
M E M O R A N D U M

September 25, 2007

To: Andrew Donohue
From: Nelson Egbert *Ni Egbert*
Re: Investment Company Disclosure Initiatives (Audit No. 421)

Attached is our audit report on IM's Investment Company Disclosure Initiatives. IM's comments on prior versions of the draft report have been incorporated as appropriate.

We would appreciate receiving any additional comments you have concerning this audit and the report. In particular, we would like to know whether you found the audit useful. We also welcome any suggestions from you concerning how we could improve future audits.

The courtesy and cooperation of you and your staff during this audit are appreciated.

Attachment

cc: Susan Nash
Brent Fields
Donna Hawkins
Jennifer McHugh
Thomas Smith Jr.
Diego Ruiz
Ken Johnson
Darlene Pryor
Peter Uhlmann
Richard Hillman, GAO

INVESTMENT COMPANY DISCLOSURE INITIATIVES

EXECUTIVE SUMMARY

We found that the Office of Disclosure Regulation (ODR) in the Division of Investment Management (IM) has identified goals and milestones for improving mutual fund disclosure and has made progress toward achieving its goals. ODR has developed and implemented rules that encourage mutual funds to submit financial and risk/return summary information in an interactive data language (eXtensible Business Reporting Language or XBRL). In the near future, ODR plans to finalize a proposal to further reform mutual fund disclosure and delivery of information to investors.

We are recommending that ODR identify outcome-based performance indicators for its disclosure reform initiatives.

OBJECTIVES, SCOPE AND METHODOLOGY

Our objectives were to determine whether IM has identified its goals for improving mutual fund disclosure and to assess the extent to which IM is achieving these goals. During the audit, we interviewed IM and other Commission staff, reviewed applicable laws and regulations, and analyzed relevant documentation, including reports on the disclosure initiatives.

We conducted this performance audit between July 2006 and June 2007 in accordance with generally accepted government auditing standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence that provides a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Reform of mutual fund disclosure is among IM's most important priorities, given the significance of mutual funds to investors. Through its reforms, IM plans to streamline the information mutual funds provide to investors, and to improve the usefulness of this information.

The Office of Disclosure Regulation (ODR) is responsible for implementing IM's initiative to reform mutual fund disclosure. ODR is a segment of the Office of

Disclosure and Insurance Product Regulation. ODR is headed by an Assistant Director, and includes a branch chief and, currently, four senior counsels.

ODR's reform initiative consists of two separate rulemaking projects.

One project encourages mutual funds to submit financial and risk/return summary information to the Commission using XBRL (eXtensible Business Reporting Language). XBRL assigns data items standardized definitions through "tags" that precede and follow the items. Software programs can read these tags, allowing easier access to and interactive analysis of the data.

The other project is intended to streamline the disclosure and delivery of mutual fund information to investors. Among other options, ODR is considering requiring use of a summary prospectus with information on investment objectives and strategies, risks, fees and expenses, and historical returns.

ODR indicated that the existing "profile" (a document, separate from the prospectus, which summarizes key prospectus information such as investment objectives and strategies, risks, fees and expenses, and historical returns) is a possible model for the streamlined disclosure document. ODR plans to address the issues that limit use of the current profile (*e.g.*, potential liability¹).

IM is coordinating its efforts with the Division of Market Regulation's (MR) proposed "point of sale" rule. This rule would address broker dealers' disclosures to investors in connection with sales of mutual fund securities.

Audit Results

We found that IM has identified its goals for improving mutual fund disclosure and has made progress toward achieving its goals. In August 2005, the Commission established a voluntary program to encourage mutual funds to submit their financial information in the XBRL format. In June 2007, the program was expanded to include risk/return summary information. IM plans to submit recommendations to the Commission soon for additional mutual fund disclosure reform (see the Background).

We are recommending that IM develop outcome-based performance indicators for its disclosure reform initiatives, as discussed below.

Outcome Measures

The Government Performance and Results Act of 1993 (GPRA), Public Law 103-62, 107 Stat. 285, requires agencies to develop performance measures to assess progress toward their goals. The measures should relate to outputs (items produced) and outcomes (results).

ODR identified its desired outputs (rules to allow XBRL submissions of risk/return summary information and to streamline disclosure and delivery of mutual fund information) and tracked their progress with internal milestones and weekly status reports. In addition, the Commission's internal "Dashboard" reports and FY 2007

¹ There was concern in the industry about the potential for claims that profiles were misleading because profiles, as summary documents, omitted certain prospectus disclosures.

performance budget included information on the IM disclosure initiatives. IM has not yet developed outcome-based performance indicators to gauge the results of its rulemaking, because the rules are either relatively new or have not yet been adopted by the Commission.

The Commission's GPRA performance budget includes performance measures that may be helpful to IM in developing outcome indicators.² One measure, "the percent of forms and submissions filed electronically and in a structured format," might help gauge the response to the new rules through the number of streamlined disclosure filings and XBRL submissions of risk/return information by mutual funds. Another measure, "the annual number of on-line searches for EDGAR filings," might help gauge investor demand for this information.

Outcome indicators can be difficult to develop, as recognized by the Office of Management and Budget and the Government Accountability Office.³ However, once developed they will help IM evaluate the results of its disclosure reform initiatives.

Recommendation A

IM should develop outcome-based performance indicators for its disclosure reform initiatives.

² Agencies prepare performance budgets in lieu of the GPRA annual performance plans. Performance budgets integrate agencies' annual performance plans into their budget requests.

³ For example, see the OMB document, "Performance Measurement Challenges and Strategies" (June 18, 2003), and GAO reports GAO/HEHS/GGD-97-138, "Managing for Results – Analytic Challenges in Measuring Performance," May 1997, and GAO-04-38, "Results Oriented Government – GPRA Has Established a Solid Foundation for Achieving Greater Results," March 2004.