U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

Accessible Version

November 15, 2017

The Honorable Jay Clayton
Chairman
United States Securities and Exchange Commission

Financial Audit: Securities and Exchange Commission's Fiscal Years 2017 and 2016 Financial Statements

Dear Mr. Clayton:

This report transmits the GAO auditor's report on the results of our audits of the fiscal years 2017 and 2016 financial statements of the United States Securities and Exchange Commission (SEC) and its Investor Protection Fund (IPF),[1] which is incorporated in the enclosed *U.S. Securities and Exchange Commission Fiscal Year 2017 Agency Financial Report*.

As discussed more fully in the auditor's report that begins on page 57 of the enclosed agency financial report, we found

- the financial statements of SEC and its IPF as of and for the fiscal years ended September 30, 2017, and 2016, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- SEC maintained, in all material respects, effective internal control over financial reporting for SEC and for IPF as of September 30, 2017; and
- no reportable noncompliance for fiscal year 2017 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The Accountability of Tax Dollars Act of 2002 requires that SEC annually prepare and submit audited financial statements to Congress and the Office of Management and Budget.[2] The Securities Exchange Act of 1934, as amended in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires SEC to annually prepare and submit a complete set of audited financial statements for IPF to Congress.[3] In accordance with the authority conferred by the Chief Financial Officers Act of 1990, as amended

[1]IPF, which was established in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), funds the activities of SEC's whistleblower award program and the SEC Office of Inspector General Employee Suggestion Program established under section 966 of the Dodd-Frank Act. IPF is a separate SEC fund, and its financial statements present SEC's financial activity associated with these programs. Accordingly, IPF's financial transactions are also included in SEC's overall financial statements. Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1844 (July 21, 2010), *classified at* 15 U.S.C. § 78u-6(g).

[2]Pub. L. No. 107-289, § 2, 116 Stat. 2049-50 (Nov. 7, 2002), *amending* 31 U.S.C. § 3515.

[3]Dodd-Frank Act, § 922(a), 124 Stat. 1844 (July 21, 2010), *adding* § 21F(g)(5) of the Securities Exchange Act of 1934, *classified at* 15 U.S.C. § 78u-6(g)(5).

by the Government Management Reform Act of 1994,[4] we have audited the SEC and IPF financial statements. Section 963 of the Dodd-Frank Act further requires that (1) SEC annually submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year, (2) the SEC Chairman and Chief Financial Officer attest to SEC's report, and (3) GAO assess the effectiveness of SEC's internal control over financial reporting and evaluate, attest to, and report on SEC's assessment.[5] Accordingly, this report also includes our reporting in response to the requirement under section 963 of the Dodd-Frank Act.

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 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, the report is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have questions about this report, please contact me at (202) 512-3133 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,

James R. Dalkin
Director
Financial Management and Assurance Team

Enclosure

See attached PDF of agency report

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[4]See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), *codified, in relevant part, as amended, at* 31 U.S.C. § 3515(c).

[5]Dodd-Frank Act, § 963(a), (b), 124 Stat. 1910 (July 21, 2010), *classified at* 15 U.S.C. § 78d-8(a), (b).

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Independent Auditor's Report

To the Chairman of the United States Securities and Exchange Commission

In our audits of the fiscal years 2017 and 2016 financial statements of the United States Securities and Exchange Commission (SEC)[6] and the Investor Protection Fund (IPF),[7] we found

- the SEC and IPF financial statements as of and for the fiscal years ended September 30, 2017, and 2016, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- SEC maintained, in all material respects, effective internal control over financial reporting for SEC and for IPF as of September 30, 2017; and
- no reportable noncompliance for 2017 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on SEC's and IPF's financial statements and on internal control over financial reporting, which includes required supplementary information (RSI)[8] and other information included with the financial statements;[9] (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments.

Report on the Financial Statements and on Internal Control over Financial Reporting

The Accountability of Tax Dollars Act of 2002 requires that SEC annually prepare and submit audited financial statements to Congress and the Office of Management and Budget.[10] The

[6]Section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires that (1) SEC annually submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year; (2) the SEC Chairman and Chief Financial Officer attest to SEC's report; and (3) GAO assess the effectiveness of SEC's internal control over financial reporting and assess, attest to, and report on SEC's assessment. Pub. L. No. 111-203, § 963 (a), (b), 124 Stat. 1376, 1910 (July 21, 2010), *classified at* 15 U.S.C. § 78d-8(a), (b). SEC evaluated its internal control over financial reporting in accordance with the Office of Management and Budget's Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act.

