



U.S. Securities and Exchange Commission

2007 Performance and Accountability Report



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U.S. Securities and Exchange Commission

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Handwritten signature of John H. Hummel in black ink.

John H. Hummel, CGFM
Chair, Certificate of Excellence
in Accountability Reporting Board

Handwritten signature of Reimond P. Van Daniker in black ink.

Reimond P. Van Daniker, DBA, CPA
Executive Director, AGA

U.S. Securities and Exchange Commission

2007 Performance and Accountability Report

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The U.S. Securities and Exchange Commission serves you by working to secure the trust in our markets that undergirds our nation's continuing prosperity in an increasingly global economy. The level of trust in our markets has enormous economic consequences—affecting everything from the affordability of food, clothing, and shelter to the creation of new jobs, increases in wages, and the protection of our retirement security.

This Performance and Accountability Report helps explain how the SEC works to sustain trust in our markets.

Message from the Chairman

Dear Investor,

The continued rapid integration of the world's capital markets is requiring a much deeper level of coordination with other national regulators than ever before. As America's investors increasingly look abroad to diversify their portfolios, both regulation and enforcement are necessarily becoming more international in terms of both outlook and responsibilities.

Today, two-thirds of America's investors own securities of non-U.S. companies. That's a 30 percent increase from just five years ago. Globally active investors have more choices; they often enjoy lower transaction costs; and they have greater opportunities to diversify risk than ever before. But they also face new dangers. Investor protection in an era of global markets is a far more complex undertaking for the SEC. For our law enforcement and regulatory missions to succeed, during 2007 we turned to our overseas counterparts for assistance with far greater frequency. And we're stepping up our efforts to extend U.S. domestic assistance to them.

During the last year, I executed agreements with the College of Euronext Regulators, the German Federal Financial Supervisory Authority, and the UK Financial Services Authority and UK Financial Reporting Council, all directed to enhancing information-sharing to strengthen our enforcement and supervisory responsibilities. At our Washington headquarters and in market capitals around the world, the SEC conducted securities regulatory training sessions for more than 1,000 foreign regulators from over 100 countries in 2007. For the 12 months ended September 30, 2007, we brought more than 50 enforcement cases involving individuals, firms, markets, or assistance from abroad.

The Internet is a splendid tool for making information available to investors and for facilitating financial transactions around the world. But it is also a boon to crooks and thieves committing identity theft, "phishing" scams, and spam e-mail campaigns promoting questionable investments. These are problems that were virtually unheard of just 15 years ago. Today, boiler-room operators no longer

need phone banks in the same jurisdiction as the investors they seek to defraud. Technology permits criminals to slip ill-gotten funds across borders with ease, completely escaping the sovereign laws that governments so assiduously defend. The only way to combat this is for all of the affected countries to cooperate.

That's why the SEC is working so intently with our foreign counterparts to make our oversight and enforcement systems seamless. Through our Office of International Affairs and our extensive participation in multinational fora, we are redoubling the agency's support for international regulatory harmonization—including cooperation with the International Accounting Standards Board, and authorities in nearly 100 nations, on International Financial Reporting Standards. The same energy animates our support for the IOSCO International Disclosure Standards, which the SEC has adopted as our own. Also during 2007, we inaugurated the PAUSE Program to help investors in the United States and around the world detect financial frauds, including individuals impersonating U.S. registered securities firms, by posting on our Web site specific information about unregistered soliciting entities that have been the subject of complaints. Many of these fraudulent solicitations are made via e-mail from overseas.

In the past year, the agency also took several steps on the regulatory front to help our markets to better integrate with the rest of the world. We opened a public dialogue on the subject of mutual recognition by high-standards countries. We proposed a rule that would permit foreign private issuers to submit to the SEC the same financial statements prepared in accordance with International Financial Reporting Standards that they file in their home country. We invested in a thorough remodeling of the Commission's financial reporting database, EDGAR, to make it interactive and compatible with similar systems under development in leading markets around the world. And we overhauled the auditing standard under Section 404 of the Sarbanes-Oxley Act, which had been a source of complaint from other national regulators. The new standard is risk-based, materiality focused, top-down,

Christopher Cox
Chairman



and scalable to company size and complexity. Investors will benefit from reduced compliance costs and more focused control audits.

In 2007, the SEC and the Federal Reserve broke an eight-year logjam and published final rules implementing the Gramm-Leach-Bliley Act, a critical step in modernizing our markets. The new rules, which will take effect starting in late 2008, spell out when banks need to register as broker-dealers. The much-needed clarity will improve investor choice in U.S. markets at a time of increasing international competitiveness. We also modernized our proxy rules by providing for electronic delivery, which will make global access for investors far easier. And we worked closely with the Euronext College of Regulators in Europe to ensure that the merged NYSE Euronext can offer services to U.S. and global investors with a seamless application of several nations' rules.

Investors want a global market. We can see that all around the world. But more than anything they want an honest market. In 2007, the SEC quickened the pace of our enforcement to ensure that despite the stress from increasingly complex international transactions, the U.S. will maintain our accustomed high levels of investor protection. In the past year, the Commission targeted hedge fund fraud and brought the most significant insider trading case in 20 years. We conducted a major program to protect older Americans from investment fraud and abusive sales practices. We saw a 30 percent drop in financial spam after highly-publicized suspensions of trading in the securities of several companies whose securities had been subject to spam stock promotions.

Our work in modernizing and internationalizing the Commission's programs to protect investors, promote healthy markets, and encourage capital formation will continue in 2008. In the coming year, we'll receive the results of a blue-ribbon study of the U.S. financial reporting system, focused on reducing unnecessary complexity and making information more useful and understandable for investors in a global market. We'll move forward on our initiatives to integrate the U.S.

market with International Financial Reporting Standards, to make interactive data a reality, and to establish a process for negotiating mutual recognition agreements with other countries.

You'll find more details on these and other important Commission initiatives in the pages that follow. Our reporting on the results of the Commission's work includes a full presentation of our financial results and performance measurements. Since 2004, the SEC has published audited annual financial statements. Our financial statements for the year just ended are presented at pages 46–50 of this report. In the opinion of the U.S. Government Accountability Office, the 2007 statements are presented fairly in all material respects in conformity with U.S. generally accepted accounting principles (GAAP). In 2008, the agency will introduce several new technology upgrades designed to support the preparation of reliable audited financial statements. The phase-in of these new software systems is designed to eliminate a material weakness in the SEC's internal controls stemming primarily from the lack of integration and compatibility in the agency's legacy automated systems. A full discussion of these initiatives is on pages 19–23.

As we have for 74 years, the SEC will continue waging battle in favor of investors and markets—and we will never lose sight of our objective of high-quality standards tailored to the new, global marketplace. The SEC will continue to lead a global conversation with our counterparts around the world to increase investor confidence, make regulation more effective and efficient, and safeguard the integrity of our markets. Our objective is as ambitious as it is important: to make the lives of every one of our citizens better, and to make the world a better place.

Sincerely,

A handwritten signature in black ink that reads "Chris Cox". The signature is written in a cursive, flowing style.

Christopher Cox
Chairman

November 15, 2007

Section 1: Management's Discussion and Analysis

The Securities and Exchange Commission (SEC) administers the federal laws governing the U.S. securities markets. As such, the SEC plays a fundamental role in maintaining the integrity and vitality of America's markets and protecting the interests of investors. The following section provides highlights of the agency's efforts during fiscal year (FY) 2007. It contains information on the agency's mission and strategic goals, notable achievements, performance results, financial highlights, and management assurances.

The Securities and Exchange Commission aims to be the standard against which federal agencies are measured. The SEC’s vision is to strengthen the integrity and soundness of U.S. securities markets for the benefit of investors and other market participants, and to conduct its work in a manner that is as sophisticated, flexible, and dynamic as the securities markets it regulates.

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

- Integrity
- Accountability
- Fairness
- Resourcefulness
- Teamwork
- Commitment to Excellence

- **Enforce compliance with federal securities laws**

The Commission seeks to detect problems in the securities markets, prevent and deter violations of federal securities laws, and alert investors to possible wrongdoing. When violations occur, the SEC aims to take prompt action to halt the misconduct, sanction wrongdoers effectively, and, where possible, return funds to harmed investors.

- **Promote healthy capital markets through an effective and flexible regulatory environment**

The savings and investments of every American are dependent upon healthy capital markets. The Commission seeks to sustain an effective and flexible regulatory environment that will facilitate innovation, competition, and capital formation to ensure that our economy can continue to grow and create jobs for our nation's future. Enhancing the productivity of America is a key goal that the SEC works to achieve by increasing investor confidence in the capital markets.

