Chairman's Statement

Who's Watching the Watchdog? Examining Financial Management at the SEC

July 27, 2005

The Securities and Exchange Commission plays a crucial role in ensuring the continued health of the U.S. capital markets by administering the federal laws that govern the U.S. securities markets. In 2004, the Commission took on an aggressive agenda, with the implementation of rulemaking projects under the Sarbanes-Oxley Act, including supervision of the Public Company Accounting Oversight Board and its regulation of auditors of public companies such as Arthur Anderson, Price Waterhouse Cooper and other auditing firms.

The Commission is expanding its role. For instance, we've seen increased promulgation of regulations to identify abuses in the mutual fund industry and requiring hedge funds to register. These rules have shown the agency's commitment to maintaining integrity in the U.S. markets, and investor confidence within the United States. Without a doubt, the Securities and Exchange Commission has both a difficult job and vital role in the United States economy.

In its own words, the Commission "aims to be the standard against which federal agencies are measured." If this is the vision, we still have a long way to go. Similarly, its rigorous reform agenda, coupled with its ability to continue expanding its regulatory role raises the question of SEC's ability to maintain effective examination and enforcement of the securities industry while making necessary internal control changes. These ambitious goals deserve candid discussion.

The Accountability for Tax Dollars Act of 2002 expanded the requirement to conduct annual audits of agencies' finances from the original 24 CFO Act agencies to all executive branch agencies in the federal government. Since then, SEC has been required to prepare and submit to Congress and the Office of Management and Budget (OMB) audited financial statements.

Fiscal Year 2004 was the first year SEC prepared its first complete set of financial statements. GAO performed this initial audit, and though the SEC received a clean audit opinion on its financial statements, GAO found three material weaknesses in the areas of appropriately preparing financial statements; keeping track of penalties owed to the government and to harmed investors, and finally, an insecure information system which makes sensitive data vulnerable.

Such disturbing audit results are inexcusable for the financial watchdog for corporate America. I'm reminded of the unique indignation you feel when you're passed on the highway by a speeding police cruiser, with no lights on. Or the outrage America felt when a long-time Federal Forest Ranger started a forest fire that destroyed 30 homes and 100,000 acres in Colorado in 2002. What I'm getting at here is that those entrusted with enforcement authority cannot be above their own standards. Americans *will* not and *should* not tolerate that sort of hypocrisy.

In addition, due to poor budgeting, the Commission understated nearly $50 million for their new buildings in NYC, Boston, and Washington, DC. The original cost estimate for the three new buildings —which was estimated in Fiscal Year 2005 -- was approximately $22 million. In fewer than three years, the cost has more than tripled. I am also aware that rather than absorbing the costs of this bad budgeting in fiscal year 2006, SEC plans to heap the financing burden for these buildings on generations down the road.

Four years ago, the Global Research Analyst Settlement required the firms involved to pay $875 million in penalties and disgorgement, including $80 million dedicated to investor education. $52.5 million of this was supposed to establish an Investor Education Fund to develop and support programs designed to equip investors. While $27.5 million of these monies were directed to state securities regulators for investor education, the transfer of $52.5 million to the NASD Foundation has raised legal questions and I anticipate solid explanations for this decision.

I look forward to hearing the progress that the SEC has already made with regard to strengthening internal controls in Fiscal Year 2005, and also look forward to discussing their intent for reform of an agency that must maintain shining standards of financial reporting, given the important role that it plays in regulating public companies and the U.S. securities markets. Thank you to our witnesses for appearing today.