[7]IPF, which was established by section 922 of the Dodd-Frank Act, funds the activities of SEC's whistleblower award program and the SEC Office of Inspector General Employee Suggestion Program established under section 966 of the Dodd-Frank Act. IPF is a separate SEC fund, and its financial statements present SEC's financial activity associated with these programs. Accordingly, IPF's financial transactions are also included in SEC's overall financial statements. Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1844 (July 21, 2010), *classified at* 15 U.S.C. § 78u-6(g).

[8]The RSI consists of the Management's Discussion and Analysis and the Combined Statement of Budgetary Resources, by Fund, which are included with the financial statements.

[9]Other information consists of information included with the financial statements, other than the RSI and the auditor's report.

[10]Pub. L. No. 107-289, § 2, 116 Stat. 2049-50 (Nov. 7, 2002), *amending* 31 U.S.C. § 3515.

Securities Exchange Act of 1934, as amended in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires SEC to annually submit a complete set of audited financial statements for IPF to Congress.[11] IPF's financial transactions are also included in SEC's overall financial statements. In accordance with the authority conferred by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994,[12] we have audited the SEC and IPF financial statements. Further, in accordance with the Dodd-Frank Act, we have assessed the effectiveness of SEC's internal control over financial reporting, evaluated SEC's assessment of such effectiveness, and are attesting to and reporting on SEC's assessment of its internal control over financial reporting. SEC's financial statements comprise the balance sheets as of September 30, 2017, and 2016; the related statements of net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended; and the related notes to the financial statements. IPF's financial statements comprise the balance sheets as of September 30, 2017, and 2016; the related statements of net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements. We also have audited SEC's internal control over financial reporting as of September 30, 2017, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

Management's Responsibility

SEC management is responsible for (1) the preparation and fair presentation of SEC's financial statements and those of IPF in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of September 30, 2017, included in the Management Assurance section of the agency financial report.

Auditor's Responsibility

Our responsibility is to express opinions on SEC's and IPF's financial statements and opinions on internal control over financial reporting for SEC and for IPF, based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material

[11]Dodd-Frank Act, § 922(a), 124 Stat. 1844 (July 21, 2010), *adding* § 21F(g)(5) of the Securities Exchange Act of 1934, *classified at* 15 U.S.C. § 78u-6(g)(5).

[12]See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), *codified, in relevant part, as amended, at* 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), *codified, in relevant part, as amended, at* 31 U.S.C. § 3515(c).

misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.[13] The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered SEC's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information 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 whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

Definition and Inherent Limitations of Internal Control over Financial Reporting

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 provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness to future periods is subject to the risk that controls may become

[13]A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Opinions on SEC's Financial Statements

In our opinion, SEC's financial statements present fairly, in all material respects, SEC's financial position as of September 30, 2017, and 2016, and its net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Opinion on IPF's Financial Statements

In our opinion, IPF's financial statements present fairly, in all material respects, IPF's financial position as of September 30, 2017, and 2016, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

Opinion on Internal Control over Financial Reporting

In our opinion, SEC maintained, in all material respects, effective internal control over financial reporting as of September 30, 2017, for SEC and for IPF, based on criteria established under FMFIA. Our opinions on SEC's internal control are consistent with SEC's assessment that its internal control over financial reporting, both for the agency as a whole and for IPF, was operating effectively as of September 30, 2017, and that no material weaknesses were found in the design or operation of the controls.

During our 2017 audit, we identified deficiencies in SEC's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.[14] Nonetheless, these deficiencies warrant SEC management's attention. We have communicated these matters to SEC management and, where appropriate, will report on them separately.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion

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

or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

Other Information

SEC's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on SEC's and IPF's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

In connection with our audits of SEC's and IPF's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

Management's Responsibility

SEC management is responsible for complying with applicable laws, regulations, contracts, and grant agreements applicable to SEC and IPF.

Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to SEC and IPF that have a direct effect on the determination of material amounts and disclosures in the SEC and IPF financial statements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to SEC and IPF.

Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2017 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to SEC and IPF. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing

standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

Agency Comments

In commenting on a draft of this report, SEC expressed pleasure that GAO found that SEC's financial statements and notes were presented fairly, in all material respects, and in accordance with U.S. generally accepted accounting principles. SEC stated that it will continue to build upon this positive result in financial reporting by continuing to improve its internal control environment. SEC stated that it plans to take actions to help strengthen the agency's enterprise risk management program, modernize the tracking of disgorgement and penalties resulting from enforcement actions, and to enhance the processing of registration fees.

SEC also stated that it is already taking a number of proactive steps to enhance the agency's information security, related to deficiencies in its controls over operations that were identified as a result of the 2016 cyber intrusion involving the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR). GAO plans to monitor SEC's actions in response to the intrusion as a separate matter. The complete text of SEC's response is reprinted in enclosure I.

James R. Dalkin
Director
Financial Management and Assurance

November 13, 2017