- **Foster informed investment decision making**

An educated investing public ultimately provides the best defense against fraud and costly mistakes. The Commission works to promote informed investment decisions through two main approaches: reviewing disclosures of companies and mutual funds to ensure that clear, complete, and accurate information is available to investors; and implementing a variety of investor education initiatives.

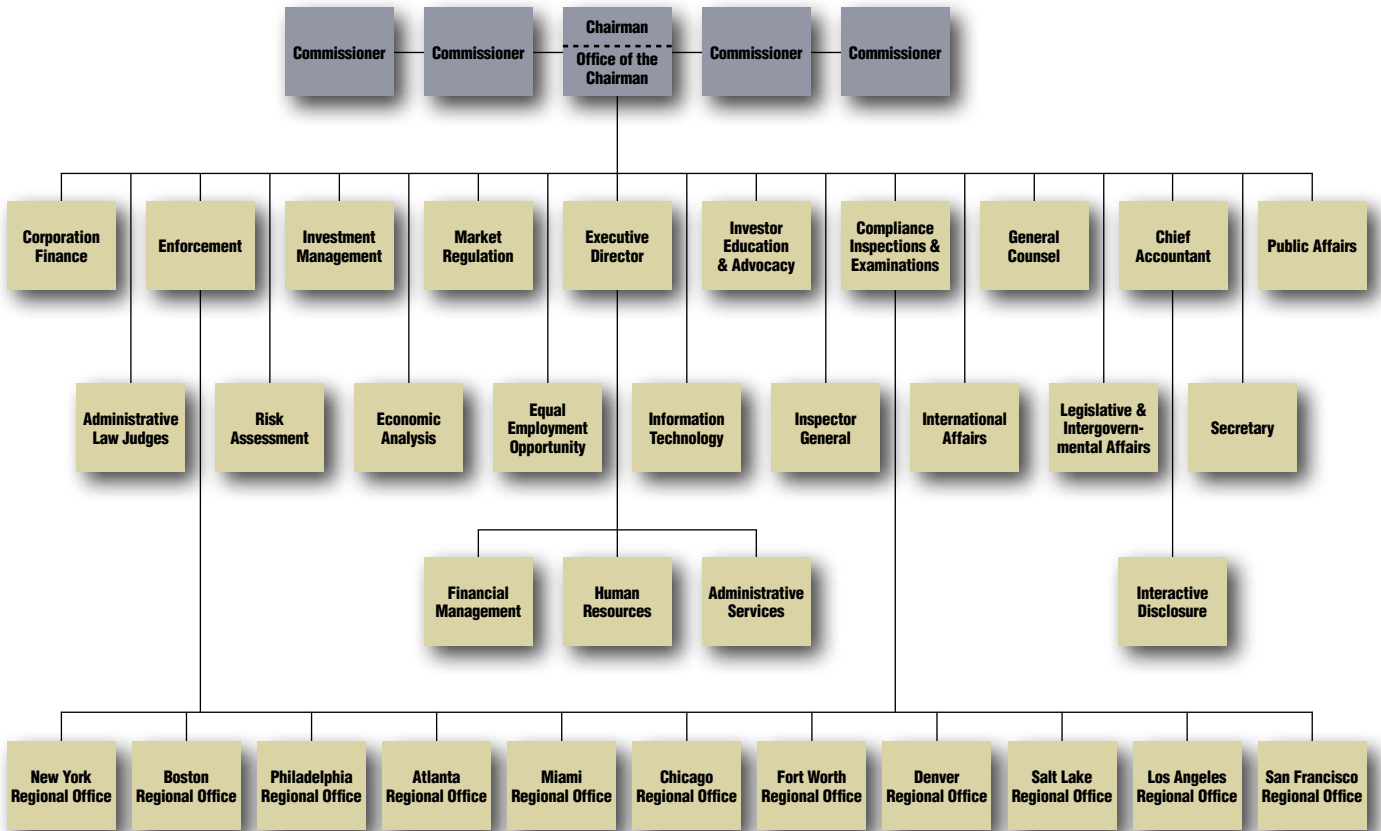
- **Maximize the use of SEC resources**

The investing public and the securities markets are best served by an efficient, well-managed, and proactive SEC. The Commission strives to improve its organizational effectiveness by making sound investments in human capital and new technologies, and by enhancing internal controls.

Organizational Structure and Resources

The SEC is an independent federal agency established pursuant to the Securities Exchange Act of 1934. 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: Commissioners*). The Chairman serves as the chief executive officer. The SEC is organized into four main divisions: Corporation Finance, Enforcement, Investment Management, and Market Regulation. It also has 18 functional offices. The Commission's headquarters are in Washington, D.C., and it has 11 regional offices throughout the country. In FY 2007, SEC received budget authority of \$882 million. At September 30, 2007, the SEC had utilized 3,470 Full-time Equivalents (FTE), including 3,431 permanent and 39 temporary FTE.

TABLE 1.1
SEC Organization Chart



FY 2007 Highlights

The following are highlights of the SEC's activities during fiscal year 2007:

Enforcing Compliance with Securities Laws

Increased Protection for Investors in Hedge Funds.

During the past year, the SEC created a hedge fund working group within the Division of Enforcement. Working with other federal law enforcement agencies and self-regulatory organizations, the group leads agency efforts to combat hedge fund insider trading. In the most significant insider trading case in 20 years, the SEC filed charges against 14 defendants in a scheme involving hedge funds that netted more than \$15 million in illegal profits on thousands of trades, using information stolen from UBS Securities LLC and Morgan Stanley.

Combating Senior Fraud. In 2007 the SEC maintained its significant enforcement, examination, and investor education initiatives designed to prevent and punish fraud aimed at seniors. We partnered with other regulators and law enforcement agencies in several significant enforcement actions and examination sweeps, and we joined with the North American Securities Administrators Association, the Financial Industry Regulatory Authority, and consumer organizations including AARP to sponsor events to educate senior investors across the U.S. Through this initiative, the Commission is targeting fraudulent investment schemes and aggressive sales tactics, including abusive "free lunch" sales seminars, and working to arm older Americans with information they can use to identify and avoid them. These efforts are targeted not only at seniors but also their caregivers, as well as pre-retirement workers, who are encouraged to plan for contingencies later in life.

Anti-Spam Initiative. In March 2007, the SEC launched an initiative to combat spam-driven stock market manipulations, which resulted in the trading suspension of 39 companies susceptible to spam stock promotions. This stepped-up SEC effort to protect investors from potentially fraudulent e-mail solicitations hyping small company stocks also brought several spam-related enforcement actions. The agency's effort was credited for a significant reduction in financial spam in a report by a major private-sector Internet security firm, which stated that a 30 percent decrease in stock market spam "was triggered by actions taken by the U.S. Securities and Exchange Commission, which limited the profitability of this type of spam." In addition, spam-related complaints to the SEC's Online Complaint Center were cut in half.

Alerting Investors to Marketplace Impostors.

The SEC introduced a new Web site to alert investors worldwide about unregistered entities engaged in solicitations of securities transactions. Through the "Public Alert: Unregistered Soliciting Entities" (PAUSE) program, the Commission publishes factual information on our Web site about unregistered soliciting entities that have been the subject of complaints forwarded by investors and others around the globe, including foreign securities regulators. By immediately alerting the public to information we receive in complaints, the SEC aims to help retail investors discover the true nature of questionable investment solicitations before they invest.

Internet Enforcement. In 2007, the Commission and its Office of Internet Enforcement concentrated significant efforts to combat the growing threats of

identity theft and account intrusions. One case resulted in the capture of \$3 million in a Latvian bank account—one of the largest asset freezes in agency history. Another landmark case, brought in conjunction with the Omaha U.S. Attorney's Office, marked the first joint criminal and civil prosecution of an account intrusion.

Micro-Cap Fraud. In 2007, in addition to bringing several important cases in the area, the Commission announced the creation of a new group within the Division of Enforcement to lead the SEC's efforts against micro-cap fraud. The Commission created the unit in response to the growing threat of fraud involving small issuers whose securities are not traded on registered exchanges. The new group will primarily focus on market manipulation and offering frauds, as well as other market violations. It also will act as an expert within the SEC and a liaison with domestic and foreign authorities regarding micro-cap fraud issues.

