Federal Accounting Standards Advisory Board

December 5, 2008

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Draft Staff Implementation Guidance: Fiduciary Q&As- **Tab F**[1]

MEETING OBJECTIVES

The purpose of this agenda session is for the Board to review:

- draft staff implementation guidance (SIG) for fiduciary activities (relating to the implementation of SFFAS 31, *Accounting for Fiduciary Activities*, which is effective starting in FY 2009),
- public comments received, and
- staff recommendations and action plans regarding the public comments.

As a result of the meeting, staff expects to have direction from the Board on whether to issue the SIG with or without additional questions that address
(a) specific types of activity identified by the U.S. Securities and Exchange Commission and/or
(b) questions from the Department of Defense.

BRIEFING MATERIAL

This memorandum summarizes public comments that were received, staff analysis and recommendations. Attached to this memorandum are:

1) Draft SIG that was issued for public comment with edits based on comments received. Comments were requested by December 3, 2008.
2) Copies of comments received
3) Minutes of an informal meeting with interested agencies on April 12, 2007
4) Issue paper from the U.S. Securities and Exchange Commission

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

BACKGROUND

Staff Implementation Guidance (SIG)

SIG is issued by FASAB staff with negative ("no objections") approval from the Board. The guidance is authoritative and is considered level D guidance in the GAAP hierarchy.

Due process for SIG includes a minimum two-week comment period, which is announced in the Federal Register and sent to the FASAB mailing list. The draft SIG and comments received are posted on the FASAB website during and after this period.

Project history

After SFFAS 31, Accounting for Fiduciary Activities, was issued on October 4, 2006, several agencies indicated that implementation guidance would be helpful. Accordingly, staff drafted implementation guidance and held an informal meeting with interested agencies on April 12, 2007 (See Attachment 3).

During 2008, staff received informal communications from the SEC regarding the classification of SEC's disgorgement funds, including an issue paper dated May 30, 2008 (See Attachment 4). The SEC's comments on the Fiduciary SIG were received on December 2, 2008 (See Attachment 2).

Revised draft SIG was posted on the FASAB website, sent to the FASAB mailing list and announced in the Federal Register for public comment. Comments were requested by December 3, 2008.

COMMENTS RECEIVED

Six comment letters were received. Five were from federal preparers and one comment letter was from a non-federal organization, the Association of Government Accountants Financial Management Standards Board (AGA FMSB). (See Attachment 2 for text of comments.)

		Federal Preparer	Non-federal Other
1	Department of Commerce	X	
2	U.S. Securities and Exchange Commission	X	
3	Department of Defense	X	
4	AGA FMSB		X
5	CFO Council	X	
6	Department of the Interior	X	

Department of Commerce Comments

The Department of Commerce comments were that the Fiduciary SIG would be helpful in implementing SFFAS 31 and did not recommend any changes.

U.S. Securities and Exchange Commission (SEC) Comments

The SEC comments had a question regarding Question 6. Question 6 was intended to address situations in which the federal government did not receive the funds, but rather

exercised no more than indirect control (such as approving a distribution plan) for funds that are held and disbursed by others.

The SEC question was in two parts:
a) whether the controlling factor in Q6 was the lack of judicial remedy, and
b) whether, if the scenario in Q6 was changed so that the federal entity had direct control over the assets, would the classification of the asset be fiduciary.

The SEC comments also mentioned that SEC management believes that the SEC's disgorgement funds are not fiduciary in nature, because there is no legally defensible ownership interest by non-federal parties. The SEC previously sent FASAB staff an SEC policy paper that explained that, based on discussion with the SEC Office of the General Counsel, non-federal parties do not have any ownership interests until an approved disgorgement distribution plan is in place. Further, the SEC's *Rules of Practice on Fair Fund and Disgorgement Plans* prevents challenges to Fair Fund Distribution Plans outside of the opportunity to comment on proposed distribution plans (See Attachment 4, page 3).

STAFF ANALYSIS OF SEC COMMENTS

The text of Q6 is copied below for easy reference.

Q6 In some cases, courts may direct third parties to make payments to an escrow account in a commercial bank to be distributed to harmed parties. The escrow accounts are not the property of the Federal government, and the interest income is subject to taxes. In some of these cases, a Federal agency may have some control over disbursements (e.g., by approving or disapproving a third-party distribution plan). Does this situation meet the definition of fiduciary activity in SFFAS 31?

No. In this example, the Federal agency has not received or collected the cash or other assets.

Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold.

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:
a) collect and receive fiduciary cash or other assets and
b) subsequently perform one or more of the activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

The Fiduciary SIG is structured as Q&As, with each question addressing a different aspect of fiduciary activities. Staff believes that the response to Q6 makes it clear that the factor addressed by Q6 is the fact that in this example the federal agency did not

collect or receive any cash or other assets. The definition of fiduciary activities in paragraph 10 of SFFAS 31 states that for an activity to meet the definition of a fiduciary activity, the federal entity has to collect or receive cash or other assets. The issue of judicial remedy is not intended to be addressed by Q6, but rather the fact that a necessary component of a fiduciary activity is the collection or receipt by the federal entity of cash or other assets in which non-federal parties have an ownership interest.

Although the intent of the question did not relate to the existence of judicial remedy, it is possible that omission of one of the criteria was confusing to readers. To ensure that the absence of judicial remedy does not mislead readers, staff suggests that the following text be added as a footnote in the second paragraph of the answer:

> Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest[ftn 1] that the Federal Government must uphold.
>
> > [ftn 1] <u>The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation. (SFFAS 31, par. 10)</u>

STAFF RECOMMENDATION REGARDING SEC COMMENTS

Staff recommends that:

(a) Q6 should retain its clear focus on whether or not there was "collection or receipt" of cash of other assets by the federal entity but include a footnote reference to the remaining criterion of judicial remedy.

(b) The Fiduciary SIG should retain its scope of addressing SFFAS 31 and should not expand its scope into a discussion of the requirements for classifying activities as earmarked funds and/or custodial activities.

Question for the Board: Does the Board agree with recommendations (a) and (b) above?

<u>Department of Defense (DoD) Comments</u>

The DoD comments identified two examples of theoretical situations that were not addressed by the Fiduciary SIG:

1) Theoretical situations where fiduciary assets are transferred from one federal entity to another.
2) Theoretical situations where fiduciary assets are deposited into a non-federal third party's account but where a federal entity has some responsibility for collections.

The DoD also noted that the discussion of custodial collections in Q3 may be confusing and is unrelated to the focus of Q3, which is fiduciary activities by more than one bureau within a federal agency.

The DoD also requested a more detailed discussion of the use of estimates.

Staff Analysis of DoD Comments
The Fiduciary SIG is intended to address questions from agencies regarding the application of SFFAS 31 to specific situations for which the agencies need implementation guidance. The SIG is not intended to be all-inclusive or to address theoretical situations.

For example, during the development of the SIG, agencies identified actual situations where for technical reasons specific funds that might have been distributed to non-federal parties were instead required to be transferred to the general fund of the Treasury. The Q&A addresses this specific situation. No agency has yet identified actual situations where fiduciary assets are transferred form one agency to another. Staff would need to ask DoD to determine whether this situation is theoretical or actual.

Staff agrees with DoD that the discussion of custodial collections in Q3 is irrelevant and proposes that those paragraphs be deleted from Q3.

Q9, which addresses estimates, was drafted in response to a question raised by an agency during the development of the Q&As as to whether amounts disclosed as accrued fiduciary revenues and/or expenses needed to be supported by individual transactions in individual beneficiaries' accounts, or whether high-level summary estimates could be used for the fiduciary disclosure. That agency indicated that Q9 was adequate and helpful.

Staff Recommendation and Action Plan for DoD Comments
Staff recommends that:

a) The question regarding estimates should not be expanded.
b) The discussion of custodial collections should be deleted from Q3.
c) Staff should contact DoD and ask if the situations described in the DoD's comments are theoretical, or whether they describe actual situations for which the DoD needs implementation guidance (for example, a need for implementation guidance would exist if the situations are actual situations that are material to the DoD's financial statements). For the latter, staff would work with DoD to develop potential Q&As. If the situations described are theoretical or immaterial to the agency's financial statements, staff would not revise or expand the SIG.

Question for the Board: Does the Board agree with staff recommendation and action plan above?

Association of Government Accountants Financial Management Standards Board (AGA FMSB) Comments
The AGA FMSB comments concurred with the SIG as drafted.

Chief Financial Officers (CFO) Council Comments
The CFO Council comments were substantively identical to the comments from the Department of Defense. Staff analysis, recommendations and action plan regarding the DoD comments begin on page 4 of this memorandum.

Department of the Interior Comments
The Department of the Interior concurred with the SIG.

NEXT STEPS
Depending upon the Board's decisions regarding the comments received from the SEC and the DoD, staff will either issue the Fiduciary SIG as drafted or work with the SEC and DoD to determine whether additional Q&As should be developed.

