiscal year are maintained in a designated account for use in future periods in accordance with the appropriation requirements. Previously mentioned in *Note 1.F. Fund Accounting Structure*, the SEC received a supplemental appropriation for \$10 million from the Treasury General Fund for use in FY 2009 and FY 2010. Unlike the annual appropriation, the supplemental funds are not offset by fees collected by the SEC.

Each fiscal year, the SEC receives Category A apportionments, which are quarterly distributions of budgetary resources made by OMB. The SEC also receives a small amount of Category B funds for reimbursable activity, which are exempt from quarterly apportionment.

The Investor Protection Fund (TAFS X5567) is a special fund that has the authority to retain revenues and other financing sources not used in the current period for future use. Dodd-Frank provides that the Fund is available to the SEC without further appropriation or fiscal year limitation for the purpose of paying awards to whistleblowers and funding the activities of the Office of the Inspector General's employee suggestion program. Each fiscal year, the SEC is required to request and obtain an apportionment from OMB to use these funds. In FY 2010, the SEC received a \$451.9 million apportionment for the Fund for use in FY 2011. All of the funds are Category B, which are exempt from quarterly apportionment.

T. Disgorgement and Penalties

The SEC maintains non-entity assets related to disgorgements and penalties ordered pursuant to civil injunctive and administrative proceedings. The SEC also recognizes an equal and offsetting liability for these assets as discussed in *Note 1.N. Liabilities*. These non-entity assets consist of disgorgement, penalties, and interest assessed against securities law violators where the Commission, administrative law judge, or in some cases, a court, has determined that the SEC should return such funds to harmed investors or may be transferred to the Investor Protection Fund or the Treasury General Fund. The SEC does not record on its financial statements any asset amounts another government entity such as a court, or a non-governmental entity, such as a receiver, has collected or will collect. Additional details regarding disgorgement and penalties are presented in *Note 13. Earmarked, Other, Disgorgement and Penalties, and Non-Entity Funds* and *Note 19. Disgorgement and Penalties*.

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NOTE 2. Non-Entity Assets

At September 30, non-entity assets of the SEC consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Intragovernmental:		
Fund Balance with Treasury:		
Registrant Deposits	\$ 44,729	\$ 40,898
Disgorgement and Penalties (Note 19)	54,269	43,622
Investments, Net:		
Disgorgement and Penalties (Note 19)	924,823	1,959,611
Total Intragovernmental Non-Entity Assets	1,023,821	2,044,131
Cash and Other Monetary Assets:		
Disgorgement and Penalties (Note 19)	2,815	—
Accounts Receivable, Net:		
Disgorgement and Penalties (Note 19)	81,939	294,508
Custodial	—	4
Other Non-Entity Assets	4	1
Total Non-Entity Assets	1,108,579	2,338,644
Total Entity Assets	7,053,860	6,224,487
Total Assets (Note 13)	\$ 8,162,439	\$ 8,563,131

NOTE 3. Fund Balance with Treasury

FBWT by type of fund as of September 30, are as follows:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Fund Balances:		
General Funds	\$ 6,438,459	\$ 5,998,787
Special Fund	451,910	—
Other Funds	98,998	84,520
Total Fund Balance with Treasury	6,989,367	6,083,307
Status of Fund Balance with Treasury:		
Unobligated Balance:		
Available	17,213	9,968
Unavailable	472,136	16,797
Obligated Balance not yet Disbursed	317,747	236,088
Non-Budgetary Fund Balance with Treasury	6,182,271	5,820,454
Total Fund Balance with Treasury	\$ 6,989,367	\$ 6,083,307

A significant portion of the increase in FBWT is due to the \$451.9 million of non-exchange revenue transferred to the Investor Protection Fund (Special Fund), which prior to the establishment of the Fund would have been transferred to the Treasury General Fund. This Special Fund will provide the financial resources for the whistleblower award program and the SEC Office of Inspector General's employee suggestion program, both of which were mandated in Dodd-Frank. As of September 30, 2010 the balance of the Special Fund is classified as unavailable under the Status of Fund Balance with Treasury noted above.

NOTE 4. Cash and Other Monetary Assets

The SEC received \$2.8 million in disgorgement and penalties collections on September 30, 2010. These collections are recorded as deposits in transit as a result of the varying processing times and cut-off dates between the SEC and Treasury. Once deposited, the SEC holds receipts in FBWT or invests in Treasury securities pending distribution to harmed investors, or transfer to the Investor Protection Fund or Treasury General Fund. There were no cash and monetary assets on September 30, 2009.

NOTE 5. Investments, Net

The SEC invests funds in overnight and short-term non-marketable market-based Treasury bills. Treasury bills are securities traded in the primary and secondary U.S. Treasury markets. The U.S. government auctions Treasury bills directly in the primary U.S. Treasury market, and subsequently investors trade them in the secondary U.S. Treasury market. In accordance with GAAP, the SEC records the value of its investments in Treasury bills at cost and amortizes the discount on a straight-line basis (S/L) through the maturity date of these securities. The market value is determined by the secondary U.S. Treasury market and represents the value an individual investor is willing to pay for these securities, at a given point in time.

At September 30, 2010, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 924,651	S/L	\$171	\$ 1	\$ 924,823	\$ 924,837

At September 30, 2009, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 1,959,163	S/L	\$ 448	\$ —	\$ 1,959,611	\$ 1,959,810

NOTE 6. Accounts Receivable, Net

At September 30, 2010, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Intragovernmental Entity Accounts Receivable:			
Reimbursable Activity	\$ —	\$ —	\$ —
Subtotal Intragovernmental Accounts Receivable	—	—	—
Entity Accounts Receivable:			
Exchange Fees	78,461	—	78,461
Filing Fees	690	107	583
Other	180	24	156
Non-Entity Accounts Receivable:			
Disgorgement and Penalties (Note 19)	656,495	574,556	81,939
Other	9	5	4
Subtotal Non-Intragovernmental Accounts Receivable	735,835	574,692	161,143
Total Accounts Receivable	\$ 735,835	\$ 574,692	\$ 161,143

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At September 30, 2009, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Intragovernmental Entity Accounts Receivable:			
Reimbursable Activity	\$ 188	\$ —	\$ 188
Subtotal Intragovernmental Accounts Receivable	188	—	188
Entity Accounts Receivable:			
Exchange Fees	138,654	—	138,654
Filing Fees	720	116	604
Other	283	21	262
Non-Entity Accounts Receivable:			
Disgorgement and Penalties (Note 19)	713,851	419,343	294,508
Other	7	2	5
Subtotal Non-Intragovernmental Accounts Receivable	853,515	419,482	434,033
Total Accounts Receivable	\$ 853,703	\$ 419,482	\$ 434,221

The SEC writes off receivables aged two or more years by removing the debt amounts from the gross accounts receivable and any related allowance for uncollectible accounts. In FY 2009, the SEC enhanced the criteria used to estimate the allowance for loss on disgorgement and penalties accounts receivable. Refer to Note 1.K. Accounts Receivable and Allowance for Uncollectible Accounts for methods used to estimate allowances.