Improving Disclosure for Investors

Interactive Data. In 2007, the SEC created the Office of Interactive Disclosure to lead the agency's global efforts to transform the nature of financial reporting by public companies. Nearly 100 countries are involved in the development of eXtensible Business Reporting Language, or XBRL. The use of XBRL can make the information in financial reports completely interactive, so that investors, analysts, journalists, and preparers of financial statements can use the information in ways never before possible. If public companies in many nations file financial reports using interactive data, users of those statements would be able to make immediate comparisons of a wide range of industry peers. The new Office is working with key public and private sector stakeholders in the United States and around the world to advance the use of interactive

data in financial reporting. It is also working with the SEC's Office of Information Technology to transform the agency's financial reporting database, EDGAR, into an interactive data platform.

Over the last few years, the SEC has encouraged public companies to file their financial reports with the agency using interactive data as part of a voluntary pilot program. During the year, the SEC's interactive data initiative continued to grow, with the market capitalization of companies participating in the program topping \$2 trillion. In 2007, NYSE Euronext became the first stock exchange to submit financial reporting information in the U.S. using interactive data.

The Commission also adopted rules permitting mutual funds to submit risk/return summary information from their prospectuses using interactive data under the voluntary program. In the near future, investors will find it far easier to access information about a participating fund's investment objectives and strategies, risks, costs, and historical performance via the agency's Web site.

During 2007, the Commission also announced the completion of all work on developing interactive data tags for the entire system of U.S. generally accepted accounting principles (GAAP).

Protecting Investors in Municipal Securities.

The Commission is redoubling its efforts to improve disclosure and accounting practices in this sizable market affecting millions of individual investors. The Commission entered an order sanctioning the City of San Diego for committing securities fraud by failing to disclose billions of dollars in pension and retiree health care obligations in its sale of its municipal bonds. The agency delivered a white paper to Congress outlining our recent enforcement actions and highlighting areas of possible legislative reform, in light of the growing size and importance of the municipal securities market

and the significant ways in which it has changed over time. The white paper proposed, among other things, that offering documents and periodic reports provided to investors contain information similar to what is required for all other securities offerings, that information on municipal securities be made available on a more timely basis, and that municipal issuers be required to use generally accepted governmental accounting standards.

Understandable Disclosure of Executive Compensation. The Commission's new rules governing executive compensation disclosure took effect in fiscal 2007. These rules have significantly improved the quality and clarity of public company information about how, and how much, top executives are paid. To gauge the effectiveness of the new disclosures, the Commission conducted an across-the-board review of the first year's experience under the new rules. The review determined that investors are in fact receiving more comprehensive information on executive compensation under the new rules than has been available in the past—and that for the first time, investors can quickly see each executive's total compensation from all sources, and compare these figures from company to company.

Reducing Complexity in Financial Reporting. The SEC created an advisory committee to examine the causes of, and remedies for, excessive complexity in the U.S. financial reporting system. The committee will provide recommendations about how to improve the usefulness of financial information to investors, reduce unnecessary complexity for U.S. companies, and better utilize advances in technology to enhance all aspects of financial reporting.

Promoting an Effective and Flexible Regulatory Environment

Rationalizing Implementation of the Sarbanes-Oxley Act. The SEC voted to repeal the Public Company Accounting Oversight Board's (PCAOB) audit standard under Section 404 of the Sarbanes-Oxley Act, and to replace it with a new standard that is risk-based, materiality focused, top-down, and scalable to company size and complexity. As a result, investors will benefit from reduced compliance costs and more focused audits of internal controls. The Commission also voted to approve new interpretive guidance to help public companies strengthen their internal controls over financial reporting while reducing unnecessary costs, particularly at smaller companies. In writing this guidance, the Commission worked closely with the PCAOB to align the interpretive guidance and the new audit standard. Together, the new interpretive guidance and the new audit standard will help focus discussions between managers and auditors on what matters most to investors—the risk that material misstatements in the company's financials will not be prevented or detected in a timely manner.

Improving Competition in Securities Brokerage. The SEC and the Board of Governors of the Federal Reserve System announced the adoption of final joint rules to define when banks have to register as securities broker-dealers under the Gramm-Leach-Bliley Act. The rules will foster greater competition in the financial services industry to the benefit of investors.

Establishment of FINRA. The Commission approved the creation of the Financial Industry Regulatory Authority (FINRA), which is now responsible

for regulatory oversight of all securities firms that do business with the public. The new entity replaces the National Association of Securities Dealers and the New York Stock Exchange's member regulation operations. The creation of FINRA will enable the establishment of a single set of rules that can operate across markets, eliminating regulatory "seams" that often made enforcement difficult.

Protecting Investors in Expanding Markets

Global Affiliation of Exchanges. The Commission approved the consolidation of the businesses of NYSE Group, Inc., the publicly-traded company that owns the New York Stock Exchange and NYSE Arca, and Euronext N.V., a company organized under the laws of the Netherlands and owner of five European exchanges. NYSE Group and Euronext are now wholly-owned subsidiaries of a new publicly-traded holding company, NYSE Euronext. The combination was conditioned on a number of important regulatory improvements for the benefit of investors.

International Regulatory Cooperation. The Commission entered into an information-sharing arrangement with the College of Euronext Regulators (comprised of the five European authorities overseeing the Euronext markets). The agreement provides a framework for coordination and consultation in connection with the oversight of NYSE Euronext and its markets.

The SEC also increased efforts to formalize regulatory information-sharing arrangements with other international counterparts. These allow confidential sharing of issuer-specific information, with the ultimate

goal of encouraging high-quality and consistent application of accounting standards. Additionally, the SEC finalized cooperative arrangements related to the supervision and oversight of markets and market participants, and handled over 800 requests related to enforcement investigations and cases.

International Financial Reporting Standards.

The Commission announced a series of actions in connection with its consideration of the effect of international financial reporting standards on U.S. markets, including a proposal to accept financial statements from foreign private issuers prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB) without requiring reconciliation to GAAP.

The Commission also issued a concept release seeking comment on whether U.S. issuers should have the option of preparing financial statements in accordance with IFRS. Under the SEC's current rules, U.S. issuers are required to prepare financial statements in accordance with GAAP. Nearly 100 countries require or allow the use of IFRS.

Foreign Private Issuer Exchange Act Deregistration.

In March 2007, the Commission approved changes to rules for foreign private issuer deregistration eliminating conditions that had been considered a barrier to entry. The rules provide foreign private issuers with greater flexibility in accessing and exiting U.S. capital markets, encouraging participation in U.S. markets and providing increased investor choice.

Performance Results Summary

This fiscal year, the Commission worked diligently to meet or exceed performance targets. Of the 24 performance measures the Commission is reporting on in FY 2007, the SEC met or exceeded 21 of 28 planned performance levels. The agency also is reporting four indicators which provide further context for understanding the agency's activities. The indicators are not included in the following table, because it is inappropriate for the agency to conduct these activities with an eye towards hitting predetermined targets.

A summary of the SEC's performance levels for FYs 2006 and 2007, organized by goal, is presented in *Table 1.2*. A discussion of the agency's program achievements and specific performance results is located in *Section 2: Performance Section*.

TABLE 1.2

Performance Results Summary

KEY: LEVEL OF PERFORMANCE ATTAINED

- + Performance Level Exceeded
- ✓ Performance Level Met
- Performance Level Not Met

	PERFORMANCE LEVEL	
	FY06	FY07
GoAl 1 ENFORCE COMPLIANCE WITH THE FEDERAL SECURITIES LAWS		
1. Distribution of cases across core enforcement areas	✓	✓
2. Enforcement cases successfully resolved	+	+
3. Percentage of first enforcement cases filed within two years	-	-
4. Number of requests to and by foreign regulators for enforcement assistance	+	+
5. Investment advisers and investment companies examined		
a. Investment advisers	-	+
b. Investment companies	-	-
GoAl 2 PROMOTE HEALTHY CAPITAL MARKETS THROUGH AN EFFECTIVE AND FLEXIBLE REGULATORY ENVIRONMENT		
1. Percentage of responses to exemptive, no-action letter, and interpretive requests issued within six months	+	+
2. Percentage of U.S. households owning mutual funds	+	✓
3. Mutual fund share of total retirement assets	+	+
4. Equity portfolio holdings of U.S. investment companies as a percentage of total U.S. stock market capitalization	+	+
5. Percentage of SRO rule filings closed in less than 60 days	+	+
6. Global access to U.S. markets		
a. Number of new foreign private issuers registering	+	+
b. Dollar amount of securities registered by foreign private issuers	-	-
7. Milestones for international regulatory cooperation	✓	✓
GoAl 3 FOSTER INFORMED INVESTMENT DECISION MAKING		
1. Number and percentage of investor complaints, questions, and requests completed by the Office of Investor Education and Advocacy (OIEA) within seven calendar days	-	✓
2. OIEA publications distributed by the General Services Administration (GSA)	-	+
3. Annual number of on-line searches for EDGAR filings	+	+
4. Percentage of reporting corporations and investment companies with disclosures reviewed by the SEC		
a. Corporations	-	+
b. Investment companies	+	+
5. Percentage of investment adviser and investment company transactional reviews completed within timeliness goals	+	+
6. Average time to issue initial comments on Securities Act filings	✓	✓
7. Percentage of forms and submissions filed electronically and in a structured format	✓	-
GoAl 4 MAXIMIZE THE USE OF SEC RESOURCES		
1. Percentage of IT projects that adhere to the agency's capital planning investment control process	-	+
2. Milestones for major IT projects	✓	✓
3. Receive an unqualified audit opinion on the SEC's audited financial statements with no material weaknesses noted in internal controls over financial reporting ICFR		
a. Audit opinion	✓	✓
b. Material weaknesses	✓	-
4. Staff turnover rate	-	-
5. Milestones achieved on major human capital initiatives	✓	-