Attachments

1) Draft Fiduciary SIG Issued for Public Comment with Draft Revisions Based Upon Comments Received (changes marked)
2) Text of Comments Received
3) Minutes of April 12, 2007 Meeting
4) SEC Issue Paper

Draft Staff Implementation Guidance: Fiduciary Q&As
Comments requested by December 3, 2008

Accounting for Fiduciary Activities – Questions and Answers

Written comments are requested by December 3, 2008, and should be sent via e-mail to fasab@fasab.gov or in hard copy to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548

Telephone 202-512-7350
FAX – 202-512-7366

Note: FASAB Staff Implementation Guidance (SIG) does not create new requirements. Any comments received will be forwarded to the Board along with staff's proposed final guidance. If a majority of the Board does not object, written SIG signed by the Executive Director will be issued and posted to the FASAB website. Notice of its release will be made in the Federal Register.

Q1. Do the requirements of Statement of Federal Financial Accounting Standards (SFFAS) 31 extend to all reports required by law or administrative action?

No. SFFAS 31, Paragraph 8, explains the scope of the standards as follows:

> [8] This statement provides financial reporting standards for fiduciary activities in the general purpose financial statements for Federal entities. The standard does not affect reporting in the *Budget of the United States* or special-purpose reports.

Accordingly, SFFAS 31 does not apply to (a) reports such as stand-alone audited financial statements that are prepared under an "other comprehensive basis of accounting" (which may be considered "special purpose reports") or (b) individual statements provided to beneficiaries.

With respect to individual statements to beneficiaries, some have suggested that the SFFAS 31 disclosures should be based on information prepared at the beneficiary ownership level and aggregated for the component entity. Component entities using this approach would develop and report accrual basis information for the individual beneficiary. The Board does not intend that this approach be required. Rather, the Board intends the accrual of fiduciary activities

to be implemented in a cost-effective manner. Therefore, a single aggregate accrual that supports information presented in the schedule of net assets and fiduciary activity in a note to the financial statements should be considered. This approach would support the disclosures required by SFFAS 31 in a cost-effective manner.

Q2. May component entities aggregate fiduciary activities for disclosure purposes?

Yes. Further, discretion is permitted in selecting activities to be presented individually.

Paragraphs 20 and 21 of SFFAS 31 provide:

> [20] For component entities with several distinct fiduciary activities, summary financial information required in paragraph 18 should be provided for each fiduciary activity presented individually. Information for fiduciary activities not presented individually (see paragraph 21) may be aggregated.
>
> [21] Selecting fiduciary activities to be presented individually requires judgment. The preparer should consider both quantitative and qualitative criteria. Acceptable criteria include but are not limited to: quantitative factors such as the percentage of the reporting entity's fiduciary net assets or inflows; and qualitative factors such as whether a fiduciary activity is of immediate concern to beneficiaries, whether it is politically sensitive or controversial, whether it is accumulating large balances, or whether the information provided in the fiduciary note disclosure would be the primary source of financial information for the public.

Paragraph 20 of SFFAS 31 identifies the summary financial information that should be provided for each fiduciary activity presented individually and explains that this financial information should be presented as aggregated for all activities not presented individually. Paragraph 21 of SFFAS 31 recognizes that judgment should be exercised in deciding if any fiduciary activities should be presented individually. For example, subject to the considerations in paragraphs 20 and 21, an entity might present summary financial information for:

- all fiduciary activities in aggregate,
- fiduciary activities aggregated by type of activity such as leasing or investing activity,

- classes[2] of beneficiaries separately as individual fiduciary activities, or
- fiduciary activities conducted by individual program offices.

The entity may present simply "total fiduciary funds" as a single column. Alternatively, the entity may present the information by program office to facilitate performance measurement. Yet another option is to present information by class of beneficiary.

Q3. In some cases several bureaus within an agency or department perform activities that result in fiduciary balances that are distributed by another bureau of the agency. Should each bureau include fiduciary activities disclosures in its stand alone audited financial statements?

If the activity meets the definition of fiduciary activity it should be reported as such.

Collections for non-Federal individuals or entities that are directly invested on behalf of the non-Federal parties or directly deposited into a non-Federal account such as a commercial bank account or a deposit fund, generally meet the definition of fiduciary and should be reported in a fiduciary note disclosure by the bureau.

Q4. In some cases, beneficiaries may direct third parties to make payments to a federal agency for credit to the beneficiaries' account. For example, the beneficiary may hold assets outside the trust and elect to liquidate the assets and have the proceeds deposited in the trust. At what point does this activity result in an asset that qualifies for disclosure as fiduciary activity?

The role of the federal entity must be understood in order to determine the extent of the fiduciary disclosure requirement in SFFAS 31. In some cases, there is no fiduciary or trust asset until an actual deposit is received. If, for example, the federal component entity has no collection responsibilities but merely receives funds directed to the entity by the beneficiary, there is no account receivable. Instead, the entity would become responsible for disclosing cash only after a deposit is made.

Q5. Is there any requirement to report fiduciary assets, liabilities or flows when the Federal entity does not perform any of the fiduciary activities listed in the definition, but does provide other services, such as advisory services that may lead to a contract being executed outside of the Federal government, with no further Federal role?

[2] Beneficiaries may belong to a class if they are (1) served by the same system or program office, (2) share certain traits or characteristics (e.g., local governments), or (3) both.

No. Certain activities that support beneficiaries may not lead to the creation of fiduciary or trust assets.

Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold.

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:
a) collect and receive fiduciary cash or other assets and
b) subsequently perform one or more of the other activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

Q6. In some cases, courts may direct third parties to make payments to an escrow account in a commercial bank to be distributed to harmed parties. The escrow accounts are not the property of the Federal government, and the interest income is subject to taxes. In some of these cases, a Federal agency may have some control over disbursements (e.g., by approving or disapproving a third-party distribution plan). Does this situation meet the definition of fiduciary activity in SFFAS 31?

No. In this example, the Federal agency has not received or collected the cash or other assets.

Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest[3] that the Federal Government must uphold.

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:
a) collect and receive fiduciary cash or other assets and
b) subsequently perform one or more of the activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

Q7. Does SFFAS 31 require reporting the monetary value of fiduciary land held in trust?

No. SFFAS 31 requires a general description of land that is held in fiduciary trust and reporting of the total quantity of land held in fiduciary trust, as follows:

[3] The ownership interest must be enforceable against the Federal Government. Judicial remedies must be available for the breach of the fiduciary obligation. (SFFAS 31, par. 10)

- beginning quantity,
- quantity received,
- quantity disposed of,
- net increase/decrease, and
- ending total quantity.

The reporting requirements for land held in fiduciary trust are found in paragraph 18 of SFFAS 31: (**bold added)**

[18] **A separate note to the financial statements should include the following information for individual fiduciary activities:**

(a) A description of the fiduciary relationship, e.g., the applicable legal authority, the objectives of the fiduciary activity, and a general description of the beneficial owners or class of owners.

(b) A Schedule of Fiduciary Activity displaying, for all periods presented:

- The beginning balance of net assets,
- The inflows from the fiduciary activities by category (e.g., contributions, investment earnings) and outflows by category (e.g., benefit payments, refunds, administrative expenses),
- The change in net assets, and
- The ending balance of net assets.

(c) A Schedule of Fiduciary Net Assets displaying the current and prior period ending balances of cash and any other assets by category (e.g., receivables, investments), and liabilities by category (e.g., accounts payable, refunds payable), and a variance analysis addressing significant changes from the prior period. **The disclosure for non-monetary fiduciary assets should include a description of the composition of the assets, the method(s) of valuation, and changes (if any) from prior period accounting methods.**
d) Component entities also may have non-valued fiduciary assets. Non-valued fiduciary assets are fiduciary assets for which required disclosure does not include dollar values. Non-valued fiduciary assets may include land held in trust. Component entities holding non-valued fiduciary assets should disclose them in a Schedule of Changes in Non-Valued Fiduciary Assets, which should include a description of non-valued fiduciary assets, beginning quantity, quantity received, quantity disposed of, net increase/decrease in non-valued fiduciary assets, and ending total quantity.

Q8. How should the concept of materiality be applied to disclosures about fiduciary activities?

The Board's position on materiality is published in the Foreword to *Original Pronouncements, Volume 1*, available on the FASAB website at: http://www.fasab.gov/codifica.html

Materiality

The Board intends that all standards' application be limited to items that are material. "Materiality" has not been strictly defined in the accounting community; rather, it has been a matter of judgment on the part of preparers of financial statements and the auditors who attest to them. Presented below is the Board's position on the issue of materiality at this time.

> The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

Additional guidance on materiality is provided in SFFAC 2, SFFAS 1, SFFAS 3, and the American Institute of Certified Public Accountants (AICPA) Code of Professional Conduct.

SFFAC 2

[78] Some of a reporting entity's components are likely to be required by law or policy to prepare and issue financial statements in accordance with accounting standards other than those recommended by FASAB and issued by OMB and GAO,[4] e.g., accounting standards issued by the Financial Accounting Standards Board or accounting standards established by a regulatory agency. Those components should continue to issue the required reports. The reporting entities of which the components are a part can issue consolidated, consolidating, or combining statements that include the components' financial information prepared in accordance with the other accounting standards. They need to be sensitive, however, to differences resulting from applying different accounting standards that could be material to the users of the reporting entity's financial statements. If these differences are material, the standards recommended by FASAB and issued by OMB and GAO should be applied. The components would need to provide any additional disclosures recommended by FASAB and included in the OMB-issued standards that would not be required by the other standards.