NOTE 7. Property and Equipment, Net

At September 30, 2010, property and equipment consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Depreciation/ Amortization Method	Capitalization Threshold for Individual Purchases	Capitalization Threshold for Bulk Purchases	Service Life (Years)	Acquisition Cost	Accumulated Depreciation/ Amortization	Book Value
Furniture and Equipment	S/L	\$ 15	\$ 50	3-5	\$ 61,133	\$ 42,754	\$ 18,379
Software	S/L	300	300	3-5	89,827	73,305	16,522
Leasehold Improvements	S/L	300	N/A	10	84,204	39,393	44,811
Total					\$ 235,164	\$ 155,452	\$ 79,712

At September 30, 2009, property and equipment consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Depreciation/ Amortization Method	Capitalization Threshold for Individual Purchases	Capitalization Threshold for Bulk Purchases	Service Life (Years)	Acquisition Cost	Accumulated Depreciation/ Amortization	Book Value
Furniture and Equipment	S/L	\$ 15	\$ 50	3-5	\$ 57,399	\$ 43,358	\$ 14,041
Software	S/L	300	300	3-5	85,145	67,737	17,408
Leasehold Improvements	S/L	300	N/A	10	80,891	29,905	50,986
Total					\$ 223,435	\$ 141,000	\$ 82,435

During FY 2010, the SEC recorded a disposal of \$4.48 million in software development project costs involving an effort to integrate its Automated Procurement System (APS) and the core financial system. The project was discontinued before it was ready for placement into production. The SEC made the decision to end the project based on cost/benefit considerations and the recent decision to move the SEC core financial system to a Federal Shared Service Provider.

NOTE 8. Liabilities Not Covered by Budgetary Resources

The SEC's liabilities include amounts that will not require the use of budgetary resources. These liabilities include registrant deposit accounts that have not been returned to registrants and the offsetting liability that corresponds to assets the SEC holds relating to collections from disgorgements and penalties and receivables as discussed in *Note 1.N. Liabilities*.

At September 30, liabilities consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Liabilities Not Covered by Budgetary Resources:		
Intragovernmental:		
Unfunded FECA and Unemployment Liability	\$ 1,719	\$ 1,441
Total Intragovernmental Liabilities	1,719	1,441
Accrued Leave	45,629	42,696
Actuarial FECA Liability	7,576	6,178
Contingent Liabilities	—	9,500
Other Accrued Liabilities:		
Legal Liability	10,823	—
Recognition of Lease Liability	9,202	12,513
Total Liabilities Not Covered by Budgetary Resources	74,949	72,328
Liabilities Not Requiring Budgetary Resources:		
Intragovernmental:		
Custodial Liability	42,380	4
Liability for Non-Entity Assets	4	1
Total Intragovernmental Liabilities	42,384	5
Registrant Deposits	44,729	40,898
Liability for Disgorgement and Penalties	1,021,466	2,297,741
Total Liabilities Not Requiring Budgetary Resources	1,108,579	2,338,644
Liabilities Covered by Budgetary Resources:		
Intragovernmental:		
Accounts Payable	5,185	9,080
Employee Benefits	6,088	5,213
Other	—	157
Total Intragovernmental Liabilities	11,273	14,450
Accounts Payable	46,260	34,084
Accrued Payroll and Benefits	31,649	27,131
Other Accrued Liabilities	9,245	8,409
Total Liabilities Covered by Budgetary Resources	98,427	84,074
Total Liabilities (Note 13)	\$ 1,281,955	\$ 2,495,046

On June 12, 2009, the Court of Appeals affirmed the decision of the Federal Labor Relations Authority (FLRA) and upheld the award on *SEC v. FLRA*, No. 08-1256, 08-1294 (D.C.Cir.). This matter involved a complaint filed by the National Treasury Employees Union (NTEU) before FLRA. No specific amount was claimed by the NTEU. In FY 2009, the SEC recognized the award as a \$9 million contingent liability, as discussed further in the Contingencies section of *Note 12. Commitments and Contingencies*. In FY 2010, the SEC reclassified the contingent liability to a legal liability, developed a methodology for processing the ordered retroactive wage adjustments, and began making payments in the fourth quarter of FY 2010. As of September 30, 2010, the SEC has estimated a range of \$10.8 million to \$12.6 million for this award liability. The SEC accrued the minimum amount in the range, \$10.8 million for FY 2010, because no amount in the estimated range is considered more probable than any other amount within the range. As of September 30, 2009 the SEC had accrued \$500,000 for other claims; there were no other claims in 2010.

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NOTE 9. Actuarial FECA Liability

FECA provides income and medical cost protection to covered federal civilian employees harmed on the job or who have contracted an occupational disease, and dependents of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits under FECA for the SEC's employees are administered by the DOL and ultimately paid by the SEC when funding becomes available.

The SEC bases its estimate for FECA actuarial liability on the DOL's FECA model. The model considers the average amount of benefit payments incurred by the SEC for the past three fiscal years, multiplied by the medical and compensation liability to benefits paid (LBP) ratio for the whole FECA program. The SEC uses the overall average percentages of the LBP ratios summarized in the table below.

For FY 2010, the LBP ratios were as follows:

LBP Category	Medical	Compensation
Highest	10.50%	12.30%
Overall Average	9.90%	11.30%
Lowest	8.90%	10.30%

For FY 2009, the LBP ratios were as follows:

LBP Category	Medical	Compensation
Highest	9.90%	12.20%
Overall Average	9.30%	11.00%
Lowest	8.40%	10.10%

For FY 2010 and FY 2009, the SEC used the overall average LBP ratios to calculate the \$7.6 million and \$6.2 million FECA actuarial liabilities for those years, respectively.

NOTE 10. Leases

The SEC has the authority to negotiate long-term leases for office space. At September 30, 2010, the SEC leased office space at 19 locations under operating lease agreements that expire between FY 2011 and FY 2022. The SEC paid \$93.3 million and \$82.8 million for rent for the fiscal years ending September 30, 2010 and 2009, respectively.

Under existing commitments, minimum lease payments through FY 2016 and thereafter are as follows:

Fiscal Year <i>(DOLLARS IN THOUSANDS)</i>	Minimum Lease Payments
2011	\$ 94,402
2012	102,439
2013	117,094
2014	115,739
2015	113,752
2016 and thereafter	604,144
Total Future Minimum Lease Payments	\$1,147,570

The total future minimum lease payments summarized includes a continuing liability, until March 31, 2012, for space leased during FY 2005 in New York. To facilitate surrender of the SEC lease obligations for the previously occupied space, the SEC and U.S. General Services Administration (GSA) entered into separate agreements with the lessor of that space whereby GSA agreed to rent the office space for the next five years of the SEC's lease, with an option to renew for an additional five years which would, unless terminated early, overlap the remaining 17 months of the SEC's lease. As part of the SEC's agreement with the previous lessor, the SEC was responsible for the estimated \$18 million difference between its annual lease liability and the annual lease liability negotiated by GSA with that lessor. The GSA exercised the five year renewal option in July 2009, so as of September 30, 2010, the SEC is responsible for one more month covered by the GSA original lease and then less than two additional years, at a reduced rate, through March 31, 2012; this liability amounts to \$3.6 million of lease payments that end in FY 2012. Required lease payments through FY 2012 are as follows:

Fiscal Year <i>(DOLLARS IN THOUSANDS)</i>	Required Lease Payments New York
2011	\$ 2,413
2012	1,192
Total Future Estimated Lease Payments	\$ 3,605

In addition to the lease liability above, during FY 2005, the SEC moved into temporary office space in New York due to renovations in the new leased office space. This temporary space was being provided to the SEC for only the lessor's operating costs, and therefore the SEC did not make rent

payments for the New York office for five months of the fiscal year. The SEC attributed rent expense on a S/L over the life of the new lease and recorded rent expense and an unfunded liability estimated at \$3 million in FY 2005 and FY 2006. Since 2006, the SEC has recorded a reduction in the unfunded lease liability in the amount of \$2.4 million and currently has a remaining balance of \$5.6 million. The yearly future amortization amounts are shown in the table below. Refer to Recognition of Lease Liability line in *Note 8. Liabilities Not Covered by Budgetary Resources*.