Limitations of the Financial Statements

The principal financial statements included in *Section 3: Financial Section* have been prepared to report the financial position and results of operations of the SEC, pursuant to the requirements of 31 U.S.C. 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 realization that they are for a component of the U.S. Government, a sovereign entity.

Improper Payments Information Act Reporting

The Improper Payments Information Act (IPIA) of 2002 requires federal agencies to review all programs and activities, identify those that are susceptible to significant erroneous payments, determine an annual estimated amount of erroneous payments made in those programs, and report the actions it is taking to reduce erroneous payments. In FY 2007, the SEC identified and reviewed two programs that had a potential high risk for improper payments. For IPIA reporting purposes, significant erroneous payments are defined as annual payments exceeding both 2.5 percent of program payments and \$10 million. SEC projections are well below both thresholds. IPIA reporting details are provided in *Section 4: Other Accompanying Information*.

Financial Statement Highlights

Overview

The SEC's financial statements were prepared in conformity with U.S. GAAP and OMB Circular A-136, *Financial Reporting Requirements*. The financial

statements, footnotes, and auditor's opinion appear in Section 3 of this Performance and Accountability Report. A summary of the SEC's major financial activities in FY 2007 and FY 2006 is presented below.

Balance Sheet and Net Position

Presented below is a condensed Balance Sheet for comparison and analysis.

TABLE 1.3

Condensed Balance Sheet

As of September 30, 2007 and September 30, 2006

(IN THOUSANDS)	FY 2007	FY 2006	\$ CHANGE	% CHANGE
Fund Balance with Treasury	\$5,888,039	\$5,178,893	\$ 709,146	14
Investments	3,602,511	3,674,528	(72,017)	-2
Accounts Receivable—Federal Agencies	155	154,506	(154,351)	-100
Accounts Receivable—Public	138,693	177,491	(38,798)	-22
Advances and Prepayments	2,100	974	1,126	116
Property, Plant and Equipment	98,280	103,631	(5,351)	-5
Total Assets	9,729,778	9,290,023	439,755	5
Accounts Payable	49,249	62,135	(12,886)	-21
Accrued Payroll, Benefits & Leave	62,360	59,615	2,745	5
Registrants' Deposit Accounts	61,689	57,464	4,225	7
Fiduciary Liability	3,615,760	3,834,662	(218,902)	-6
Custodial Liability	63,614	71,545	(7,931)	-11
Capital Lease Liability	16,865	27,641	(10,776)	-39
Other Accrued Liabilities	6,473	14,839	(8,366)	-56
Total Liabilities	3,876,010	4,127,901	(251,891)	-6
Unexpended Appropriations	—	9,201	(9,201)	-100
Cumulative Results of Operations	5,853,768	5,152,921	700,847	14
Total Net Position	5,853,768	5,162,122	691,646	13
Total Liabilities and Net Position	\$ 9,729,778	\$9,290,023	\$ 439,755	5

Assets

Fund Balance with Treasury

In FY 2007, *Fund Balance with Treasury* increased to 60.5 percent of total assets from 55.7 percent of total assets in FY 2006. The increase in funds held by the SEC is attributed to collections in excess of the current year's appropriated funding. The revenues collected include securities transaction fees, securities registration fees and other fees as described below under "Net Cost of Operations."

Investments

The SEC's *Investments* balance consists entirely of disgorgement and penalties collected from securities law violators plus related interest earned. These funds are held by the SEC pending future distribution to harmed investors. The SEC invests these funds in overnight and short-term market-based Treasury bills issued through the Treasury Department's Bureau of Public Debt. Investments held by the SEC have increased dramatically since FY 2005. This increase is the result of provisions in the Sarbanes-Oxley Act of 2002 which allowed for the distribution of penalties to harmed investors augmented by certain unusually large disgorgement collections in FY 2006. The investment balance is expected to decrease as fund distributions accelerate. In FY 2007, new collections transferred to investments of \$314.5 million were offset by distributions to harmed investors of \$580.5 million.

Accounts Receivable

At September 30, 2007 and 2006, the SEC's *Accounts Receivable* from the public is \$404.7 million and \$353.6 million, respectively, offset by an estimated allowance for doubtful accounts of \$266.0 million and \$176.1 million, respectively. The \$38.8 million decrease in net Accounts Receivables from the public is related to a decrease in receivables established from enforcement-related actions and a decrease in securities-related receivables as a result of the reduction in fee rates in FY 2007.

The \$154.3 million decrease in Federal Receivables is due to a receivable at the end of 2006 relating to an order to transfer funds from a Federal court late in September 2006.

Liabilities

The SEC's liabilities consist of routine operating accounts payable, accrued payroll and benefits, registrant deposit accounts, and fiduciary and custodial liabilities associated with disgorgement and penalties assessed against securities law violators.

Custodial Liability

The *Custodial Liability* relates to disgorgement and penalty receivables assessed against securities law violators. The SEC records a custodial liability for the net amount of such receivables, after taking into account the estimated allowance for doubtful accounts. Upon collection, these amounts will either be transferred to the fiduciary accounts or transferred to the General Fund of the Treasury. The net decrease is due to a lower volume of high penalty financial fraud cases in FY 2007.

Fiduciary Liability

The SEC's largest liability is the *Fiduciary Liability*. This liability reflects amounts collected by the SEC in enforcement proceedings that are held for future distribution to harmed investors. When collected, these receipts are held as fiduciary assets in *Fund Balance with Treasury* or *Investments*, pending distribution to investors, and this equal and offsetting liability is reported on the Balance Sheet. The net decrease of \$218.9 million in Fiduciary Liability is due to efforts by the SEC to accelerate the process of distributing funds to harmed investors.

Net Position

The increase in Net Position of \$691.6 million in FY 2007 is the result of collections of securities transaction, registration and other fees in excess of program costs for current year operations.

Net Cost of Operations

The Statement of Net Cost of Operations represents the gross cost incurred by the SEC less exchange revenue earned.

TABLE 1.4

Condensed Statement of Net Cost

For the years ended September 30, 2007 and September 30, 2006

(IN THOUSANDS)	FY 2007	FY 2006	\$ CHANGE	% CHANGE
Enforce compliance with federal securities laws	\$ 529,454	\$ 579,076	\$ (49,622)	-9
Promote healthy capital markets through an effective and flexible regulatory environment	79,704	77,263	2,441	3
Foster informed investment decision making	135,917	135,856	61	0
Maximize the use of SEC resources	97,466	96,728	738	1
Total Gross Program Cost	842,541	888,923	(46,382)	-5
Less: Earned Revenue Not Attributed to Programs	1,507,750	1,882,619	(374,869)	-20
Net (Income) from Operations	\$ (665,209)	\$ (993,696)	\$ 328,487	-33

For FY 2007 and 2006, the SEC's net income from operations totaled \$665.2 million and \$993.7 million, respectively.

The SEC's Earned Revenue Not Attributed to Programs consists of revenues from fees paid pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934. These fees consist of securities transaction fees paid by securities exchanges, and securities registration, tender offer, merger, and other fees paid by issuers. The fees are used to fund SEC programs and operations up to the limits established through the annual appropriation process. The SEC reports this revenue as "not attributed to programs" since the fees are generated by the operations of the SEC as a whole, rather than the efforts of one program or operating activity.