SFFAS 1

[4] Note: After October 1999, FASAB issues standards absent an objection from the Office of Management and Budget (OMB) or the Government Accountability Office (GAO).

[12] Except as otherwise noted, the accounting and reporting provisions of the accounting standards recommended in this Statement need not be applied to items that are qualitatively and quantitatively immaterial.

[13] The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

SFFAS 3

[8] The accounting and reporting provisions of the Board's accounting standards need not be applied to immaterial items. The determination of whether an item is immaterial requires the exercise of considerable judgment, based on consideration of specific facts and circumstances.

[9] FASB's Statement of Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information," discusses the concept of materiality. According to this statement, the determination of whether an item is material depends on the degree to which omitting or misstating information about this item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement. This concept includes both qualitative and quantitative considerations. An item that is not considered material from a quantitative standpoint may be considered material if it would influence or change the judgment of the financial statement user.

In addition, the AICPA Code of Professional Conduct, Rule 203 states **(bold added)**:

> Rule 203—Accounting Principles A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles **that has a material effect on the statements or data taken as a whole**. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Materiality with respect to fiduciary disclosures should be based on professional judgment considering relevant qualitative and quantitative factors. Examples of quantitative factors include but are not limited to the relationship of fiduciary amounts to other appropriate information in the entity's principal financial statements including disclosures. For example, the quantitative materiality determination for each fiduciary

item could be made based on the significance of those amounts to amounts recognized on the principal financial statements of the reporting entity, and/or on the significance of an individual item within the fiduciary amounts to all fiduciary amounts presented by the reporting entity.
In all cases, qualitative materiality aspects should be appropriately considered.

Q9. May estimating techniques be used when reporting fiduciary disclosures?

Yes, estimating techniques may be used when reporting fiduciary disclosures. For example, accrual estimates may be developed and reported on a summary level. When estimates are used for summary information for fiduciary activities, the fiduciary note should include disclosure of the use of estimates and explain that the actual results may vary from the estimates reported.

Attachment 2: Comments Received on Fiduciary Staff Implementation Guidance

#1 U.S. Department of Commerce **Federal Preparer**

MEMORANDUM FOR: Wendy M. Payne, Executive Director, Federal Accounting Standards Advisory Board

From: Gordon T. Alston, Deputy Director for Financial Management, Department of Commerce

Date: November 26, 2008

Subject: Department of Commerce Response to Draft Staff Implementation Guidance Accounting for Fiduciary Activities Questions and Answers

The Department of Commerce has reviewed the draft Staff Implementation Guidance Accounting for Fiduciary Activities Questions and Answers. We find these Questions and Answers to be informative and useful, and do not have any comments.

If you have any questions, please contact me at (202) 482-1207 or galston@doc.gov, or Bruce Henshel at (202) 482-0646 or bhenshel@doc.gov.

Thank you.

cc: Tony Akande
Bruce Henshel

#2 U.S. Securities and Exchange Commission **Federal Preparer**

>>> On 12/2/2008 at 9:21 AM, <ChadwickK@sec.gov> wrote:

As we have previously discussed, the Securities and Exchange Commission (SEC) receives collections from civil injunctive and administrative proceedings that order the payment of disgorgement of ill-gotten gains (disgorgement), civil monetary penalties (penalties), and post-judgment interest (interest) against violators of federal securities law. The SEC's accounting policy for this activity was reviewed last fiscal year to assess the impending impact of Statement of Federal Financial Accounting Standards (SFFAS) 31 requirements.

Historically all disgorgement activity was initially recorded as custodial activity in United States Department of the Treasury (Treasury) General Fund Receipt Account 501099,Fines, Penalties, and Forfeitures, Not Otherwise Classified (General Fund 501099). Subsequently disgorgement funds, as well as any related penalties collected under the “Fair Funds” provision of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act), which are expected to be distributed to harmed investors were reclassified as fiduciary balances and accounted for under the **dedicated collection provisions** of SFFAS 7: Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, paragraphs 83 through 87.

We determined that disgorgement, penalties and interest expected to be transferred to the General Fund of the Treasury are properly recognized as custodial activity. Disgorgement, penalties and interest assessed against securities law violators, that will be distributed to the victims of securities law violations or that will be held by the SEC until the Commission determines whether to distribute such monies to victims or transfer such monies to the Treasury, are collected in a Deposit Fund, as such they are precluded from treatment as custodial activity.

These balances appear to be outside of both standards replacing the dedicated collection provisions. Although it may be argued that they are earmarked funds, in that the specifically identified funds are designated for distribution to the victims of securities law violations in support of the SEC mission, the ability of the SEC to exercise discretion as to the disposition of these assets, that is, whether to disburse to harmed investors or transfer to the General Fund of the Treasury, points to a different conclusion: that they are not earmarked funds.

For classification purposes, disgorgements are federal, non-entity assets under the control of the SEC. The receivables and collections are not exchange revenue; revenue and expense recognition is not supported by the U.S. Standard General Ledger (SGL) for Deposit Funds.

For Fiscal Year (FY) 2008 the non-entity assets representing the receivables and the associated cash and investment of undistributed balances collected, and an offsetting liability was reported on the balance sheet. As we understand, without the availability of judicial remedy, under SFFAS 31, this activity will not be categorized as fiduciary

#2 U.S. Securities and Exchange Commission Federal Preparer

funds; therefore no additional changes are anticipated for FY 2009.

We are requesting confirmation that the controlling factor in Q6 (below for ready reference), dealing with court ordered payments, is the lack of judicial remedy, and that assets would not categorized as fiduciary in cases where the court orders these funds to be paid to the federal entity for distribution. If the scenario in Q6 is changed so that the court orders the payment to go to the Federal entity rather than the commercial bank, and the Federal entity controls the assets and distribution plan; would the classification of the assets be fiduciary?

Under the new scenario, if the assets are not fiduciary, would they be classified as federal, non-entity assets under the control of the federal entity?

Q6. In some cases, courts may direct third parties to make payments to an escrow account in a commercial bank to be distributed to harmed parties. The escrow accounts are not the property of the Federal government, and the interest income is subject to taxes. In some of these cases, a Federal agency may have some control over disbursements (e.g., by approving or disapproving a third-party distribution plan). Does this situation meet the definition of fiduciary activity in SFFAS 31?
No. In this example, the Federal agency has not received or collected the cash or other assets.
Per SFFAS 31, par. 10, in a fiduciary activity a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold.
For an activity to meet the definition of a fiduciary activity, the Federal entity has to:
a) collect and receive fiduciary cash or other assets and
b) subsequently perform one or more of the activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

Kristine M. Chadwick
CFO & Associate Executive Director
Office of Financial Management
U.S. Securities and Exchange Commission
6432 General Green Way, Mail Stop 0-3
Alexandria, VA 22312
202 551-7836
202 230-2101 mobile

#3 Department of Defense **Federal Preparer**

>>> "Gillis, Kathryn, Ms, OSD-COMPT" <Kathryn.Gillis@osd.mil> 12/2/2008 2:22 PM >>>
Thank you for the opportunity to comment on Questions and Answers for Accounting of Fiduciary Activities. Attached are comments and concerns regarding questions three, four, and nine. Please do not hesitate to contact me should you have questions.

Thank you,

Kathryn Gillis
Office of the Under Secretary of Defense (Comptroller)
Financial Reporting & Analysis
(703) 697-6875

Question 3

This Question is intended to address the accounting treatment of transfers of fiduciary collections from one Federal agency to another.

This answer could benefit from additional clarification. First, the answer states that "If the activity meets the definition of fiduciary activity it should be reported as such." This sentence indicates that all Federal components would treat fiduciary collections as fiduciary activity.

However, the answer then states that collections transferred between agencies are custodial, and quotes authoritative guidance that clearly and specifically relates only to collections of government funds, e.g. "The collection of the major sources of funds for the **appropriations**, e.g., taxes, royalty payments, and fines, is the responsibility of just a few reporting entities…" and "A separate statement of custodial activities would be appropriate for those entities whose primary mission is **collecting taxes or other revenues, particularly sovereign revenues** that are intended to finance the entire Government's operations..." (emphasis added). Likewise, the example provided, collection of income taxes, specifically relates to the collection of government funds.

The combination of the two sets of guidance leaves the question unanswered. What is the accounting treatment when fiduciary amounts are collected by Component A, and then transferred to Component B for management and eventual distribution?

This answer requires more thought. Fiduciary collections are not Federal assets and are not reported in the principal financial statements. Requiring a Federal component to treat a portion of fiduciary collections as custodial would be misleading. The first sentence in the answer appears to be correct. "*If the activity meets the definition of fiduciary activity it should be reported as such.*" The transfer of management control of fiduciary assets between Federal components does not change the fiduciary nature

#3 Department of Defense **Federal Preparer**

of the funds, thus the funds should not be commingled with Federal funds on the Custodial Statement or elsewhere.