Fiscal Year <small>(DOLLARS IN THOUSANDS)</small>	Future Amortization Amounts
2011	\$ 533
2012	533
2013	533
2014	533
2015	533
2016 and thereafter	2,932
Total Future Amortization Amounts	\$ 5,597

NOTE 11. Imputed Financing

The SEC recognizes an imputed financing source and corresponding expense to represent its share of the cost to the federal government of providing pension and postretirement health and life insurance benefits (Pension/Other Retirements Benefits) to all eligible SEC employees. For September 30, 2010 and 2009, the total amount of imputed financing amounted to approximately \$36.2 million and \$26.0 million, respectively.

NOTE 12. Commitments and Contingencies

A. Commitments

The Securities Investor Protection Act of 1970 (SIPA), as amended, created the Securities Investor Protection Corporation (SIPC) to provide certain financial protections to customers of insolvent registered securities brokers, dealers, firms, and members of national securities exchanges for up to \$500,000 per customer. SIPA authorizes the SIPC to create a fund to maintain all monies received and disbursed by the SIPC. SIPA also gives the SIPC the authority to borrow funds from the SEC in the event that the SIPC Fund is or may appear insufficient for purposes of SIPA. Dodd-Frank amended Section 4(h) of the SIPA (15 U.S.C. 78ddd(h)) by increasing the borrowing limit amount from \$1 billion to \$2.5 billion.

To borrow the funds, SIPC must file with the SEC a statement of the uses of such a loan and a repayment plan, and then the SEC must certify to the Secretary of the Treasury that the loan is necessary to protect broker-dealer customers and maintain confidence in the securities markets. The Treasury would make these funds available to the SEC through the purchase of notes or other obligating instruments issued by the SEC. Such notes or other obligating instruments would bear interest at a rate determined by the Secretary of the Treasury. As of September 30, 2010, the SEC had not loaned any funds to the SIPC, and there are no outstanding notes or other obligating instruments issued by the SEC.

Based on the amounts of customer property and customer claims in the Bernard L. Madoff Investment Securities LLC and Lehman Brothers Inc. liquidations, the current size of the SIPA Fund and SIPC's ongoing assessments on brokers are estimated to provide sufficient funds to cover payments relating to the Madoff and Lehman matters. However, in the event of other losses or claims or of liabilities in the Madoff and Lehman matters that are higher than estimated, SIPC may determine to seek a loan from the SEC.

As mentioned in *Note 1.F. Fund Accounting Structure*, the Investor Protection Fund will be used to pay awards to whistleblowers if they voluntarily provide original information to the SEC that leads to the successful enforcement by the SEC of a covered judicial or administrative action in which monetary sanctions exceeding \$1 million are imposed. The legislation allows whistleblowers to receive between 10 and 30 percent of the monetary sanctions collected in the covered action or in a related action, with the actual percentage being determined at the discretion of the SEC using criteria provided in the legislation. The statutory criteria requires the SEC to consider the significance of the information to the success of the covered judicial or administrative action, the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action, the programmatic interest of the SEC in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws, and such additional relevant factors as the Commission may establish by rule or regulation. Section 924(a) of Dodd-Frank requires the SEC to issue regulations to implement the program by April 2011. Among other things, these regulations will delineate eligibility for a whistleblower award and the procedures for applying for an award in SEC

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actions and related actions. All potential whistleblowers, including those submitting information before adoption of the SEC regulation, will be required to comply with the procedures specified in the regulation in order to be eligible for an award. The SEC will not pay whistleblower claims until the final regulations are adopted by the Commission.

As of September 30, 2010, there are no submitted claims against the Investor Protection Fund, and the SEC has not recognized any liabilities associated with the Fund. The SEC has not recognized a contingent liability in regards to potential whistleblower claims because they do not meet the criteria for recognition in accordance with the Statement of Federal Financial Accounting Standards (SFFAS) 5, *Accounting for Liabilities of the Federal Government* as amended by SFFAS 12, *Recognition of Contingent Liabilities of the Federal Government*.

In addition to future lease commitments discussed in *Note 10. Leases*, the SEC is obligated for the purchase of goods and services that have been ordered, but not received. As of September 30, 2010, net obligations for all of the SEC's activities were \$317.7 million, of which \$98.4 million was delivered and unpaid. As of September 30, 2009, net obligations for all of SEC's activities were \$236.1 million, of which \$83.6 million was delivered and unpaid.

B. Contingencies

The SEC recognizes contingent liabilities when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable. The SEC is party to various routine administrative proceedings, legal actions, and claims brought against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the federal government. As of September 30, 2009, the SEC had accrued \$500,000 for claims of this type; there were no claims of this type in 2010.

In a separate legal issue in FY 2009, the Court of Appeals affirmed the decision of the FLRA and upheld the award on *SEC v. FLRA*. Further information about this case can be found in *Note 8. Liabilities Not Covered by Budgetary Resources*. As of September 30, 2009, the SEC had estimated a range of \$9 million to \$12 million for this award liability. In accordance with the SFFAS 5, *Accounting for Liabilities of the Federal Government*, the SEC accrued the minimum amount in the range, \$9 million for FY 2009, because no amount in the estimated range was considered more probable than any other amount within the range. Subsequently in FY 2010, the SEC recognized the contingency as an unfunded legal liability.

NOTE 13. Earmarked, Other, Disgorgement and Penalties, and Non-Entity Funds

The SEC's earmarked funds arise from disgorgement and penalty collections transferred to the Investor Protection Fund and offsetting collections from securities transaction fees, registration fees, and other fees authorized by the Securities Act and the Exchange Act. *Note 1.G. Earmarked Funds* displays additional details regarding the SEC's earmarked funds.

As discussed in *Note 1.F. Fund Accounting Structure*, the SEC received supplemental appropriations for use in FY 2009 and FY 2010. These funds are not earmarked and are presented under Other Entity Funds.

For FY 2010, the assets, liabilities, net position, and net income from operations relating to earmarked, other, disgorgement and penalties, and non-entity funds consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Earmarked	Other Entity Funds	Disgorgement and Penalties	Non-Entity Funds	Total
Balance Sheet as of September 30, 2010					
ASSETS					
Fund Balance with Treasury	\$ 6,888,373	\$ 1,996	\$ 54,269	\$ 44,729	\$ 6,989,367
Cash and Other Monetary Assets	—	—	2,815	—	2,815
Investments, Net	—	—	924,823	—	924,823
Accounts Receivable, Net	79,200	—	81,939	4	161,143
Advances and Prepayments	4,579	—	—	—	4,579
Property and Equipment, Net	79,109	603	—	—	79,712
Total Assets (Note 2)	\$ 7,051,261	\$ 2,599	\$ 1,063,846	\$ 44,733	\$ 8,162,439
LIABILITIES					
Accounts Payable	\$ 51,313	\$ 132	\$ —	\$ —	\$ 51,445
Accrued Payroll and Benefits	37,622	115	—	—	37,737
FECA and Unemployment Liability	9,295	—	—	—	9,295
Accrued Leave	45,629	—	—	—	45,629
Custodial Liability	—	—	42,380	—	42,380
Liability for Non-Entity Assets	—	—	—	4	4
Registrant Deposits	—	—	—	44,729	44,729
Liability for Disgorgement and Penalties	—	—	1,021,466	—	1,021,466
Contingent Liabilities	—	—	—	—	—
Other Accrued Liabilities	29,270	—	—	—	29,270
Other	—	—	—	—	—
Total Liabilities (Note 8)	\$ 173,129	\$ 247	\$ 1,063,846	\$ 44,733	\$ 1,281,955
NET POSITION					
Unexpended Appropriations	\$ —	\$ 1,749	\$ —	\$ —	\$ 1,749
Cumulative Results of Operations	6,878,132	603	—	—	6,878,735
Total Net Position	6,878,132	2,352	—	—	6,880,484
Total Liabilities and Net Position	\$ 7,051,261	\$ 2,599	\$ 1,063,846	\$ 44,733	\$ 8,162,439