Exchange revenue decreased by \$374.9 million due to a decrease in the exchange fee rates in 2007. The rates changed as follows: (i) proxy solicitations and statements in corporate control transactions fees decreased to \$30.70 per million from \$107.00 per million; (ii) securities transaction fees on the exchange and in the over-the-counter markets decreased to \$15.30 per million from \$30.70 per million; and (iii) the assessment on security futures transactions decreased to \$0.0042 for each round turn transaction from the rate of \$0.009 for each such transaction.

The 5 percent decrease in program costs reflects the fact that the SEC and most other government agencies operated on a continuing resolution appropriation in FY 2007. In addition, FY 2006 included certain non-recurring costs related to the occupancy of new operating locations in Washington D.C. and New York.

Budgetary Resources and Outlays

The Statement of Budgetary Resources provides information on the budgetary resources that were made available to the SEC during the fiscal year and the

status of those resources at the end of the fiscal year. The SEC receives its funding from fee revenue earned, which must be appropriated by Congress before it can be used by the Commission.

TABLE 1.5

Selected Budgetary Resources

For the years ended September 30, 2007 and September 30, 2006

(IN THOUSANDS)	FY 2007	FY 2006	\$ CHANGE	% CHANGE
Budgetary Resources	\$ 966,607	\$5,775,491	\$(4,808,884)	-83
Collections	1,538,749	1,903,648	(364,899)	-19
Non-Reimbursable Obligations	876,274	896,911	(20,637)	-2
Net Outlays/(Collections)	710,848	981,734	(270,886)	-28

Budgetary Resources consist of the resources available to the SEC at the beginning of the year, plus the appropriations, spending authority from offsetting collections, and other budgetary resources received during the year. Total resources decreased by \$4.8 billion in FY 2007. This decrease is primarily due to a change in accounting principle related to prior year collections in excess of budgetary authority. As a result of this change, the financial statement line, *Unobligated Balance, Brought Forward, October 1*, decreased to \$186.7 million from the reported \$4,878 million FY 2006 ending balances of unobligated funds. The prior year collections previously reported in this line continue to be reported on the Balance Sheet in *Fund Balance with Treasury* and *Cumulative Results of Operations*. However, these amounts are no longer reported as

budgetary resources of the SEC. See Note 1.C *Change in Accounting Principle* in the Financial Section for additional discussion of this accounting change. The reduction in collections of \$364.9 million is a direct result of the reduction in rates, as referred to in the Net Cost of Operations.

Obligations and Outlays

The decrease of \$20.6 million in non-reimbursable obligations for FY 2007 reflects the fact that the SEC and most other government agencies operated on a continuing resolution appropriation in FY 2007.

Net Outlays reflect disbursements net of offsetting collections and distributed offsetting receipts. The decrease in Net Collections was primarily due to the FY 2007 reduction in exchange fee rates as mentioned above.

Custodial Activity

The Statement of Custodial Activity reports the collections by the SEC of disgorgement and penalty amounts from securities laws violators. These collections constitute non-exchange revenue, as they arise from the SEC's authority to demand payment from violators of the law.

TABLE 1.6

Condensed Statement of Custodial Activity

For the years ended September 30, 2007 and September 30, 2006

<i>(IN THOUSANDS)</i>	FY 2007	FY 2006	\$ CHANGE	% CHANGE
Sources of Collections: Disgorgement & Penalties	\$496,386	\$1,804,043	\$(1,307,657)	-72
Sources of Collections: Other	138	90	48	53
Accrual Adjustment	(7,931)	(23,967)	16,036	67
Total Custodial Revenue	488,593	1,780,166	(1,291,573)	-73
Disbursed to: Department of Treasury	176,761	122,030	54,731	45
Disbursed to: Other	319,763	1,682,103	(1,362,340)	-81
Change in Liability Accounts	(7,931)	(23,967)	16,036	67
Total Disposition of Collections	\$ 488,593	\$1,780,166	\$(1,291,573)	-73

Collections

The variance in collection activity is due to a reduction in fair funds collections of \$1,307.6 million for 2007, due to a lower volume of financial fraud cases with large settlements. In FY 2006, the SEC won fines and penalties in several large cases. These collections are expected to be distributed to harmed investors in subsequent years.

In FY 2007, the current year distributions exceeded the current year collections due to a significant decrease in collections relative to prior years. In addition to the decrease in collections, the SEC undertook an initiative to distribute more funds to harmed investors relative to prior years.

Distributions

FY 2007 distributions included \$176.8 million transferred to the General Fund of the Treasury, \$580.5 million distributed to harmed investors, with \$260.7 million of that total transferred from the Fiduciary Fund to cover distributions to the public. FY 2006 distributions included \$122.0 million transferred to the General Fund of the Treasury, \$108.5 million distributed to investors, and \$1,573.6 million held pending future distribution. The decrease in amounts transferred to the fiduciary fund is directly related to the total decrease in collections discussed above. The \$54.7 million increase in funds transferred to the General Fund of the Treasury is due to an increased ability to collect on fines and penalties.

Federal Managers' Financial Integrity Act

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 is implemented by the Office of Management and Budget (OMB) Circular No. A-123, revised, Management's Responsibility for Internal Control.

Section 2 of the FMFIA requires federal agencies to report, on the basis of annual assessments, any material weaknesses that have been identified in connection with its internal and administrative controls. The reviews that took place during FY 2007 provide qualified assurance that SEC systems and management controls comply with the requirements of the FMFIA, with the exception of a material weakness in internal control over 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, 2007 in accordance with the FMFIA and OMB Circular No. A-127, *Financial Management Systems*, as applicable. This evaluation identified system non-conformances.

Internal controls were also evaluated by the SEC's independent auditors, the Government Accountability Office (GAO).

Chairman's Assurance Statement

The management of the SEC is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the FMFIA. Internal control is an integral component of the Commission's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The Commission is able to provide a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA, with the exception of a material weakness and system non-conformances as discussed below.

The Commission conducted its evaluation of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123. A material weakness in internal controls over financial reporting and system non-conformances surfaced in FY 2007 as a result of this evaluation. Other than the exceptions noted, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.



Christopher Cox
Chairman
November 15, 2007

The SEC conducted its annual assessment of the effectiveness of internal control in accordance with the requirement of OMB Circular No. A-123, *Management's Responsibility for Internal Control*.

In accordance with guidance issued by the SEC's Office of the Executive Director, 32 office heads conducted reviews of their financial, administrative, and program management controls in FY 2007. The offices range in size from 8 to 486 positions, with an average of 117 positions at the end of FY 2007. This segmentation ensures comprehensive coverage of all SEC offices.

Each office head prepared an annual assurance statement that identified any control deficiencies that merit the attention of the Chairman. These statements were based on information gathered from various sources, including, among other things:

- Management's personal knowledge gained from the daily operation of the office;
- Management reviews and dashboard reports (which are monthly reports used to track the progress on operational, budgetary, and staffing objectives, and to adjust processes and resources as necessary);
- GAO and Office of Inspector General reports;
- Self-assessments;
- Annual performance plans and reports;
- Audits of the agency's financial statements;
- Reports and other information from Congress or the Office of Management and Budget; and
- Additional reviews relating to the office's operations, including those discussed in the *Other Reviews* section below.

Each year, the agency's Financial Management Oversight Committee (FMOC) evaluates the Section 2 and 4 submissions, recommendations from the Office of the Inspector General, and other supplemental sources of information. Based on this review, the FMOC advises the Chairman as to whether the SEC had any internal control or system design deficiencies serious enough to be reported as a material weakness or non-conformance.

other Reviews

Also during the year, the Office of Inspector General and the Office of Information Technology conducted a combined total of 21 alternative reviews. The reviews covered 18 of the 32 assessable units (56 percent). Some components had multiple reviews.

Further, the Office of Information Technology certified and accredited 26 major applications; recertified the agency's accounting and general support systems because of major upgrades; and completed 16 electronic authentication risk assessments. E-authentication is a review process at the transaction level designed to help agencies ensure that authentication processes provide the appropriate level of assurance.

Finally, GAO audited the Commission's financial statements. GAO's procedures included audits of the FY 2007 financial statements, internal control over financial reporting and compliance with laws and regulations, the SEC's compliance with selected provisions of law and regulations applicable to the management of financial resources, and actions taken in response to prior GAO audit recommendations.

Internal Controls over Financial Reporting

During FY 2007, increased rigor was applied to further compliance with laws and regulations over the past years' standard. Overall, greater discipline was instilled over the financial reporting process, increasing transparency, reliability, and integrity. In FY 2008, Office of Financial Management (OFM) will continue to improve compensating controls. However, transitioning from manual interfaces to full integration of core and feeder financial systems will be critical to improving efficiency and effectiveness of controls over financial reporting. The need is clear for integrating data with the core accounting system in order to reduce the amount of manual calculations and data entry currently required. Efficiencies will be put into practice to ensure sustainable processes.