If FASAB intends that transfers of Fiduciary assets (non-Federal funds) are to be recorded as "custodial activity," which currently are specifically limited to Federal funds, significant additional guidance is necessary. This guidance should address:

- Balance sheet presentation of the assets in the primary financial statements (e.g. if the collecting agency treats this as Custodial, which portions of Custodial accounting rules apply),
- Presentation of inflows and outflows on the Custodial Statement,
- Situations where the amount expected to be transferred to another Federal agency is not known with certainty at the point of collection and/or changes prior to transfer, and
- Recognition of the inflow of fiduciary assets by the receiving federal agency.

In either case, different guidance is needed for any situation where Fiduciary assets are transferred to Federal ownership. This transaction would require recognition of the flow activity as revenue, gain or some other type of financing source by the appropriate component of the Federal government.

It is recommended that the response be revised to provide specific guidance related to transfers of Fiduciary assets between Federal agencies. In addition, the guidance should not require or imply that non-Federal fiduciary assets be reported as federally-owned custodial assets.

Question 4

This Question addresses payments made by third parties to a federal agency for credit to the beneficiaries' accounts.

The answer appears incomplete. The answer addresses cases where the Federal agency does not have collection responsibilities, but then is silent on situations where the Federal agency does have collection responsibilities. It is recommended that the guidance clarify the circumstances surrounding Federal agencies with collection responsibilities.

Question 9

This question addresses the use of estimating techniques when reporting fiduciary disclosures.

It is recommended that the answer elaborate on the nature of estimates. In addition, the response should address existing requirements for using and disclosing estimates as outlined in other standards such as those imposed by SFFAS 6 and 23 and the corresponding Exposure Draft, *Estimating the Historical Cost of General Property, Plant, and Equipment*

#4 AGA Financial Management Standards Board **Non-Federal Other**

Advancing Government Accountability

2208 Mount Vernon Ave
Alexandria, VA 22301

(703) 684-6931
(703) 548-9367 (fax)

December 3, 2008

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Payne:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Federal Accounting Standards Advisory Board (FASAB) on its draft staff implementation guide (SIG) for Statement of Federal Financial Accounting standards (SFFAS) 31, Accounting for Fiduciary Activities. The SIG is entitled *Accounting for Fiduciary Activities – Questions and Answers*. The FMSB, comprising 23 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

The FMSB wishes to commend the FASAB staff for its document. We think it provides appropriate guidance that will be helpful to the federal government agencies in complying with the standard.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions concerning the letter, please contact Anna D. Gowans Miller, CPA, AGA's director of research and staff liaison for the FMSB, at amiller@agacgfm.org or 703.684.6931 ext. 313.

Sincerely,

Robert L. Childree, Chair,
AGA Financial Management Standards Board

cc: Samuel T. Mok, CGFM, CIA, CICA
AGA National President

Association of Government Accountants
Financial Management Standards Board

July 2008 – June 2009

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Stephen B. Watson

Andrew C. West

Relmond P. Van Daniker, Executive Director, AGA (Ex-Officio Member)

Anna D. Gowans Miller, Technical Manager, AGA, Staff Liaison

#5 CFO Council **Federal Preparer**

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Re: Draft Staff Implementation Guidance *Accounting for Fiduciary Activities – Questions and Answers*

Dear Ms. Payne:

Thank you for the opportunity to provide comments on the document, *Accounting for Fiduciary Activities – Questions and Answers*. Enclosed is the Chief Financial Officers Council – Standardization Committee's FASAB Response Work Group's consolidated response to your request for comments dated November 18, 2008.

If you have any questions, do not hesitate to contact me at 202-208-4701.

Sincerely,

David C. Horn for,

Daniel L. Fletcher
Chairman, Standardization Committee
Chief Financial Officers Council

Enclosure

#5 CFO Council **Federal Preparer**

Question 1
No Comment

Question 2
No Comment

Question 3

This question is intended to address the accounting treatment of transfers of fiduciary collections from one Federal agency to another.

This answer could benefit from additional clarification. First, the answer states that "If the activity meets the definition of fiduciary activity it should be reported as such." This sentence indicates that all Federal components would treat fiduciary collections as fiduciary activity.

However, the answer then states that collections transferred between agencies are custodial, and quotes authoritative guidance that clearly and specifically relates only to collections of government funds, e.g. "The collection of the major sources of funds for the **appropriations**, e.g., taxes, royalty payments, and fines, is the responsibility of just a few reporting entities…" and "A separate statement of custodial activities would be appropriate for those entities whose primary mission is **collecting taxes or other revenues, particularly sovereign revenues** that are intended to finance the entire Government's operations..." (emphasis added). Likewise, the example provided, collection of income taxes, specifically relates to the collection of government funds.

The combination of the two sets of guidance leaves the question unanswered. What is the accounting treatment when fiduciary amounts are collected by Component A, and then transferred to Component B for management and eventual distribution?

This answer requires more thought. Fiduciary collections are not Federal assets and are not reported in the principal financial statements. Requiring a Federal component to treat a portion of fiduciary collections as custodial would be misleading. The first sentence in the answer appears to be correct. "*If the activity meets the definition of fiduciary activity it should be reported as such.*" The transfer of management control of fiduciary assets between Federal components does not change the fiduciary nature of the funds, thus the funds should not be commingled with Federal funds on the Custodial Statement or elsewhere.

If FASAB intends that transfers of fiduciary assets (non-Federal funds) are to be recorded as "custodial activity," which currently are specifically limited to Federal funds, significant additional guidance is necessary. This guidance should address:

#5 CFO Council **Federal Preparer**

- Balance sheet presentation of the assets in the primary financial statements (e.g. if the collecting agency treats this as Custodial, which portions of Custodial accounting rules apply);
- Presentation of inflows and outflows on the Custodial Statement;
- Situations where the amount expected to be transferred to another Federal agency is not known with certainty at the point of collection and/or changes prior to transfer; and,
- Recognition of the inflow of fiduciary assets by the receiving federal agency.

In either case, different guidance is needed for any situation where fiduciary assets are transferred to Federal ownership. This transaction would require recognition of the flow activity as revenue, gain or some other type of financing source by the appropriate component of the Federal government.

We suggest that this response be revised to provide specific guidance related to transfers of fiduciary assets between Federal agencies. In addition, we suggest that this guidance should not require or imply that non-Federal fiduciary assets be reported as federally-owned custodial assets.

Question 4

This question addresses payments made by third parties to a federal agency for credit to the beneficiaries' accounts.

The answer appears incomplete. The answer addresses cases where the Federal agency does not have collection responsibilities, but then is silent on situations where the Federal agency does have collection responsibilities. We suggest that this guidance be included.

Question 5
No Comment

Question 6
No Comment

Question 7
No Comment

Question 8
No Comment

Question 9

This question addresses the use of estimating techniques when reporting fiduciary disclosures and includes the following requirement:

#5 CFO Council **Federal Preparer**

> When estimates are used for summary information for fiduciary activities, the fiduciary note should include disclosure of the use of estimates and explain that the actual results may vary from the estimates reported.

The above requirement differs from the disclosure requirements found in the Exposure Draft (ED), Estimating *the Historical Cost of General Property, Plant, and Equipment.* Specifically, while the Estimating Historical Cost ED requires that disclosures include "the use and general basis of any estimates used"; the ED does not require that financial reports "explain that the actual results may vary from the estimates reported." Further, a statement that "actual results may vary" may cause a reader to doubt the accuracy of the reported information.

The Basis for Conclusions of the Estimating Historical Cost ED acknowledges that use of estimates to approximate historical cost. Specifically,

> A15. … In addition, the Board believes that the use of reasonable estimates is proper given the appropriate disciplines surrounding the use of estimates.
>
> A17. … The Board believes that acknowledging the continuing appropriateness of estimates based on non-traditional documentation as provided by SFFAS 23 is prudent under the current circumstances. Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

Thus, if the estimate does not create a material misstatement, a disclosure that "actual results may vary from the estimates reported" is unnecessary. On the other hand, if the estimate is not reliable, the estimation methodology should be revised. We suggest that the disclosure language from the Estimating Historical Cost ED be used in this document.

#6 Department of the Interior **Federal Preparer**

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

Ms. Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Re: Accounting for Fiduciary Activities – Questions and Answers

Dear Ms. Payne:

Thank you for the opportunity to provide comments on *Accounting for Fiduciary Activities – Questions and Answers*. We appreciate the efforts of the Federal Accounting Standards Advisory Board Staff to publish this clarification. We have no substantive comments but offer one typographical observation: on the answer to question 3, second paragraph, third line, "pf" should be "of".

If you have any questions, please call me at (202) 208-4701.