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<i>(DOLLARS IN THOUSANDS)</i>	Earmarked	Other Entity Funds	Disbursement and Penalties	Non-Entity Funds	Total
Statement of Net Cost					
For the Year Ended September 30, 2010					
Gross Program Costs	\$ 1,050,910	\$ 7,508	\$ —	\$ 5	\$ 1,058,423
Less Earned Revenues Not Attributable to Program Costs	1,382,691	—	—	165	1,382,856
Net (Income) Cost from Operations	\$ (331,781)	\$ 7,508	\$ —	\$ (160)	\$ (324,433)
Statement of Changes in Net Position					
For the Year Ended September 30, 2010					
Net Position, Beginning of Period	\$ 6,058,225	\$ —	\$ —	\$ —	\$ 6,058,225
Appropriations Used	—	8,111	—	—	8,111
Non-Exchange Revenue	451,910	—	—	—	451,910
Imputed Financing	36,216	—	—	—	36,216
Other	—	—	—	(160)	(160)
Net Income (Cost) from Operations	331,781	(7,508)	—	160	324,433
Net Change	819,907	603	—	—	820,510
Cumulative Results of Operations	6,878,132	603	—	—	6,878,735
Unexpended Appropriations:					
Beginning Balances	—	9,860	—	—	9,860
Appropriations Received	—	—	—	—	—
Appropriations Used	—	(8,111)	—	—	(8,111)
Total Unexpended Appropriations	—	1,749	—	—	1,749
Net Position, End of Period	\$ 6,878,132	\$ 2,352	\$ —	\$ —	\$ 6,880,484

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For FY 2009, the assets, liabilities, net position, and net income from operations relating to earmarked, other, disgorgement and penalties, and non-entity funds consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Earmarked	Other Entity Funds	Disgorgement and Penalties	Non-Entity Funds	Total
Balance Sheet as of September 30, 2009					
ASSETS					
Fund Balance with Treasury	\$ 5,988,927	\$ 9,860	\$ 43,622	\$ 40,898	\$ 6,083,307
Cash and Other Monetary Assets	—	—	—	—	—
Investments, Net	—	—	1,959,611	—	1,959,611
Accounts Receivable, Net	139,708	—	294,508	5	434,221
Advances and Prepayments	3,557	—	—	—	3,557
Property and Equipment, Net	82,435	—	—	—	82,435
Total Assets (Note 2)	\$ 6,214,627	\$ 9,860	\$ 2,297,741	\$ 40,903	\$ 8,563,131
LIABILITIES					
Accounts Payable	\$ 43,164	\$ —	\$ —	\$ —	\$ 43,164
Accrued Payroll and Benefits	32,344	—	—	—	32,344
FECA and Unemployment Liability	7,619	—	—	—	7,619
Accrued Leave	42,696	—	—	—	42,696
Custodial Liability	—	—	—	4	4
Liability for Non-Entity Assets	—	—	—	1	1
Registrant Deposits	—	—	—	40,898	40,898
Liability for Disgorgement and Penalties	—	—	2,297,741	—	2,297,741
Contingent Liabilities	9,500	—	—	—	9,500
Other Accrued Liabilities	20,922	—	—	—	20,922
Other	157	—	—	—	157
Total Liabilities (Note 8)	\$ 156,402	\$ —	\$ 2,297,741	\$ 40,903	\$ 2,495,046
NET POSITION					
Unexpended Appropriations	\$ —	\$ 9,860	\$ —	\$ —	\$ 9,860
Cumulative Results of Operations	6,058,225	—	—	—	6,058,225
Total Net Position	6,058,225	9,860	—	—	6,068,085
Total Liabilities and Net Position	\$ 6,214,627	\$ 9,860	\$ 2,297,741	\$ 40,903	\$ 8,563,131

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<i>(DOLLARS IN THOUSANDS)</i>	Earmarked	Other Entity Funds	Disbursement and Penalties	Non-Entity Funds	Total
Statement of Net Cost					
For the Year Ended September 30, 2009					
Gross Program Costs	\$ 980,825	\$ 140	\$ —	\$ —	\$ 980,965
Less Earned Revenues Not Attributable to Program Costs	1,109,806	—	—	85	1,109,891
Net (Income) Cost from Operations	\$ (128,981)	\$ 140	\$ —	\$ (85)	\$ (128,926)
Statement of Changes in Net Position					
For the Year Ended September 30, 2009					
Net Position, Beginning of Period	\$ 5,903,289	\$ —	\$ —	\$ —	\$ 5,903,289
Appropriations Used	—	140	—	—	140
Non-Exchange Revenue	—	—	—	—	—
Imputed Financing	25,955	—	—	—	25,955
Other	—	—	—	(85)	(85)
Net Income (Cost) from Operations	128,981	(140)	—	85	128,926
Net Change	154,936	—	—	—	154,936
Cumulative Results of Operations	6,058,225	—	—	—	6,058,225
Unexpended Appropriations:					
Beginning Balances	—	—	—	—	—
Appropriations Received	—	10,000	—	—	10,000
Appropriations Used	—	(140)	—	—	(140)
Total Unexpended Appropriations	—	9,860	—	—	9,860
Net Position, End of Period	\$ 6,058,225	\$ 9,860	\$ —	\$ —	\$ 6,068,085

NOTE 14. Intragovernmental Costs and Exchange Revenue

The Statement of Net Cost presents the SEC's results of operations for its major programs. The SEC assigns all costs incurred to ten programs, consistent with its budget submissions. The full cost of SEC programs is determined by the sum of (1) the costs of resources directly or indirectly consumed, and (2) the costs of identifiable supporting services provided by other responsibility segments within the agency. Typical examples of indirect costs include costs of general administrative services, general research and technical support, security, rent, and operating and maintenance costs for buildings, equipment, and utilities. The SEC allocates support costs to its programs using activity-based cost accounting.

Exchange revenue is not directly assignable to a specific program and is presented in total. Total intragovernmental and public costs for the fiscal years ended September 30, 2010 and 2009, are summarized below.