Description. In FY 2007, due to changes in key personnel including the Chief Financial Officer and Chief of the Financial Statements and Policy Branch, certain processes were subjected to internal review revealing deficiencies in internal control and instances of non-conformance with federal financial system requirements. The GAO identified a material weakness in the SEC's internal controls over its financial reporting process, with specific deficiencies cited concerning the period-end financial reporting process, disgorgements and penalties accounts receivable, accounting for transaction fee revenue, and preparing financial statement disclosures.

Corrective Actions Taken. Improved oversight processes were implemented to ensure compliance with GAAP and OMB requirements relative to period-end financial reporting process and preparation of footnote disclosures.

The SEC is dedicated to proactively identifying and correcting control deficiencies such as those manifested in the use of manual journal entries, and improper posting models and processes as cited by GAO in the FY 2007 audit report. Financial information integrity improvements are evidenced by significant advances in many areas. The SEC increased the transparency of the financial reporting process. Process and control documentation was improved or developed, as necessary, over the past year. Position papers have been developed articulating SEC policy. Standard Operating Procedures have been drafted for the preparation of financial statements. Through the documentation and review process, inadequate controls over several of the SEC's business processes were identified. As a short-term solution, incremental improvements were made to compensating controls. As a long-term solution, improvements to financial management systems are planned. The improvements made this year have set the stage for the upgrade of the SEC's financial systems, created efficiencies, and begun the institution of sustainable processes.

- Monthly financial reporting and review processes were instituted
- Ongoing monitoring processes were established to ensure data integrity
- Quarterly certification processes were strengthened
- An undelivered order review process was instituted
- A process was put in place to accomplish bulk loading of manual journal entries, eliminating duplicative data entry

In the 4th quarter, OFM established a monthly cycle for General Ledger close and preparation of financial reports. The monthly generation and review of balances and reports, previously only performed quarterly, are expected to result in more timely and useful information that will facilitate the use of financial information in management decision making.

In addition, the SEC implemented the use of standard analytical reports to highlight key operational risk. These reports include, but are not limited to, Abnormal Balances, Variance Analysis, Suspense Aging, Reporting Consistency Checks, and the early implementation of U.S. Treasury Tie-Point Project analytics. These analytic reviews of financial data were conducted to ensure the quality of financial data, and used to proactively detect and correct data anomalies. Through the use of these standard reports, OFM was able to capture and remedy several process deficiencies throughout the year.

Control over manual data entry has been improved. The Branch Chief, Financial Statements and Policy, approves all entries manually posted to the General Ledger and posting models established by Branch staff.

In FY 2006, the SEC had a reportable condition related to its recording and reporting of disgorgement and penalties ordered as a result of SEC enforcement actions. During FY 2007, the SEC took a number of important steps to ensure the integrity of enforcement-related disgorgement and penalty data. The agency implemented a new financial management system (Phoenix) as part of a multi-year effort to replace its existing case tracking database. Phoenix provides enhanced management, administrative, and monitoring controls that reasonably ensure that (a) the initial recording of disgorgement and penalties ordered as a result of enforcement actions is accurate and timely, (b) ongoing activities such as payments, termination of collection activity, and amended orders are documented and reported, and (c) disgorgement and penalty data are consistently reviewed for reliability, timeliness and completeness. In addition, the system provides for enhanced audit trail capabilities, increased transparency of information which allows management to monitor the activities within the system, the ability to attach the documentation supporting all transactions within the system itself, and increased management reporting functions. The SEC also implemented new policies and procedures as well as mandatory computer-based training modules for mid- and senior-level managers. Nonetheless, integration of disgorgement and penalty receivable amounts from Phoenix is through manual processes and significant analysis is performed outside the system to determine the general ledger postings of transactions, as addressed in the next section.

Based on an internal review of compliance with required form and content, changes were made this year to the presentation of the financial statements and footnote disclosures. Examples of the changes made to more closely conform to OMB A-136 guidance include presentation of costs on the Statement of Net Cost by strategic goal, and improved footnote disclosures related to valuation of marketable securities, segregation of entity/non-entity asset balances and differences between the Statement of Budgetary Resources and the President's Budget. A change in accounting principle this year eliminated material prior year differences between the Statement of Budgetary Resources and the Budget of the United States Government.

A more rigorous methodology to achieve compliance with the Improper Payments Information Act (IPIA) of 2002 was deployed in FY 2007, following the guidance prescribed by OMB for implementation.¹ Methodology and results were both fully documented and made available to the auditors.

The Prompt Payment Final Rule (formerly OMB Circular A-125, "Prompt Payment") requires payment of commercial obligations within certain time periods and interest penalties when payments are late. In fiscal year 2007, the SEC improved the timeliness of vendor invoice payments and corrected a system problem with the calculation of the interest for returned vendor invoices. This resulted in a significant reduction of late payments and interest paid. The number of late payments was reduced by 38 percent and the dollar amount of interest paid was reduced by 36 percent from the previous fiscal year.

Corrective Actions Planned. Corrective actions will be taken in the short term to mitigate the control deficiencies cited by GAO. Plans are under development to implement short-term solutions to reduce intermediary information processing steps, including extensive use of spreadsheets, manipulation of data, and manual journal entries, in FY 2008. The process will be reviewed and SEC will tighten compensating controls supporting the calculation of receivable balances until automated

integration is achieved. SEC will continue to replace routine manual entries and adjustments with approved posting models when feasible. For example, pro-forma SGL compliant entries for operating under a continuing resolution were recently implemented to replace manual journal entries made in the first quarter of FY 2007.

Process and control documentation efforts are on-going. A project plan has been developed to document each significant activity recorded in the general ledger, including the closing process and the preparation of the financial statements. The anticipated delivery date for the initial draft procedural manual to the SEC is March 31, 2008, with the final delivery and completion date being June 30, 2008. Nonetheless, the risks cited are mitigated by managerial review of consistency reports and other review processes put in place in the last quarter of this fiscal year.

Financial Management System Non-conformance

Although the SEC is not required to comply with the FFMIA, the agency assesses its financial management systems annually for conformance with the requirements of OMB Circular A-127 and other Federal financial system requirements. The agency also makes continuous efforts to strengthen and integrate its financial management systems.

Description. SEC systems supporting Receivables, Property and Equipment, and Investments balances do not conform to financial management system requirements. Moreover, subsystems are integrated with the SEC's core accounting system through manual processes in which summary level data is posted to the core accounting system on a periodic basis. With manual data entry, the inherent risk of error increases. Associated with the system non-conformances are risks due to use of unconventional posting models, inference of certain data attributes (rather than maintaining at a transaction level consistent with the SGL) and the inability to readily trace certain adjusting summary level

¹ Appendix C, Part I to OMB Circular A-123, Management's Responsibility for Internal Controls, issued through OMB Memorandum M-06-23 dated August 10, 2006

entries to source documents. To illustrate, a major limitation of Phoenix is its inability to capture the related accounting impact of each financial event.

Corrective Actions Taken. In 2007, the SEC put a variety of controls in place to compensate for this non-conformance as previously discussed.

The SEC has begun an upgrade of its core financial system. System requirement development is underway for automated interfaces to the core financial system related to Receivables, Investments, and Property and Equipment.

Corrective Actions Planned. System integration will eliminate the need for the bulk of the manual journal entries currently being used, which will enhance the timeliness, accuracy and reliability of the data while reducing the need to maintain redundant schedules. The upgrade of the core financial system will incorporate accurate configuration for the SEC's business processes, development of pro-forma entries validated against the SGL, replacement of the routine use of manual entries with pro-forma entries, and integration of appropriate preventative edits for pro-forma entries. The upgrade is expected to be completed in FY 2008.

Most accounts receivable data is captured in Phoenix, the SEC's system for managing disgorgements and penalties resulting from the agency's enforcement cases. The SEC is developing system requirements for an automated interface for Phoenix to ensure that receivable transactions posted to the core accounting system are compliant with the SGL at the transaction level. In addition, the SEC is reviewing alternatives for automating, upgrading or replacing subsidiary systems for Investments and Property and Equipment, along with the associated interfaces. As a short-term, stopgap measure, the SEC will utilize database solutions to minimize manual intervention and increase compensating controls over the financial reporting process.