Sincerely,

David C. Horn for,

Daniel L. Fletcher
Director, Office of Financial Management

Fiduciary Activities Q&A – Meeting Minutes- April 12, 2007

Attendees:
Deb Carey, Securities and Exchange Commission
David Horn, Dept. of the Interior
Kristen Kociolek, Government Accountability Office
Margaret Williams, Dept. of the Interior, Office of Special Trust
Robert Winter, Dept. of the Interior, Office of Special Trust
Fred Winter, KPMG
Wendy Payne, FASAB
Eileen Parlow, FASAB

FASAB Executive Director Wendy Payne opened the discussion by asking if attendees had a copy of the draft Q&As (attached). She said that today's informal public meeting was the beginning of a process to provide implementation guidance for Statement of Federal Financial Accounting Standards (SFFAS) 31, *Accounting for Fiduciary Activities.* She said that

- The goal was to develop Q&As that were complete, clear and necessary.
- The next step would be to develop a draft for formal public comment.
- Today's meeting was to discuss the questions, and perhaps get some initial comments on the draft answers to the questions.

Ms. Payne asked if there were any questions that should be eliminated and whether the questions were clear. The meeting attendees indicated no objections to the inclusion or clarity of any of the draft questions. Ms. Payne noted that the questions had been vetted by interested parties including the Department of the Interior, so the lack of objections was not a surprise.

Ms. Payne then asked if there were any questions that should be added.

Ms. Carey of the Securities and Exchange Commission (SEC) said that there is one item that may or may not be within the scope of SFFAS 31. She said that sometimes as the result of an SEC enforcement action, the court will direct someone to pay funds into an outside escrow account that is not under the direct control of the federal government. She asked if such funds would be subject to the requirements of SFFAS 31.

Ms. Parlow said that this example seems similar to one of the draft questions, which addresses funds deposited into an outside escrow account. She said that the Department of the Interior had asked about a similar situation in which funds that were deposited into an escrow account and never came under the control of the federal government.

Ms. Payne asked who administers the escrow accounts. Ms. Carey replied that private banks administer the escrow accounts. Ms. Payne asked who directs the payments from the escrow accounts. Ms. Carey replied that for the cases she is asking about, the court directs the payments. (In cases where the SEC directs the payments, the money

is deposited in the U.S. Treasury rather than private banks.) However, the SEC generally reserves the right to approve or disapprove the distribution plan.

Ms. Payne said that FASAB staff could set up a future meeting with SEC representatives to discuss this issue. She asked if there were any other potential questions.

Ms. Payne then asked if there were any concerns about the draft answers to the Q&As. When there was no response, she said that any new issues that arise during the process and future comments on the Q&As could be addressed to Ms. Parlow.

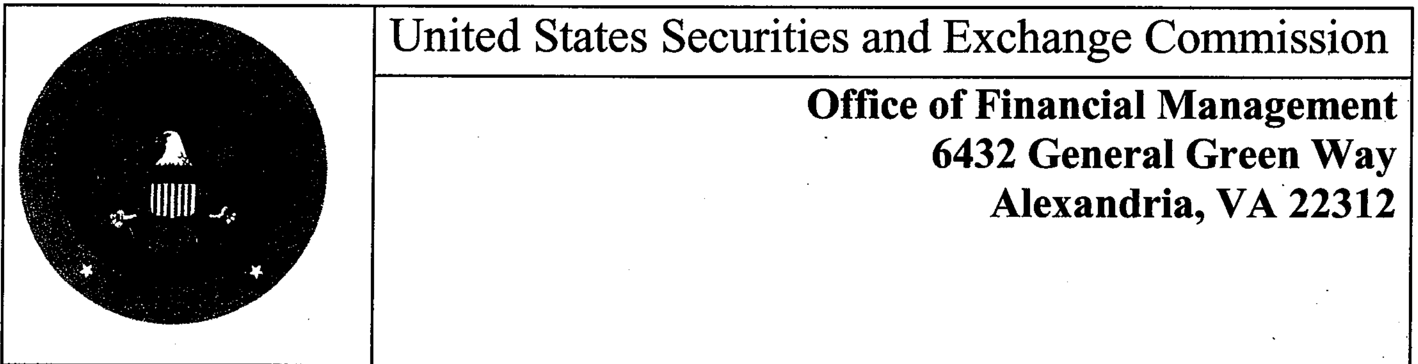
Ms. Payne explained that the process for issuing Staff Implementation Guidance (SIG) is designed to provide speedy guidance. She said that once staff is satisfied that we have all the questions and the answers clear, we will go to the next step: a 15-day public exposure and made any resulting edits, and then go to the Board for negative assurance (no objections). SIG can theoretically be issued in 30 to 45 days. However, it may take additional time to resolve the SEC's question.

Ms. Parlow asked the Department of Interior representatives if they had any situations similar to what the SEC representative described. Mr. Winter asked if the public comments received would be made available. Ms. Payne replied that they would be, but because the content of the Q&As is believed to be non-controversial and the comment period is accordingly short, few comments would be expected.

Ms. Payne thanked the participants and adjourned the meeting.

Attachment 4: SEC Issue Paper

Disgorgement and Penalty Collections
Issue Paper



Date: 5/30/2008

Document No: OFM 08-04-IP

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1 Overview

1.1 Executive Summary

Securities and Exchange Commission (SEC) disgorgement and penalty balances intended to be distributed to harmed investors meet the definition of a federal asset as defined by Statement of Federal Financial Accounting Concepts (SFFAC) *5, Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements.* SFFAC 5, issued December 26, 2007, defines a federal entity asset as "a resource that embodies economic benefits or services that the federal government controls" (paragraph 18). Disgorgement fund assets are economic resources and the SEC controls access to these economic benefits or services and can obtain them and/or deny or regulate the access of other entities.

The Fiduciary Model established by Statement of Federal Financial Accounting Standards (SFFAS) 31, *Accounting for Fiduciary Activities,* does not apply to disgorgement amounts ordered or collected by the SEC. Fiduciary activity, as defined by SFFAS 31, relates to collections in which non-federal parties have an ownership interest that the federal government must uphold. Further, this ownership interest must be enforceable against the federal government, and judicial remedies must be available for the breach of the fiduciary obligation. Based on discussions with representatives of the Office of the General Counsel (OGC), non-federal parties do not have any ownership interests until an approved disgorgement distribution plan is in place. Further, the SEC's *Rules of Practice and Rules on Fair Fund and Disgorgement Plans* prevents challenges to Fair Fund Distribution Plans outside of the opportunity to comment on proposed distribution plans.

As federal assets, SEC disgorgement and penalty amounts ordered or collected which are intended to be distributed to harmed investors meet the criteria of earmarked funds. Earmarked funds are defined as specifically identified revenues and other financing sources that are required by statute to be used for designated activities, benefits or purposes, and that must be accounted for separately from the Government's general revenues. The term "earmarked" (or "earmark") has multiple definitions within the federal government. The concept "earmarked funds" relates to a specific category of revenue collections from non-federal parties, while "Congressional earmarks" refer to spending directions, limitations or set-asides placed in agency appropriation language. Earmarked funds discussed in this document are unrelated to Congressional earmarks.

Accordingly,

1. Effective for FY 2008, the SEC will change its accounting method for disgorgements and related penalties expected to be distributed to harmed investors from the Custodial Model to the Earmarked Funds Model. Based on a new SFFAC 5 definition of federal entity assets, and new clarifying fiduciary and custodial definitions presented by SFFAS 31, the Custodial Model and Fiduciary Models are not considered to be appropriate for these disgorgement activities. Although SFFAS 31 is not effective until

FY 2009, its definition of "custodial" is considered by FASAB to be the current definition.

2. This change is a result of new, clarifying guidance provided by SFFAS 31. Thus, the change to adopt the Earmarked Model will be treated as a change in accounting principle in accordance with SFFAS 21, *Reporting Correction of Errors and Changes in Accounting Principles.*

3. The Earmarked Model will result in a more prominent disclosure of these activities on the face of the SEC's financial statements. This presentation will properly reflect the fact that the Sarbanes-Oxley Act of 2002 and other legislation expanded the SEC's mission to include consideration of the impact of securities law violations on investors.

4. Penalties expected to be forwarded to the General Fund of the Treasury upon collection are currently recognized as custodial activity. No change is needed to current accounting procedures for this activity.

1.2 Background

The Securities and Exchange Commission (SEC) receives collections from enforcement proceedings that result in the assessment of disgorgement, penalties, and interest against violators of federal securities law. This activity is currently recognized as non-entity revenue based on the argument that amounts collected are not available to finance day-to-day operations of the SEC. Historically these receivables and collections have been presented on the Balance Sheet, Statement of Custodial Activity (SCA) and supporting footnotes.

Federal accounting standards establish accounting principles for federal financial reporting and address accounting events not common in the private sector. The accounting models considered potentially applicable to the SEC's custodial and fiduciary activity are complex, and may not be intuitive to those more familiar with private sector accounting. In addition, SFFAS 31 establishes a very strict definition of fiduciary activity. This definition may differ from the common usage of the term fiduciary in other contexts. SFFAS 31 is effective beginning in Fiscal Year (FY) 2009. Early implementation is not permitted.

1.3 Purpose

The objective of this document is to re-examine the nature of disgorgement, penalty, and interest collections of the Commission in light of the changes, if any, required by SFFAS 31, when that guidance becomes effective in FY 2009. The applicability of OMB Circular A-136, *Financial Reporting Requirements,* and Statements of Federal Financial Accounting Standards to these activities will also be considered. Recommendations will be made with regard to both current year (FY 2008) and FY 2009 accounting and reporting.