FY 2010			
(DOLLARS IN THOUSANDS)	Intragovernmental Gross Cost	Gross Cost with the Public	Total
SEC Programs:			
Enforcement	\$ 61,669	\$ 293,782	\$ 355,451
Compliance Inspections and Examinations	39,798	189,591	229,389
Corporation Finance	22,757	108,409	131,166
Trading and Markets	9,388	44,719	54,107
Investment Management	8,306	39,567	47,873
Risk, Strategy, and Financial Innovation	3,148	14,995	18,143
General Counsel	6,901	32,879	39,780
Other Program Offices	8,432	40,171	48,603
Agency Direction and Administrative Support	22,300	106,231	128,531
Inspector General	933	4,447	5,380
Total Entity	\$ 183,632	\$ 874,791	\$ 1,058,423
Less: Exchange Revenues			1,382,856
Net (Income) Cost from Operations			\$ (324,433)

FY 2009 (Reclassified)			
(DOLLARS IN THOUSANDS)	Intragovernmental Gross Cost	Gross Cost with the Public	Total
SEC Programs:			
Enforcement	\$ 56,284	\$ 277,098	\$ 333,382
Compliance Inspections and Examinations	35,802	176,259	212,061
Corporation Finance	20,898	102,884	123,782
Trading and Markets	7,937	39,073	47,010
Investment Management	8,154	40,141	48,295
Risk, Strategy, and Financial Innovation	2,423	11,931	14,354
General Counsel	6,238	30,710	36,948
Other Program Offices	7,621	37,519	45,140
Agency Direction and Administrative Support	19,442	95,716	115,158
Inspector General	816	4,019	4,835
Total Entity	\$ 165,615	\$ 815,350	\$ 980,965
Less: Exchange Revenues			1,109,891
Net (Income) Cost from Operations			\$ (128,926)

Intragovernmental costs arise from exchange transactions made between two reporting entities within the federal government, in contrast with public costs which arise from exchange transactions made with a non-federal entity.

FINANCIAL SECTION

NOTE 15. Exchange Revenues

For the fiscal years ended September 30, 2010 and 2009, exchange revenues consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Securities Transactions Fees	\$ 1,163,633	\$ 927,112
Securities Registration, Tender Offer, and Merger Fees	218,755	181,671
Other	468	1,108
Total Exchange Revenues	\$ 1,382,856	\$ 1,109,891

NOTE 16. Status of Budgetary Resources

A. Apportionment Categories of Obligations Incurred

The distinction between Category A and B funds is the time of apportionment. Category A funds are subject to quarterly apportionment by OMB. Category B funds represent budgetary resources distributed by a specified time period, activity, project, object, or a combination of these categories. The SEC's Category B funds represent amounts apportioned at the beginning of the fiscal year for the SEC's reimbursable activity. For the fiscal years ended September 30, 2010 and 2009, obligations incurred as reported on the SBR consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Obligations Incurred		
Direct Obligations		
Category A	\$ 1,103,007	\$ 964,640
Reimbursable Obligations		
Category B	282	1,236
Total Obligations Incurred	\$ 1,103,289	\$ 965,876

In addition, the amounts of budgetary resources obligated for undelivered orders include \$219.3 million and \$152.8 million at September 30, 2010 and 2009, respectively.

B. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

A comparison between the FY 2010 SBR and the actual FY 2010 data in the President's budget cannot be presented, as the FY 2012 President's budget which will contain the FY 2010 data is not yet available; the comparison will be presented in next year's financial statements. There are no differences between the FY 2009 SBR and the FY 2009 data in the President's budget except for a rounding difference of \$1 million in Gross Outlays.

NOTE 17. Custodial Revenues

As of September 30, 2010, \$42.4 million of disgorgement and penalty accounts receivables, net of allowance, was designated as payable to the Treasury General Fund per court order. As discussed in *Note 1.D. Changes in Accounting Presentation* and *Note 1.N. Liabilities*, these receivables, their offsetting liabilities, and the revenues generated in obtaining them, are classified as custodial.

For the fiscal years ended September 30, 2010 and 2009, the source of custodial non-exchange revenues is shown below. Collections will be transferred to Treasury or the Investor Protection Fund.

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Cash Collections:		
Disgorgement and Penalties	\$ 1,116,632	\$ 815,802
Other	1	10
Amounts to Be Collected	42,380	4
Total Custodial Revenue	\$ 1,159,013	\$ 815,816

Financial Statements

FINANCIAL SECTION

**NOTE 18. Reconciliation of Net Cost of Operations (Proprietary) to Budget
(formerly the Statement of Financing)**

For the fiscal years ended September 30, 2010 and 2009:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
RESOURCES USED TO FINANCE ACTIVITIES:		
Budgetary Resources Obligated:		
Obligations Incurred (Note 16)	\$ 1,103,289	\$ 965,876
Less: Spending Authority from Offsetting Collections and Recoveries	(1,461,657)	(1,047,046)
Net Obligations	(358,368)	(81,170)
Other Resources:		
Imputed Financing from Cost Absorbed by Others (Note 11)	36,216	25,955
Total Resources Used to Finance Activities	(322,152)	(55,215)
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS:		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits		
Ordered But Not Yet Provided	(67,775)	6,185
Resources That Finance the Acquisition of Assets Capitalized on the Balance Sheet	(27,319)	(24,844)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(95,094)	(18,659)
Total Resources Used to Finance the Net Cost of Operations	(417,246)	(73,874)
COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:		
Components Requiring or Generating Resources in Future Periods:		
Costs That Will Be Funded by Resources in Future Periods	2,933	3,867
Net (Increase) Decrease in Revenue Receivables Not Generating Resources until Collected	60,320	(92,169)
Change in Lease Liability	(3,311)	(3,255)
Change in Legal Liability	10,823	—
Change in Unfunded Liability	(7,824)	10,176
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	62,941	(81,381)
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	25,408	26,414
Revaluation of Assets or Liabilities	4,634	—
Other Costs That Will Not Require Resources	(170)	(85)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in Future Periods	29,872	26,329
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	92,813	(55,052)
Net (Income) Cost from Operations	\$ (324,433)	\$ (128,926)

NOTE 19. Disgorgement and Penalties

The SEC's non-entity assets consist of disgorgement, penalties, and interest assessed against securities law violators by the Commission, administrative law judge, or in some cases, a court. The SEC also recognizes an equal and offsetting liability for these non-entity assets as discussed in *Note 1.N. Liabilities*. When the Commission or court issues an order for the SEC to collect disgorgement, penalties, and interest from securities law violators, the SEC establishes an account receivable due to the SEC. When collected, the SEC holds receipts in FBWT or invests in Treasury securities pending distribution to harmed investors or transfer to the Investor Protection Fund or the Treasury General Fund. Disbursements related to disgorgements and penalties include distributions to harmed investors, payments to tax authorities, and fees paid to plan administrators and the Bureau of Public Debt. When it is not practical to return funds to investors or when court orders expressly state that funds are to be remitted to the U.S. Treasury, the SEC transfers funds to the Investor Protection Fund or to the Treasury General Fund. The SEC does not record on its financial statements any amounts ordered to another government entity such as a court, or a non-governmental entity such as a receiver. Additional details regarding disgorgement and penalties are presented in *Note 1.T. Disgorgement and Penalties*, *Note 2. Non-Entity Assets* and *Note 13. Earmarked, Other, Disgorgement and Penalties, and Non-Entity Funds*.

At September 30, the net inflows and outflows for FBWT, Investments, and Accounts Receivable related to disgorgement and penalties consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	FY 2010	FY 2009
Fund Balance with Treasury:		
Beginning Balance	\$ 43,622	\$ 37,707
Collections	1,214,911	885,318
Purchases and Redemptions of Treasury Securities	1,036,168	1,032,328
Disbursements	(1,123,799)	(1,095,929)
Transfers to Investor Protection Fund	(451,910)	—
Transfers to Treasury	(664,723)	(815,802)
Total Fund Balance with Treasury (Note 2)	54,269	43,622
Cash and Other Monetary Assets		
Net Activity	2,815	—
Total Cash and Other Monetary Assets (Notes 2 and 4)	2,815	—
Investments, Net:		
Beginning Balance	1,959,611	2,982,542
Net Activity	(1,034,788)	(1,022,931)
Total Investments, Net (Notes 2 and 5)	924,823	1,959,611
Accounts Receivable, Net:		
Beginning Balance	294,508	88,118
Net Activity	(212,569)	206,390
Total Accounts Receivable, Net (Notes 2 and 6)	81,939	294,508
Total Disgorgement and Penalties (Note 13)	\$ 1,063,846	\$ 2,297,741

Required Supplementary Information

FINANCIAL SECTION

Required Supplementary Information (Unaudited)

This section provides the Required Supplementary Information as prescribed by OMB Circular No. A-136, *Financial Reporting Requirements*.