Federal Information Security Management Act (FISMA)

FISMA requires federal agencies to conduct an annual self-assessment of their IT security programs, to develop and implement remediation efforts for identified security weaknesses and vulnerabilities, and to report compliance to OMB. The SEC's Inspector General and Chief Information Officer performed a joint review of the agency's compliance with FISMA requirements, and submitted the report to OMB in late September. The report showed that the agency has continued to make progress in mitigating information security risk and complying with FISMA requirements, and no significant deficiencies were identified. In particular, the SEC has completed the implementation of its incident response program, successfully reaccredited its "general support system" (the agency's foundational IT infrastructure), and achieved over 99 percent compliance with security and privacy awareness training. The review also identified some additional opportunities for improvement, in particular with respect to the documentation associated with the certification and accreditation process; these findings will be addressed in the coming year.

Section 2: Performance Section

The mission of the SEC is accomplished through four strategic goals focused on efforts to enforce compliance with the federal securities laws; promote healthy capital markets; foster informed investment decision making; and maximize the use of agency resources. Through various activities, SEC programs strive to achieve the four strategic goals by meeting performance targets. Annually, the performance results are analyzed to determine the success of program activities.

organized by strategic goal, the following section discusses FY 2007 program achievements and progress toward reaching FY 2007 performance targets. Actual performance levels achieved for FY 2007 and analysis of the performance results are included for each performance measure.

Performance Results by Strategic Goal

The SEC's 2004–2009 strategic plan established four goals and 10 supporting outcomes that the agency seeks to achieve in carrying out its mission. The SEC uses a variety of performance measures to ascertain its progress in achieving these desired outcomes. In FY 2007, the SEC met or exceeded planned performance levels for 21 of 24 total performance measures. See Performance Results Summary *Table 1.2* in *Section 1: Management's Discussion and Analysis*.

This section also presents four indicators which provide further context for understanding the agency's activities. The indicators do not include targets because it would be inappropriate for the agency to conduct certain activities with an eye towards hitting predetermined targets rather than evaluating the evidence as presented. All performance measures and indicators include at least three years of historical data.

In FY 2007, the SEC's Market Regulation program was evaluated by the Office of Management and Budget using its Program Assessment Rating Tool (PART). The evaluation assessed the program's purpose and design, strategic planning, management, and results. For the second consecutive year, the SEC received the highest rating possible, "Effective." The agency plans to use the results of PART reviews to further enhance and strengthen program performance.

SEC managers use performance data to improve the quality of program management and to demonstrate accountability in achieving program results. The performance data presented in this report are complete and reliable, and are as of September 30, 2007.

Goal 1: Enforce Compliance with Federal Securities Laws

In order to enforce compliance with federal securities laws, in FY 2007 the SEC focused on detecting potential problems or issues in the securities markets early, preventing violations of federal securities laws, and sanctioning violators of federal securities laws. The agency's Enforcement and Examination programs are primarily responsible for these outcomes.

Program Achievements

Enforcement Program

In FY 2007, the SEC initiated 776 investigations, 262 civil actions, and 394 administrative proceedings covering a wide range of issues, including financial fraud, abusive backdating of stock options, insider trading, violations by broker-dealers, and fraud related to mutual funds. The Commission prevailed in the great majority of the enforcement actions. The SEC's enforcement cases in FY 2007 resulted in a total of approximately \$1.6 billion in disgorgement and penalties ordered against securities law violators. Notable enforcement actions taken by the SEC in FY 2007 can be found in *Appendix B: Major Enforcement Cases*.

The SEC also invested in technologies to increase the effectiveness of the Enforcement program. The agency developed a new case management system which will enhance the information available to program managers to monitor their caseload and shift resources as necessary. In addition, the Division of Enforcement's Forensic Lab continued to employ new scientific, mathematical, and engineering techniques to uncover potential digital evidence such as e-mail, financial records, transaction data, and Internet activity.

Improved Management of Disgorgements and Penalties and Fair Funds Distribution. As a result of SEC enforcement cases, approximately \$13.8 billion in disgorgement and penalties from FY 2003 through FY 2007 were ordered to be paid to the SEC, courts, or other appointed trustees. More than 75 percent of the total amounts ordered had been collected by the end of FY 2007. With the deployment of the new Phoenix system, the SEC improved management of the disgorgements and penalties that arise from the Commission's actions and significantly enhanced the agency's internal controls over these financial transactions. In FY 2007, the SEC announced the creation of a dedicated office that will specialize in this area.

Cross Border Enforcement. The SEC was involved in numerous cases with significant international components. The Office of International Affairs used the Multilateral Memorandum of Understanding of the International Organization of Securities Commissions (IOSCO) and other avenues to obtain information relevant to SEC investigations and litigation from foreign regulators.

Examination Program

The SEC's examination program works to detect violations of the securities laws and to encourage firms to implement strong compliance programs for the protection of investors. In FY 2007, the Office of Compliance Inspections and Examinations (OCIE) continued to refine and implement risk assessment techniques to identify firms and activities that present the greatest compliance risks.

In an effort to improve the effectiveness and efficiencies of its examinations, OCIE explored new technologies and initiatives throughout the year to enhance its examinations. For example, extensive effort was devoted to the development of a new tool for examiners to use in performing quantitative analysis of trade data and other large data sources obtained from registrants, a key component of how the agency identifies compliance issues within regulated entities. In addition, OCIE substantially enhanced training for examiners with respect to new rules applicable to securities firms and current trends in the securities industry, including broker-dealers

providing investment advisory services and the activities of hedge fund advisers.

Risk-Based Examinations. In FY 2007, OCIE conducted more than 2,400 examinations of investment advisers and companies, broker-dealers, transfer agents, and self-regulatory organizations (SRO). SEC examiners continued to conduct routine inspections of higher-risk advisers and fund groups on a three-year cycle and lower-risk advisers through random sampling. Broker-dealer exams focused on compliance and risk management of select large and complex brokerage firms, and staff continued their oversight of SRO's regulation of trading and member firm activity. OCIE also conducted inspections of SRO programs, and together with the SEC's Office of the Chief Accountant, OCIE initiated an inspection of the Public Company Accounting Oversight Board (PCAOB).

Overall, 75 percent of investment adviser and investment company examinations and almost 82 percent of broker-dealer inspections revealed some type of deficiency or control weakness. Where appropriate, OCIE referred inspection results to enforcement staff or SRO for further review. Importantly, most examinations resulted in improvements in the firms' compliance programs.

Fostering Improvements in Compliance. SEC staff sought to improve compliance with the federal securities laws by providing additional information and resources to registered financial firms. OCIE and the Division of Investment Management jointly conducted the Chief Compliance Officers (CCO) *CCOutreach* Program, which seeks to encourage strong industry compliance practices. In FY 2007, SEC staff conducted 27 regional seminars and one national seminar focusing on fund and adviser compliance issues. The SEC also conducted a CCO *CCOutreach* seminar for over 50 European-based investment advisers registered with the SEC. The program, hosted in Luxembourg, was the first *CCOutreach* event in Europe for foreign-based, SEC-registered investment advisers. In addition, OCIE enhanced communications with industry firms by publishing the first in a planned series of "*ComplianceAlerts*." These publications provide firms with information on key exam findings regarding compliance issues that may assist firms in avoiding the occurrence of compliance breaches.

TABLE 2.21
PERFORMANCE MEASURE

Percentage of Investment Adviser and Investment Company Transactional Reviews Completed within Timeliness Goals (Target exceeded—two planned performance levels exceeded, one planned performance level met)

DESCRIPTION: For initial registration statements, the SEC's goal is to comment within 30 days after they are filed. (The agency's goal is 60 days for registration statements of insurance product separate accounts.) The SEC also aims to comment on post-effective amendments within 45 days and preliminary proxy statements within 10 days after they are filed.

	FY03	FY04	FY05	FY06	FY07 PLAN	FY07 ACTUAL
Initial						
Registration Statements	81%	88%	90%	88%	85%	87%
Post-Effective Amendments	86%	98%	97%	96%	90%	95%
Preliminary Proxy Statements	100%	100%	100%	99%	99%	99%

ANALYSIS OF RESULTS: The SEC met or exceeded all of its FY 2007 goals for timeliness, reviewing 87 percent of initial registration statements, 95 percent of post-effective amendments, and 99 percent of preliminary proxy statements within the agency's targeted timeframes.

TABLE 2.22
PERFORMANCE MEASURE

Average Time to Issue Initial Comments on Securities Act Filings (Target met)

DESCRIPTION: The target of 30 days has become a *de facto* industry standard for the maximum time to receive SEC comments. Companies often build this timeframe into their plans. The 30-day timeframe is considered aggressive, given the other mandatory reviews the Commission conducts and the fluctuation in filing volume that impacts workload plans.