1.4 Scope

The business processes discussed only relate to the SEC's Division of Enforcement (Enforcement) proceedings which result in the payment of amounts to the SEC. These collections include disgorgement of ill-gotten gains, civil monetary penalties, and post-judgment interest. Other proceedings can result in amounts payable to Federal Courts, non-federal receivers, or to other parties. These events are excluded from the scope of this paper, as well as other activity currently reported on the SCA.

1.5 Authoritative Guidance

The Federal Accounting Standards Advisory Board (FASAB) drafted two standards which collectively were intended to replace the "Dedicated Collection" reporting requirements established by SFFAS 7. SFFAS 27, *Identifying and Reporting Earmarked Funds,* became effective in FY 2006 and SFFAS 31 will be effective in FY 2009. FASAB originally intended that these documents be completed and published at approximately the same time. However, the fiduciary document was the subject of extensive conceptual discussion and debate related to accounting issues at another federal agency. These discussions dramatically changed the content of the initial exposure draft on this topic, and in addition, delayed the completion of this document by several years. As a result, the accounting standards related to earmarked funds were effective a full year prior to the publication of the accounting standards for fiduciary funds. (SFFAS 27 was effective for FY 2006, which began October 1, 2005; SFFAS 31 was published October 24, 2006) The appropriate accounting model for SEC's disgorgement and related activity hinged to a large extent on whether this activity would be fiduciary per federal accounting definitions, thus the model could only be determined by reviewing these two standards as a whole.

We also examined SFFAC 5, dated December 26, 2007, due to its clarification on the definition of federal entity assets and related financial statement elements. It should be noted that although SFFACs are not Generally Accepted Accounting Principles (GAAP), they constitute "other literature" and may only be relied upon to resolve specific accounting issues in the absence of GAAP literature.

2 Definition of Terms

Accounting terms applicable to this document are defined below. In addition, additional guidance specific to those concepts is included as applicable.

Asset – An asset is a resource that embodies economic benefits or services that the federal government controls. *(SFFAC 5, par 11)*

Custodial Activity – Custodial collections are amounts collected by one federal component entity on behalf of another federal component entity and associated with that other entity in the federal budget. *(SFFAS 31, par 56)*

The organizational entity that collects the revenues is responsible for reporting only the collection and subsequent disposition of the funds. The organizational entity responsible for carrying out the program(s) financed by a trust fund will report all assets, liabilities, revenues, and expense of the fund, notwithstanding the fact that another entity has custodial responsibility for the assets. *(see SFFAC 2, par 35, footnote 3)*

The collecting entity reports custodial collection activity on the Statement of Custodial Activity. This statement should display the sources and amounts of the collections of custodial revenues, any increases or decreases in amounts collectable but not collected, the disposition of the collections through transfers to other entities, the amounts retained by the collecting entity, and any increase or decrease in the amounts to be transferred. (see *OMB Circular A-136, 2007* and *SFFAC 2, par 101)*

Dedicated Collections – Dedicated Collections are defined in SFFAS 7, paragraph 83, as "Funds held by the reporting entity that are financed with dedicated collections and that are held for later use to accomplish the fund's purpose." SFFAS 7 states that special accountability is required for the sake of the taxpayers or other contributors who make payments to the fund with the expectation that the collections will be used for the purposes for which they were dedicated, and for the sake of those who expect to benefit from the fund's future expenditures. Specifically, separate financial disclosures regarding dedicated collections are required in the entity's general purpose financial statements and/or related the notes. Other than these additional disclosures, SFFAS 7 did not establish any specific accounting treatment for this activity.

As noted above, FASAB has issued two accounting standards addressing earmarked funds and fiduciary activity which, collectively, were intended to address the activities defined as Dedicated Collection by SFFAS 7. The Dedicated Collection provisions of SFFAS 7 are not applicable to earmarked funds effective FY 2006 and are fully rescinded effective FY 2009. Specifically, the "Scope of this Statement" section of SFFAS 27 states:

> The Board's proposed standard for "Fiduciary Activities" and this standard on "Earmarked Funds" together address all activities or funds considered "dedicated collections" by Statement of Federal Financial Accounting Standards (SFFAS) 7. When finalized, the fiduciary activities standard will rescind the "dedicated collections" provisions in SFFAS 7. This standard supersedes the "dedicated collections" provisions in SFFAS 7 (paragraphs 83-87) for earmarked funds.

Deposit Funds - OMB Circular A-11, *Preparation, Submission, and Execution Of The Budget,* states that deposit funds (Treasury Fund Symbols 6000–6999) are used to record deposits and disbursements of monies not owned by the Government or not donated to

the Government (amounts donated to the Government are deposited in a special or trust fund account). Further, there are no budgetary entries associated with deposit fund transactions. *(OMB Circular A-11, section 20.12)*

Disgorgement – Individuals or companies that violate SEC regulations are typically required to pay both civil money penalties and disgorgement. Civil money penalties are punitive, while disgorgement is intended to represent ill-gotten gains (or losses avoided) resulting from individuals violating the federal securities laws. The Commission seeks disgorgement to ensure that securities law violators do not profit from their illegal activity. When appropriate, the disgorged funds are returned to the injured investors. Disgorgements can be ordered in either administrative proceedings or civil actions, and the cases can be settled or litigated. Payment of disgorgement can be either completely or partially waived based on the defendant demonstrating an inability to pay. *(SEC OIG, Disgorgements (Audit 311), January 11, 2001)*

Earmarked Funds – Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government's general revenues. The criteria that must be met to meet the definition of earmarked funds are presented in paragraph 6 of SFFAS 27 and are as follows:

1. A statute committing the federal government to use specifically identified revenues and other financing sources only for designated activities, benefits or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and;
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguish the earmarked fund from the Government's general revenues.

The activity of earmarked funds differs from fiduciary activities in that earmarked fund assets are Government-owned while fiduciary assets are owned by non-federal parties. *(*see OMB Circular A-136, 2007 and SFFAS 31*)*

The term "earmarked" (or "earmark") is used within the federal government with three distinct definitions:

1) "Earmarks," which are Congressional set-asides in agency appropriation language;
2) "Earmarked collections," which are certain offsetting collections identified and defined for budgetary purposes in Circular A-11; and
3) "Earmarked funds," which are funds financed by specifically identified revenues, as defined by Statement of Federal Financial Accounting Standards (SFFAS) No. 27, Identifying and Reporting Earmarked Funds.

The first use of the term "earmark" is the most common. OMB has defined "earmarks" in this context as follows:

> Earmarks are funds provided by the Congress for projects or programs where the congressional direction (in bill or report language) circumvents Executive Branch merit-based or competitive allocation processes, or specifies the location or recipient, or otherwise curtails the ability of the Executive Branch to manage critical aspects of the funds allocation process. (OMB Memorandum M-07-17, Tracking Earmarks in the 2008 Appropriations Process, May 31, 2007).

The second and third uses of the term "earmarked" are similar, but not identical. Both relate to amounts received or collected by the federal government. "Earmarked collections" are normally amounts collected from business-type operations that offset the operating costs of the agency, and the reporting requirements are limited to the budgetary recognition of this activity. "Earmarked funds," on the other hand, may result from either exchange or non-exchange revenue sources, and the reporting requirements impact two proprietary statements and related disclosures. Thus, while there may be overlap between "earmarked collections" and "earmarked funds," the concepts and reporting requirements are different.

Exchange Revenue – Exchange revenues arise when a Government entity provides goods and services to the public or to another Government entity for a price. Another term for exchange revenue is "earned revenue." *(SFFAS 7, paragraph 2)*

Fiduciary Activity – Fiduciary activity is the collection or receipt, and the management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. Non-federal parties must have an ownership interest in cash or other assets held by the federal entity under provision of law, regulation, or other fiduciary arrangement. The ownership interest must be enforceable against the federal government. Judicial remedies must be available for the breach of the fiduciary obligation. *(SFFAS 31, paragraph 10)*

Fiduciary activities are initiated by fiduciary collections. Fiduciary collections are an inflow to a federal entity or its non-federal designee (such as a commercial bank) of cash or other assets that are and remain the property of non-federal parties. Fiduciary collections may be preceded by the recognition of fiduciary accounts receivable. *(SFFAS 31, paragraph 11)*

Under the fiduciary model, the collecting agency excludes both the assets and related flow activity from its primary financial statements, as these amounts are not considered to be assets or operating activity of the federal agency. However, the agency must disclose the fiduciary relationship and related information in the Notes to the Financial Statements.

As noted above, fiduciary activity differs from earmarked funds in that earmarked fund assets are Government-owned while fiduciary assets are owned by non-federal parties. (see OMB Circular A-136, 2007 and SFFAS 31)

Fines and Penalties – Monetary requirements imposed on those who violate laws or administrative rules. *(SFFAS 7, paragraph 61)* Fines and penalties are non-exchange revenues as defined below.