Statement of Budgetary Resources by Fund

For the fiscal years ended September 30, 2010 and 2009:

(DOLLARS IN THOUSANDS)	Salaries and Expenses and Other Funds	Supplemental Fund	Investor Protection Fund	Total	FY 2009
	X0100, 3220, F3875	09/10 0100	X5667		
BUDGETARY RESOURCES:					
Unobligated Balance, Brought Forward, October 1	\$ 19,011	\$ 7,754	\$ —	\$ 26,765	\$ 57,696
Recoveries of Prior Year Unpaid Obligations	18,753	—	—	18,753	28,982
Budget Authority:					
Appropriation	—	—	451,910	451,910	10,000
Spending Authority from Offsetting Collections:					
Earned:					
Collected	1,443,347	—	—	1,443,347	1,017,763
Change in Receivables from Federal Sources	(188)	—	—	(188)	143
Change in Unfilled Customer:					
Advance Received	(157)	—	—	(157)	157
Without Advance from Federal Sources	(98)	—	—	(98)	1
Subtotal	1,442,904	—	451,910	1,894,814	1,028,064
Temporarily not Available Pursuant to Public Law	(347,694)	—	—	(347,694)	(122,101)
Total Budgetary Resources	\$ 1,132,974	\$ 7,754	\$ 451,910	\$ 1,592,638	\$ 992,641
STATUS OF BUDGETARY RESOURCES:					
Obligations Incurred:					
Direct (Note 16)	\$ 1,095,360	\$ 7,647	\$ —	\$ 1,103,007	\$ 964,640
Reimbursable (Note 16)	282	—	—	282	1,236
Subtotal	1,095,642	7,647	—	1,103,289	965,876
Unobligated Balance Available:					
Realized and Apportioned for Current Period	17,106	107	—	17,213	9,968
Unobligated Balance Not Available	20,226	—	451,910	472,136	16,797
Total Status of Budgetary Resources	\$ 1,132,974	\$ 7,754	\$ 451,910	\$ 1,592,638	\$ 992,641
CHANGE IN OBLIGATED BALANCE:					
Obligated Balance, Net:					
Unpaid Obligations, Brought Forward, October 1	\$ 234,292	\$ 2,107	\$ —	\$ 236,399	\$ 250,974
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(311)	—	—	(311)	(167)
Total Unpaid Obligated Balance, Net	233,981	2,107	—	236,088	250,807
Obligations Incurred Net	1,095,642	7,647	—	1,103,289	965,876
Gross Outlays	(995,299)	(7,864)	—	(1,003,163)	(951,469)
Recoveries of Prior Year Unpaid, Obligations Actual	(18,753)	—	—	(18,753)	(28,982)
Change in Uncollected Customer Payments from Federal Sources	286	—	—	286	(144)
Obligated Balance, Net, End of Period:					
Unpaid Obligations	315,882	1,890	—	317,772	236,399
Uncollected Customer Payments from Federal Sources	(25)	—	—	(25)	(311)
Total, Unpaid Obligated Balance, Net, End of Period (Note 12)	\$ 315,857	\$ 1,890	\$ —	\$ 317,747	\$ 236,088
NET OUTLAYS:					
Net Outlays:					
Gross Outlays	\$ 995,299	\$ 7,864	\$ —	\$ 1,003,163	\$ 951,469
Offsetting Collections	(1,443,190)	—	—	(1,443,190)	(1,017,920)
Distributed Offsetting Receipts	194	—	—	194	(702)
Net Outlays/(Collections)	\$ (447,697)	\$ 7,864	\$ —	\$ (439,833)	\$ (67,153)

Appendix I: Material Weaknesses

During our audit of the United States Securities and Exchange Commission's (SEC) fiscal years 2010 and 2009 financial statements, we identified two material weaknesses¹ in internal control as of September 30, 2010. These material weaknesses concern internal control over SEC's (1) information systems, and (2) financial reporting and accounting processes.

Information Systems

During fiscal year 2010, SEC had pervasive deficiencies in the design and operation of SEC's information security and other system controls that span across its general support system and all key applications that support financial reporting. Many of these deficiencies have existed since SEC began preparing financial statements back in fiscal year 2004. These deficiencies jeopardize the confidentiality, availability, and integrity of information processed by SEC's key financial reporting systems and pose a risk of material misstatement in financial reporting. These continuing deficiencies and the newly identified general and application control deficiencies are in the areas of (1) security management, (2) access controls, (3) configuration management, (4) segregation of duties, and (5) contingency planning. Specifically, in fiscal year 2010, SEC did not adequately

- implement effective vulnerability and patch management programs,
- restrict system user privileges resulting in inappropriate or unapproved user access to its systems,
- implement a sufficient change management process to prevent unapproved and unauthorized changes to its general support system and key applications,
- segregate computer-related duties and functions,
- transmit sensitive data securely,
- implement an effective disaster recovery or contingency planning process, and
- remediate information system deficiencies timely.

These general and application control deficiencies exist in part because SEC does not have adequate technical resources and has not fully established an overall effective security-wide program. In addition, SEC has not implemented effective monitoring and oversight procedures of its information systems operations. SEC also does not have a mechanism in

¹ A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

place to promptly resolve deficiencies found during its information system control evaluations. Further, SEC does not always effectively use corrective action plans as a tool to assist in the prioritization of vulnerability remediation and is not directing resources to address the vulnerabilities in a timely manner.

We also continued to find ineffective automated controls for SEC's general ledger system and supporting applications, and ineffective security controls over the databases and supporting processes used to generate and maintain SEC's financial reports. Many of SEC's key financial reporting applications occur manually outside the general ledger system through the use of spreadsheets and databases because many of SEC's key financial system applications do not automatically interface with the general ledger system and because SEC's general ledger system and certain software applications and configurations are not designed to provide accurate, complete, and timely transaction-level financial information needed to accumulate and readily report reliable financial information. Further, SEC's general ledger system lacks the capacity to timely and accurately generate and report information needed to prepare financial statements and manage operations on an ongoing basis. For example, the general ledger is unable to generate an accurate consolidated trial balance that can be used for the compilation of financial statements and cannot produce a set of financial statements. Instead, SEC uses a financial reporting and analysis tool to produce its monthly trial balances and financial statements. However, this tool is housed in a database that did not have electronic logging or an audit trail, and did not have the capability to track login/logout activity and/or other security-related events specified by the system's audit policy, such as when records are updated, values are changed, or accounting data are inappropriately altered. Therefore, an individual could gain access and make unauthorized system changes that would not be detected.

As we have reported in previous years, SEC's general ledger has unconventional posting models and other system limitations for certain activities that require extensive recording of adjusting journal entries, creating significant risk of error or misstatement in SEC's financial reporting. For example, incorrect posting configurations in its general ledger resulted in SEC recording invalid budget transactions that necessitated over \$39 million in adjusting entries during fiscal year 2010 to properly record these transactions. In addition, the accounts receivable module of the general ledger was not configured to provide information to support activity in the related general ledger accounts, such as providing an aging of its accounts receivable. In another example, SEC's general

ledger system is not able to calculate and record interest due on delinquent disgorgement receivable amounts as part of its disgorgement receivable balance.