FY03	FY04	FY05	FY06	FY07 PLAN	FY07 ACTUAL
27.7 days	27.8 days	26.1 days	26.2 days	<30 days	25.5 days

ANALYSIS OF RESULTS: In FY 2007, the SEC issued initial comments on registration statements under the Securities Act of 1933 and the Securities Exchange Act of 1934 within an average of 25.5 days of filing, significantly less than its target goal of 30 days. In addition, the agency continued to monitor the average duration between the date it receives a company response to SEC's initial comments and final resolution.

TABLE 2.23
PERFORMANCE MEASURE

Percentage of Forms and Submissions Filed Electronically and in a Structured Format (Target not met)

DESCRIPTION: The SEC continues to emphasize electronic filing to make information available to the public in a format that can be easily obtained and analyzed. The SEC currently has over 100 forms that must be filed with the agency, which annually generate hundreds of thousands of filings. The agency is redesigning its form filing capabilities to rely on more structured formats (*e.g.*, information is captured in a comma delimited, XML, XBRL, or other format). This measure gauges the percentage of forms that are available to be filed in a structured format and the percentage of resulting filings that are received in the structured format. In addition, this measure identifies the overall percentage of forms that are in electronic format and the overall percentage of resulting filings that are received electronically by the SEC.

	FY03	FY04	FY05	FY06	FY07 PLAN	FY07 ACTUAL
Forms						
Percentage in a structured format	4%	4%	5%	8%	9%	8%
Percentage in another electronic format	68%	68%	67%	62%	67%	62%
Total percentage in electronic format	72%	72%	72%	70%	76%	70%
Filings Received						
Percentage in a structured format	21%	36%	35%	35%	36%	35%
Percentage in another electronic format	55%	52%	54%	55%	54%	53%
Total percentage in electronic format	76%	88%	89%	90%	90%	88%

ANALYSIS OF RESULTS: Although the SEC added eight new form types, they were in an unstructured electronic format; and other initiatives intended to add forms in other electronic formats were not completed. As a result, the SEC did not achieve its goals for increasing both the percentage of electronic forms and the percentage of forms in a structured format. However, it is expected that the SEC will complete additional electronic forms initiatives in FY 2008.

Section 3: Financial Section

The following financial statements present the financial position, net cost of operations, changes in net position, budgetary resources, and custodial and fiduciary activities of the SEC's core business activities as required by the Accountability of Tax Dollars Act of 2002.

These financial statements and accompanying notes are prepared in conformity with U.S. generally accepted accounting principles (GAAP) and presented in accordance with the form and content guidelines established by OMB Circular A-136.

Disgorgements and Penalties
Accounts Receivable:

As part of its enforcement responsibilities, SEC issues orders and administers judgments ordering, among other things, disgorgements, civil monetary penalties, and interest against violators of federal securities laws.⁵ SEC recognizes a receivable when SEC is designated in an order or a final judgment to collect the assessed disgorgements, penalties, and interest. At September 30, 2007, the gross amount of disgorgements and penalties accounts receivable was \$330 million, with a corresponding allowance of \$266 million resulting in a net receivable of \$64 million.

In our reviews of the interim June 30, 2007, and year-end September 30, 2007, balances of accounts receivable for disgorgements and penalties, we found errors in SEC's spreadsheet formulas resulting in overstatements of these receivable balances for both periods. These errors consisted of incorrectly changed spreadsheet formulas that affected the final calculated balances. SEC subsequently detected and corrected the June 30 errors, but then made different spreadsheet calculation errors in the year-end balances as of September 30, 2007, which we detected as part of our audit. SEC made adjustments to correct the errors, which were not material. However, SEC's process for calculating its accounts receivable for disgorgements and penalties presents a high risk that significant errors could occur and not be detected. The main cause of these errors is the breakdown this year in the manual controls that were intended to compensate for the lack of an integrated accounting system for disgorgements and penalties, as discussed above. Specifically, although the journal entries posting the amounts to the general ledger were reviewed, this review did not extend to the preparation of the spreadsheet SEC used to document the accounts receivable calculation at June 30 and September 30, 2007, and therefore, was not sufficient to detect significant spreadsheet formula errors.

Accounting for Transaction Fee
Revenue:

As one of its sources of revenue, SEC collects securities transaction fees paid by self-regulatory organizations (SRO) to SEC for stock transactions. SRO transaction fees are payable to the SEC twice a year—in March for the previous months September through December, and in September for the previous months January through August. Since the SROs are not required to report the actual volume of transactions until 10 business days after

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.

financial reporting process discussed above did not allow SEC finance staff sufficient time to carry out thorough and complete reviews of the disclosures in light of the November 15 reporting deadline.⁶

Significant Deficiencies

We also identified three control deficiencies that adversely affect SEC's ability to meet its internal control objectives. These conditions concern deficiencies in controls over (1) information security, (2) property and equipment, and (3) accounting for budgetary resources, which are summarized below.

Information Security

SEC relies extensively on computerized information systems to process, account for, and report on its financial activities and make payments. To provide reasonable assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, effective information security controls are essential. These controls include security management, access controls, configuration management, physical security, and contingency planning. Weaknesses in these controls can impair the accuracy, completeness, and timeliness of information used by management and increase the potential for undetected material misstatements in the agency's financial statements.

During fiscal year 2007, SEC made important progress in mitigating certain control weaknesses that were previously reported as unresolved at the time of our prior review. For example, SEC developed a comprehensive program for monitoring access activities to its computer network environment, tested and evaluated the effectiveness of controls for the general ledger system, and documented authorizations for software modifications. SEC also took corrective action to restrict access to sensitive files on its servers, change default database accounts that had known or weak passwords, and apply strong encryption key management practices for managing secure connections.

Despite this progress, SEC has not consistently implemented certain key information security controls to effectively safeguard the confidentiality,

⁶OMB directs executive branch agencies to issue their audited financial statements by November 15 for the preceding fiscal year ending on September 30. OMB Circular No. A-136, *Financial Reporting Requirements*, § I.5 (rev. June 27, 2007).

integrity, and availability of its financial and sensitive information and information systems. During this year's audit, we identified continuing and new information security weaknesses that increase the risk that (1) computer resources (programs and data) will not be adequately protected from unauthorized disclosure, modification, and destruction; (2) access to facilities by unauthorized individuals will not be adequately controlled; and (3) computer resources will not be adequately protected and controlled to ensure the continuity of data processing operations when unexpected interruptions occur. For example, SEC had not yet mitigated weaknesses related to malicious code attacks on SEC's workstations, had not yet adequately documented access privileges for a major application, and had not yet implemented an effective intrusion detection system. New control weaknesses in authorization, boundary protection, configuration management, and audit and monitoring that we identified this year include for example, the use of a single, shared user account for posting journal vouchers in a financial application, inadequate patching of enterprise databases, and inadequate auditing and monitoring capabilities on its database servers. Lapses in physical security enabled unauthorized network access from a publicly accessible location within SEC Headquarters. In addition, SEC did not have contingency plans for key desktops that support manual processes such as the preparation of spreadsheets. These weaknesses existed, in part, because SEC has not yet fully implemented its information security program.

Collectively, these problems represent a significant deficiency in SEC's internal control over information systems and data. Specifically, the continuing and newly identified weaknesses decreased assurances regarding the reliability of the data processed by the systems and increased the risk that unauthorized individuals could gain access to critical hardware and software and intentionally or inadvertently access, alter, or delete sensitive data or computer programs. Until SEC consistently implements all key elements of its information security program, the information that is processed, stored, and transmitted on its systems will remain vulnerable, and management will not have sufficient assurance that financial information and financial assets are adequately safeguarded from inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction. We will be issuing a separate report on issues we identified regarding information security concerns at SEC.

Property and Equipment

SEC's property and equipment consists of general-purpose equipment used by the agency; capital improvements made to buildings leased by SEC for office space; and internal-use software development costs for

This Performance and Accountability Report was produced with the energies and talents of the SEC staff. To these individuals we offer our sincerest thanks and acknowledgement. We would also like to acknowledge the Government Accountability Office and the SEC's Office of Inspector General for the professional manner in which they conducted the audit of the Fiscal Year 2007 Financial Statements. Finally, we offer special thanks to Deva & Associates, P.C. and Financial Communications Inc. for their contributions in the design and production of this report.

To comment on, or obtain additional copies of the SEC's FY 2007 Performance and Accountability Report, please send an e-mail to: SECPAR@sec.gov.



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