Non-Exchange Revenue – Inflows of resources that arise from the exercise of the Government's power to demand payments from the public (e.g., taxes, duties, fines, and penalties) as well as voluntary donations *(SFFAS 7, paragraph 2)* Non-exchange revenue is recognized when a reporting entity establishes a specifically identifiable, legally enforceable claim to cash or other assets. In the case of custodial activity, the collecting entity reports the activity on the SCA. The non-exchange revenue is recognized by the recipient agency.

Qualified Settlement Fund - A qualified settlement fund is defined by Internal Revenue Service (IRS) regulations as a fund, account, or trust that satisfies the following requirements specified at 26 CFR 1.468B-1 (c):

1. It is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;
2. It is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability--
   (i) Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (hereinafter referred to as CERCLA), as amended, 42 U.S.C. 9601 et seq.; or
   (ii) Arising out of a tort, breach of contract, or violation of law; or
   (iii) Designated by the Commissioner in a revenue ruling or revenue procedure; and
3. The fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Principal Financial Statements (also referred to as "Basic Financial Statements") - In Appendix E, *Consolidated Glossary,* of *Statements of Federal Financial Concepts and Standards, Original Pronouncements,* FASAB states that it "considers principal financial statements an essential part of a reporting entity's financial reporting, and therefore recommends authoritative guidelines for the measurement and presentation of the information." Further, this glossary defines the basic financial statements as follows:

"...the basic financial statements are those on which an auditor would normally be engaged to express an opinion...The basic financial statements in financial reports prepared pursuant to the Chief Financial Officers Act, as amended, are called the

"principal financial statements." The Form and Content of these statements are determined by OMB. (see also Principal Financial Statements)

OMB Circular A-136, Section III.4.2, states that the basic financial statements include:

1. Balance Sheet;
2. Statement of Net Cost (SNC);
3. Statement of Changes in Net Position (SCNP);
4. Statement of Budgetary Resources (SBR);
5. Statement of Custodial Activity (SCA), when applicable; and
6. Statement of Social Insurance (SOSI), when applicable.

The Statement of Social Insurance is not applicable to the Commission. This document will use the term "principal financial statements" to refer to the financial statements presented in the Commission's *Performance and Accountability Report* (PAR), specifically statements 1 through 5 listed above.

3 Discussion of Definitions and Federal Accounting Concepts

This section will review selected definitions and accounting concepts relevant to the determination of the proper accounting treatment for enforcement related receivables and collections.

3.1 Disgorgement versus Restitution

While the concept of disgorgement is in some ways related to the concept of restitution, these two activities are not synonymous. Disgorgement is intended to impact the violator of securities laws by returning that violator to the financial position he/she would have been in if the violation had not occurred. On the other hand, restitution is intended to make the harmed party whole.

While disgorgements and restitution may seem to be related, there is often no direct relationship between disgorgement and restitution. A violator of securities laws may benefit financially from violation of securities laws without directly harming another party. This could occur, for example, if proceeds from illegal activity are invested over a period of time. The SEC may order disgorgement of all amounts earned, even though no other party was directly harmed, since the intent of disgorgement is to return the violator to the financial position he/she would have been in absent the violation. On the other hand, an investor may lose money in the stock market due to actions of the violator of securities laws even if the violator was not party to any of the transactions which resulted in a loss to the harmed investor. That could occur, for example, when the violator illegally manipulates a stock price. Many investors may lose money unrelated to any gains achieved by the violator. Again, the violator might be ordered to disgorge his/her own illegal profits and pay additional penalties.

Under existing law, the SEC is concerned with disgorgement, not restitution. (Although the Commission has at times recommended that restitution be ordered, the Commission does not collect restitution payments.)

3.2 Fiduciary Definition

As noted above, fiduciary activity, as defined by SFFAS 31, relates to collections in which non-federal parties have an ownership interest that the federal government must uphold. The ownership interest must be enforceable against the federal government, and judicial remedies must be available for the breach of the fiduciary obligation. This definition of fiduciary differs from the standard dictionary definition of fiduciary, as well as the legal application of the fiduciary concept. This definition also differs from the working definition of fiduciary commonly used within the SEC.

The fact that there are many definitions of the term "fiduciary" creates some confusion when determining the appropriate accounting treatment for the SEC's disgorgement activity. SFFAS 31 was published in October 2006. Although the standard is not effective until FY 2009, this document provides the only definition of "fiduciary" applicable to the preparation and presentation of federal financial reports prepared in accordance with GAAP.

3.3 Summary of Accounting Concepts for Federal Collections and Activity

In FY 2008, the four accounting concepts that may be applicable to disgorgement activity are the Custodial Activity model, the Earmarked model, the Dedicated Collections model and the Non-Exchange Revenue model. Regardless of the model applied, these collections and the underlying activity are considered to be assets and business events of the federal entity. In each case, the Commission must post a complete set of accounting transactions, recognizing changes in balance sheet amounts as well as all related flow activity. Thus, if the collections are recognized as assets on the balance sheet, the Commission must also recognize appropriate flow transactions related to the receipt and distribution of those balances.

SFFAS 31 is effective in FY 2009, and two significant changes take effect. First, the Fiduciary Accounting model is established under which certain collections and related activity are not considered to be assets and business events of a federal entity. Second, the Dedicated Collection model is rescinded.

The fiduciary model applies to collections in which non-federal parties have an ownership interest. Further, SFFAS 31 states that "Fiduciary activities are initiated by fiduciary collections" indicating that the non-federal ownership interest exists at the time the federal government takes custody of the assets. Fiduciary Activity is disclosed in the Notes to the Financial Statements, however, there is no recognition of these transactions on the principle financial statements of the SEC.

For any collections not meeting the fiduciary definition, the SEC must apply one of the four potential accounting models that are applicable to federal activity. A high level summary of

related balance sheet and flow statement presentation is presented below for each of the federal activity accounting models.

1) *Custodial Activity:* Custodial collections are amounts collected by one federal agency on behalf of another federal agency. (Custodial activity includes non-exchange revenue collections that will be deposited in the General Fund of the Treasury upon receipt.)
   Balance Sheet - The agency recognizes an asset and offsetting liability for the net amount of any receivables, as well as any collections not yet deposited in the General Fund of the Treasury. There is no impact on Net Position.
   Flow Activity – The agency reports related non-exchange revenues, distributions and change in liability balance on the Statement of Custodial Activity (SCA).

2) *Earmarked Funds:* Earmarked funds are specifically identified revenues and other financing sources that are required by statute to be used for designated activities, benefits or purposes, and that must be accounted for separately from the Government's general revenues.
   Balance Sheet - The agency recognizes assets, liabilities and net position in the normal course of business. Asset and liability amounts are presented on the balance sheet commingled with other activity, and footnote disclosures are used to disclose the earmarked amounts. Net Position balances are segregated between earmarked and non-earmarked balances on the face of the statement.
   Flow Activity – Exchange revenue and costs incurred by earmarked funds are reported on the Statement of Net Cost (SNC). Non-exchange revenue is reported on the Statement of Changes in Net Position (SCNP) as earmarked activity. In addition, Net Cost of Operations and all other balances are segregated between earmarked and non-earmarked activity on the SCNP. It should be noted that earmarked assets are agency assets. The distribution of agency assets to the public is always recognized as an expense of the agency. Thus, if any enforcement related balances are recognized as earmarked activity, any related distributions will be reported as an expense on the SNC.

3) *Dedicated Collections:* Dedicated collections are defined by SFFAS 7 as collections for which special accountability is required either for the sake of the those who make payments to the fund with the expectation that the collections will be used for a specific purpose and/or for the sake of those who expect to benefit from the fund's future expenditures. Dedicated collection disclosure requirements apply through the end of FY 2008. Dedicated Collection disclosures are in addition to appropriate recognition of the underlying transactions in the principle financial statements. In addition, dedicated collection disclosure requirements could apply to both to federally owned and non-federally owned assets. Note, dedicated collections disclosure requirements are not applicable to activity classified as "earmarked" beginning with the effective date of SFFAS 27 (FY 2006).
   Balance Sheet – Dedicated collections are recognized in the normal course of business. All related balances are presented on the Balance Sheet, commingled with other activity. Footnote disclosure is used to report balances related to dedicated collections.

Flow Activity – Dedicated collections are recognized in the normal course of business, most likely as non-exchange revenue for inflows and expenses for outflows. All related balances are presented on the SCNP and SNC, as applicable, and are commingled with other activity. Footnote disclosure is used to report inflows and outflows related to dedicated collections.

4) *Non-Exchange Revenue:* Disgorgement and related amounts collected by the Commission which do not meet any of the special categories above will be recognized in accordance with federal accounting guidance for non-exchange revenue.

3.4 Other Factors

Standards promulgated by FASAB are authoritative for federal financial reporting, however, all relevant facts must be addressed in the application of these requirements. The fundamental conclusion that certain disgorgement related collections are federal assets may be challenged on several bases, including the inclusion of this activity in deposit funds; the omission of related transactions from the *Budget of the United States Government* and *Financial Report of the United States Government*; and the payment of federal income taxes on income earned by the Funds.

The implications of these seemingly contradictory conclusions are described below, along with the resolution of each issue.