Until these system deficiencies, limitations, and vulnerabilities are addressed, SEC cannot rely on the internal controls contained in its automated accounting system and supporting financial applications systems to provide reasonable assurance that, in the absence of effective compensating procedures, (1) its financial statements, taken as a whole, are fairly stated; (2) the information SEC relies on to make decisions on a daily basis is accurate, complete, and timely; and (3) sensitive data and financial information are appropriately safeguarded. Instead, SEC has to rely on manual compensating controls that are cumbersome, labor-intensive, and error-prone, to ensure data completeness and accuracy in order to achieve reliable financial reporting. As discussed later in this report, during fiscal year 2010, these manual compensating procedures were not always effective at ensuring reliable financial reporting. Consequently, these deficiencies represent a material weakness in internal control over information systems given their pervasive impact on financial reporting and SEC's ability to meet the fundamental objective of internal control. Specifically, this material weakness in information systems increases the potential for undetected material misstatements in SEC's financial statements and inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction of its financial information and assets.

Financial Reporting and Accounting Processes

During fiscal year 2010, we continued to find deficiencies in controls over SEC's financial reporting process, budgetary resources, and registrant deposits. We reported these same deficiencies last year and in prior audits. SEC has taken actions toward addressing these previously reported deficiencies; however, notwithstanding these efforts, these deficiencies remain in fiscal year 2010. During this year's audit, we also identified new deficiencies concerning disgorgement and penalties² and required supplementary information. These continuing deficiencies and the newly identified deficiencies this year indicate that SEC's monitoring process was not always effective in identifying and correcting internal control

² A disgorgement is the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible. A penalty is a monetary payment from a violator of securities law that SEC obtains pursuant to statutory authority. A penalty is fundamentally a punitive measure, although penalties occasionally can be used to compensate harmed investors.

issues in a timely manner. The collective nature of the deficiencies we identified is such that a reasonable possibility exists that a material misstatement of SEC's financial statements would not be prevented, or detected and corrected on a timely basis. Consequently, these deficiencies collectively represent a material weakness in SEC's internal control over financial reporting.

Financial Reporting Process

Because of serious deficiencies in information system controls discussed previously, SEC is unable to rely on automated controls in its general ledger system or any of its key financial reporting applications to protect the integrity of the financial data. Instead, the recording of significant transactions is accomplished through the use of spreadsheets, databases, manual workarounds, and data handling that rely on significant analysis, reconciliation, and review to calculate amounts for the general ledger postings of transactions. These compensating manual processes are resource-intensive and prone to error, and coupled with the significant amount of data involved, increase the risk of materially misstated account balances in the general ledger. During this year's audit, SEC's compensating procedures were not always effective at ensuring the completeness and accuracy of the financial data obtained from the application systems or at detecting errors and misstatements in financial reporting activities. For example, in SEC's calculation of its monthly accounts payable accrual, SEC's system query did not accurately and completely capture all of the appropriate accounts payable activity, resulting in understating the accounts payable balance during certain months of the year. These errors were not identified through the spreadsheet control checks, and the resulting understatements were not detected by the supervisory review and approval of the entries posted to the general ledger. We also found errors in SEC's spreadsheet used for calculating future lease payments, which resulted in a \$40 million understatement of lease payments disclosed in the draft notes accompanying the financial statements, and errors in its formula for calculating gross cost with the public, which resulted in a \$21 million misstatement in the draft notes. In addition, SEC's monthly review of its fee rate calculations pertaining to its securities transaction revenue did not identify that SEC was using the wrong fee rate for April, May, and June.³ In

³ SEC collects securities transaction fees paid by self-regulatory organizations (SRO) to SEC for stock transactions. SEC calculates the fees due and bills the SROs based on actual transaction volume reported on a monthly basis by SROs to SEC.

another example, SEC's initial June reconciliation of investment transactions did not agree with supporting documentation, yet the reconciliation was signed indicating that it had been reviewed. SEC made the necessary adjustments to enable it to present financial statements that were fairly stated in all material respects for fiscal years 2010 and 2009.

Budgetary Resources

Since our 2007 audit of SEC, we have reported significant deficiencies in SEC's accounting for obligations, which represent legal liabilities against funds available to SEC to pay for goods and services ordered, and related budgetary transactions reported on its Statement of Budgetary Resources. During fiscal year 2010, SEC incurred approximately \$1.1 billion in obligations. Also during the year, SEC deobligated approximately \$12 million for prior year transactions that were either cancelled or the dollar amount of the obligation was decreased.

During this year's audit, we continued to identify the same deficiencies over budgetary transactions that we identified in prior audits, and we also identified new deficiencies in this area. Specifically, as discussed previously in this report, we continued to find posting configuration limitations that resulted in errors in recording budget transactions. We also continued to find obligations that were not always recorded timely and were not always supported by documentation evidencing the obligation as having been approved by an authorized individual. SEC took actions during fiscal year 2010 to address these deficiencies. For example, SEC worked to enhance its posting models and begin to fix issues within the general ledger that were necessitating a significant amount of correcting entries. The amount of adjusting entries was reduced this year because of these fixes, but \$39 million in corrections were still required to properly record certain budget transactions because of continuing system configuration deficiencies.

During fiscal year 2010, we found that SEC did not have an effective process for monitoring and reviewing its open obligations to ensure that they remained valid and that adjustments are made properly and timely. In fiscal year 2010, SEC began using a system-generated *Open Obligations* report to monitor and review its open obligations. However, SEC's written procedures pertaining to the use of this report do not provide guidance on the performance of validation procedures to ensure the accuracy and completeness of the information in the report prior to using the report. In our review of the *Open Obligations* report for the month of June, we identified a number of issues concerning the accuracy and completeness of the report. For example, in the report were several instances where the

liquidation amounts were in excess of original obligation amounts and where the liquidation amounts were recorded against nonexistent obligations, both of which aggregated to about \$1.1 million. Moreover, the outstanding balance reflected in the report for many of the obligations was calculated incorrectly and reflected amounts that exceeded the amount per the invoice that initiated the obligation. In response to our findings concerning the accuracy and completeness of the report, SEC determined that the discrepancies were the result of systemic errors in the logic of the report and plans to address these issues in fiscal year 2011.

Further, our review this year of open obligations identified obligations that did not appear to be valid because there was no recent activity pertaining to these obligations. For example, we identified several travel obligations related to SEC officials who left the agency over 12 months ago, yet SEC continued to incorrectly carry an open travel obligation for these individuals. We also found several open obligations for which contract close out procedures were not completed timely, resulting in SEC continuing to carry balances of open obligations for contracts that have been completed. In addition, we found several instances in which obligations that were approved to be deobligated, were not done properly or in a timely manner. For example, we found obligations that were approved for full deobligation but were either partially deobligated or were deobligated in the wrong accounting period. We also found instances in which the deobligation took 15 months to be completed from the time it was approved. Deobligating resources timely can be important to an agency to free up resources that may be made available for incurring new obligations or adding to existing obligations. Contributing to SEC's weakness in this area is that SEC does not have a policy that addresses the timeframes for recording deobligations for all types of its obligations.

Registrant Deposits

SEC is partially funded through the collection of securities registration, tender offer, merger, and other fees (filing fees) from registrants. SEC records the filing fees it collects as revenue. If registrants submit amounts to SEC in excess of the actual fee payment due for a specific filing, SEC records the excess amounts collected in a registrant deposit liability account until earned by SEC from a future filing. SEC's policy is to return the amount in the deposit liability account to the registrant if the account has not had any activity against it for 6 months. As of September 30, 2010, SEC's liability for registrant deposits totaled \$45 million.

As in prior years, our testing of filing fee transactions during this year's audit identified amounts recorded in the registrant deposit account

liability that were not properly returned to registrants and amounts that were not properly recognized as revenue in the correct fiscal year. Specifically, of the \$45 million in registrant deposit accounts at September 30, 2010, SEC reported over \$25 million in deposit accounts that were dormant for 6 months or more. Our audit also identified amounts in the registrant account liability that SEC earned in prior years and therefore should have been recognized as revenue in those years. SEC was aware that some of the liability amounts were earned. For example, as of September 30, 2010, SEC identified \$1.9 million in the liability account that should have been recognized as revenue in prior years.

SEC has a process to recalculate and verify that the correct registrant fee is collected for each filing. However, for 48 of the 53 filings we reviewed, SEC did not verify that the correct registrant fee was collected. In one instance, SEC's review did identify an incorrect registrant fee submission but did not take the necessary steps to follow through to properly recognize the \$3.2 million in revenue pertaining to this submission until approximately 6 months after the error was discovered, and only after being notified by the filer upon the filer's review of its account statement. SEC acknowledged that it has not dedicated the resources necessary to address what it considers to be a labor-intensive process of researching the deposit account activity to determine if amounts should be refunded or recognized as revenue. Also because of insufficient staff resources allocated to this area, SEC has a backlog of filings that are still awaiting the review and verification process to ensure the filings were submitted for the correct amounts. Until this backlog of filings is reviewed and the filing fee amounts are verified and properly recorded, filing fee revenue and the related registrant deposit account liability amounts could be misstated and not be detected by SEC in a timely manner.

Disgorgement and Penalties

As part of its enforcement responsibilities, SEC issues orders and administers judgments ordering, among other things, disgorgement, civil monetary penalties, and interest against violators of federal securities laws. SEC recognizes a receivable accompanied by an equal and offsetting liability to account for amounts payable to SEC when SEC is designated in an order or a final judgment to collect the assessed disgorgement, penalties, and interest on behalf of harmed investors or for payment to the general fund of the U.S. Treasury. SEC recognizes amounts collected that are to be deposited in the general fund of the U.S. Treasury as revenue on its Statement of Custodial Activity. As of September 30, 2010, the net amount of SEC's disgorgement and penalties accounts receivable was \$82 million. SEC's custodial revenue collected from disgorgement and

penalties and transferred to the general fund of the U.S. Treasury during fiscal year 2010 was \$665 million.

During this year's audit, we noted deficiencies in SEC's accounting for disgorgement and penalties transactions that increase the likelihood that the affected balance sheet amounts and custodial balances could be misstated and not be detected in a timely manner. Specifically, SEC does not have a process for recording receivables in situations where the original order is superseded by a subsequent order that redirects residual monies, remaining after a distribution is made to harmed investors, to be paid to SEC for transfer to the U.S. Treasury. These orders, referred to by SEC as transfer orders, can be significant. For example, one of these judgments ordered that \$58 million in residual monies be paid to SEC for transfer to the U.S. Treasury; however, SEC did not establish a receivable for this approved transfer order. Moreover, once custodial-type collections occur, we found that SEC was not transferring such collections to the U.S. Treasury in a timely manner. We identified approximately \$25 million in custodial collections that remained on SEC's balance sheet at a point during the year when it should have been transferred to the U.S. Treasury and recognized as revenue on its Statement of Custodial Activity.

We also found concerns during this year's audit with SEC's process of recording cash collections. SEC receives collections for the payment of disgorgement and penalties and other activities, by check, wire transfers, or automated clearing house deposits. During fiscal year 2010, SEC collected 1,577 checks totaling over \$229 million. During our review this year of SEC's collections, we found checks, totaling about \$2.8 million, that were not recorded in the proper accounting period. This is largely because SEC's standard operating procedure for the recording of check collections is to record the collection in the general ledger after the SEC receives confirmation from the bank that the check has been deposited. This process could take several days from the date the check was initially received by SEC. However, SEC does not have a compensating procedure to ensure that checks received, particularly those checks received at, or close to, the end of an accounting period, are recorded in a timely manner or in the proper period.

Required Supplementary Information

In fiscal year 2010, the Dodd-Frank Act established the need for a new Treasury Account Symbol in SEC's fund accounting structure to account for activities of the newly created SEC Investor Protection Fund.⁴ SEC reports activity for this significant fund, which totaled \$452 million at September 30, 2010, together with activity from other funds in the Statement of Budgetary Resources. U.S. generally accepted accounting principles require that budgetary information aggregated for purposes of the Statement of Budgetary Resources should be disaggregated for each of the reporting entity's major budget accounts and presented as required supplementary information. However, because of a misinterpretation of accounting principles, SEC's draft financial reporting results did not include the required supplementary information pertaining to the budget accounts for its Investor Protection Fund. SEC ultimately prepared the required supplementary information for its September 30, 2010, financial reporting.

⁴The Investor Protection Fund (Fund) provides funding for a whistleblower award program, in which SEC makes award payments from the Fund to eligible people who provide original information to SEC that leads to SEC's successful enforcement of a judicial or administrative action in which monetary sanctions exceeding \$1 million are imposed. See Dodd-Frank Act, Pub. Law No. 111-203, § 922(g), 124 Stat. 1376, 1844 (July 21, 2010)(*codified at* 15 U.S.C. § 78u-6).

Appendix II: Comments from the United States Securities and Exchange Commission



THE CHAIRMAN

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

November 12, 2010

Mr. James R. Dalkin
Director, Financial Management and Assurance
United States Government Accountability Office
441 G Street, N.W.
Washington, DC 20548

Dear Mr. Dalkin:

Thank you for the opportunity to review and comment on the results of your audit of the SEC's financial statements and internal controls over financial reporting. I am pleased that the Government Accountability Office's FY 2010 audit found that the SEC's financial statements and notes are presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles.

As you know, the SEC has identified two material weaknesses, one in information systems and a second in financial reporting and accounting processes. This latter material weakness results from the combination of five deficiencies related to financial reporting, budgetary resources, filing fees, disgorgements and penalty transactions, and required supplementary information.

Both of these material weaknesses can be addressed in large part through improvements to our core financial system, which will both enhance security and significantly reduce manual processes.

Thus, the key to the SEC's remediation strategy is our new initiative to replace the agency's core financial system by migrating to a federal government Shared Service Provider (SSP). This migration will allow the agency to put in place better protections for financial data and to enhance its financial reporting processes through further automation. The SEC has issued a Letter of Intent with the Enterprise Services Center at the Department of Transportation which formalizes the joint effort to develop detailed requirements for the system. The SEC plans to shift to the new environment in FY 2012.

To ensure effective leadership through a transition to a SSP, the SEC will be heavily relying on several recently-hired senior financial managers, including, our Chief Operating Officer, Chief Financial Officer, and Chief Information Officer. We will also soon be hiring a Chief Accounting Officer to further strengthen expertise in this important area. This senior management team will lead the transition to the SSP and a variety of other efforts to remediate the SEC's material weaknesses.

**Appendix II: Comments from the United States Securities
and Exchange Commission**

Mr. James R. Dalkin
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I very much appreciate the professional manner in which you and your team executed the audit, and I look forward to continuing our productive dialogue in the coming months as we work to strengthen our internal controls over financial reporting. If you have any questions or concerns, please feel free to contact me.

Sincerely,



Mary Schapiro
Chairman

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