1. *Qualified Settlement Funds* - The Division of Enforcement has determined that disgorgement and penalty collections that are held for distribution to harmed investors are Qualified Settlement Funds (QSF) in accordance with the IRS definition. In private letter ruling (PLR) 1111299-06 dated October 12, 2006, the IRS confirmed this determination. (A PLR is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts and is issued in response to a written request submitted by a taxpayer.) The conclusions documented in this PLR are in direct response to the facts presented to the IRS by the SEC, including the assertion that the assets collected are not owned by the SEC. Accordingly, the interest income earned by these funds is subject to the payment of federal income taxes, and these taxes are being paid. Inclusion of these funds in the operating accounts of the SEC would require that the Commission report federal income taxes paid in the principal financial statements.

   Resolution: The IRS develops income tax regulations independent of the requirements for preparation of federal agency financial reports. The Accounting Standards promulgated by FASAB and adopted in accordance with the bylaws established by FASAB are authoritative for federal financial reporting. A hierarchy for determination of Generally Accepted Accounting Principles applicable to federal agencies has been established. IRS guidance does not appear in this hierarchy. As Statements of Federal Financial Accounting Standards are not silent regarding this activity, the content of IRS guidance is not relevant. Further, FASAB staff indicated that the payment of income taxes, while unusual, does not have any direct bearing on the application of SFFAS No. 31.

2. *Deposit Funds* - The disgorgement amounts are presently held in Treasury Fund Symbol (TFS) 50X6563, *Disgorgement and Penalty Amounts Held for Investors, Securities and Exchange Commission.* This TFS is designated by OMB and the Department of Treasury as a "deposit fund." Accordingly, the amounts held in this account are not treated as federally-owned funds in the *Financial Report of the United States Government.* Likewise, all activity related to the collection and disbursement of these amounts is excluded from the *Budget of the United States Government.*

   According to OMB Circular A-11, *Preparation, Submission and Execution of the Budget,* a deposit fund is an account established to record amounts held temporarily by the Government until ownership is determined, or held by the Government as an agent for others. On the other hand, a special fund is a fund account for receipts earmarked for specific purposes and the expenditure of these receipts. Assets in deposit funds are excluded from the *Budget of the United States* and are not subject to apportionment and other forms of federal funds control.

   Resolution: In SFFAS 31, paragraph 7, FASAB discussed the possibility that monies classified as "deposit funds" for purposes of reporting to OMB and Treasury may not meet the definition of "fiduciary" established by that standard. Specifically:

   > Regardless of how a fund group may be classified in reporting to the Treasury FMS or to the OMB, only those activities that meet the definition of fiduciary activity promulgated in this standard are subject to the reporting requirements of this standard....Deposit funds that do not meet the definition of fiduciary activities, and therefore are not disclosed in the fiduciary note disclosure, should be recognized in the principal financial statements.

   The SEC will work with OMB and Treasury to establish a more appropriate Treasury Fund Symbol for this activity. However, the type of fund symbol applied does not drive accounting recognition under GAAP.

3. *Bureau of Public Debt* – The majority of the amounts held in TFS 50X6563 are invested in U.S. Treasury Securities issued by the Bureau of Public Debt (BPD). These amounts are reported in the *Financial Report of the United States Government* as investments held by the public. In addition, for the purpose of interagency reconciliation, the Bureau of Public Debt treats these investments as held by the public rather than as investments held by another federal agency. However, the SEC reports these investments as "intragovernmental" investments, *i.e.,* investments issued by a federal agency.

   Resolution: This issue is directly related to the Deposit Funds issue discussed above. The determination by BPD to report these investments as "with the public" is based solely on the fact that these investments are recognized in a Deposit Fund. This treatment by the BPD does not impact the recognition of these assets in SEC financial statements prepared in accordance with GAAP. However, the SEC will continue to

work with the BPD to ensure that these assets continue to earn interest pending final distribution decisions.

4 Application of Federal Accounting Concepts

The "decision trees" presented in this section were developed to aid in determining the classification of the disgorgement activities in the context of federal accounting requirements.

4.1 Federal versus Non-Federal

Federal ownership can be determined by reference to the asset definition established by SFFAC 5 (issued December 26, 2007) and by reference to the definition of "fiduciary" established by SFFAS 31 (effective FY 2009). SFFAC 5, paragraph 18, defines a federal entity asset as "a resource that embodies economic benefits or services that the federal government controls." SFFAS 31 states that fiduciary activity relates to collections in which non-federal parties have an ownership interest that the federal government must uphold. Further, this ownership interest must be enforceable against the federal government, and "judicial remedies" must be available for the breach of the fiduciary obligation.

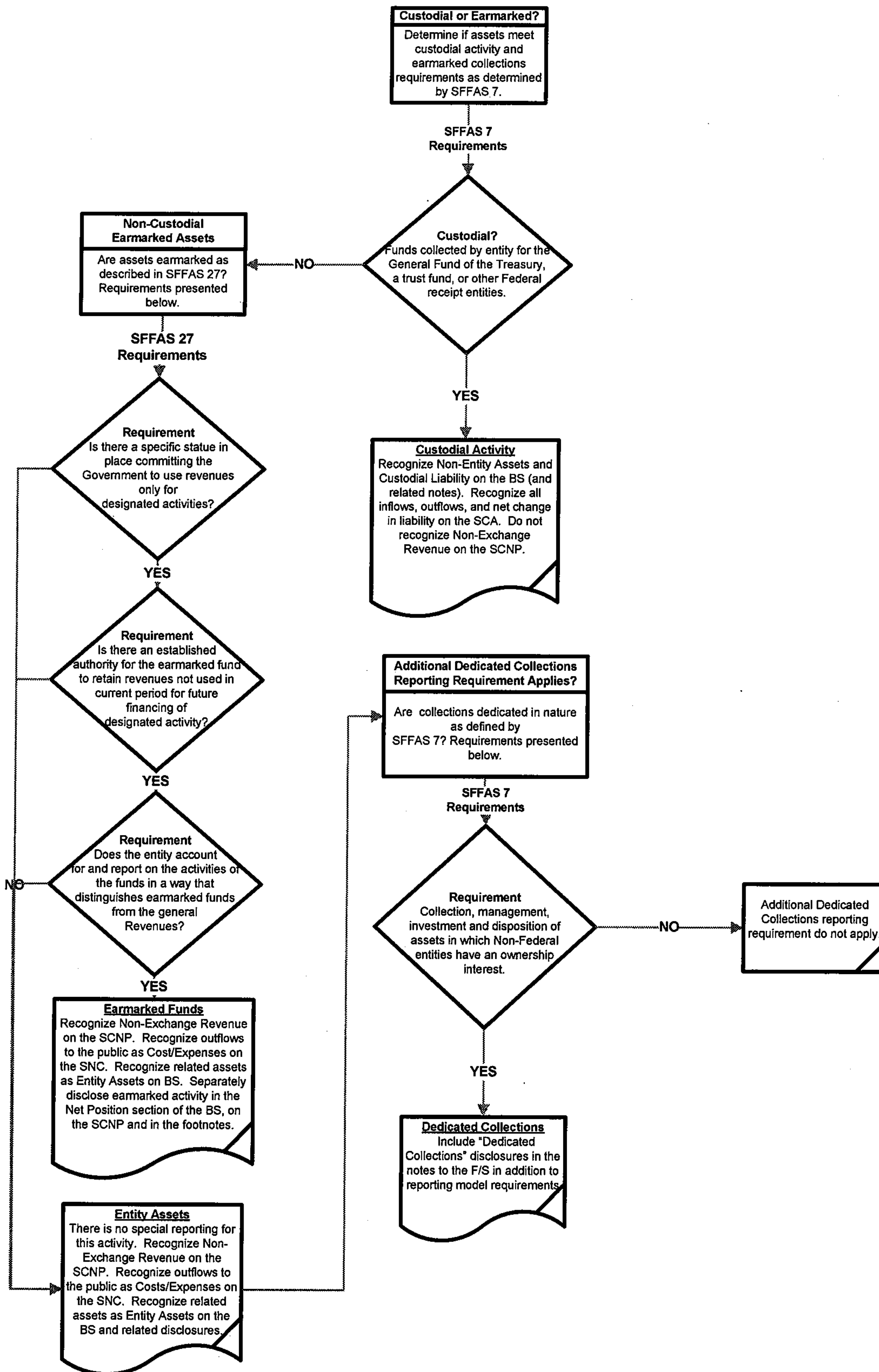
Prior to the issuance of these documents, the distinction between federal and non-federal ownership did not drive federal financial reporting decisions. Thus, in 2008 and prior, all assets held by the SEC, whether federally owned or owned by the public are reported in the financial statements of the SEC. If non-federal parties have a claim on the underlying assets, the assets are offset by a liability to the public on the Balance Sheet.

In 2009 and forward, if the assets are determined to be owned by non-federal parties under guidance established by SFFAS 31, the assets and all related flow activity are excluded from the primary financial statements of the SEC. This activity would be disclosed in a footnote to the financial statements. On the other hand, if the assets do not meet the fiduciary definition established by SFFAS 31, the assets will be recognized as assets of the federal government. In this case, the assets and all related flow activity will be recognized on the SEC's financial statements.

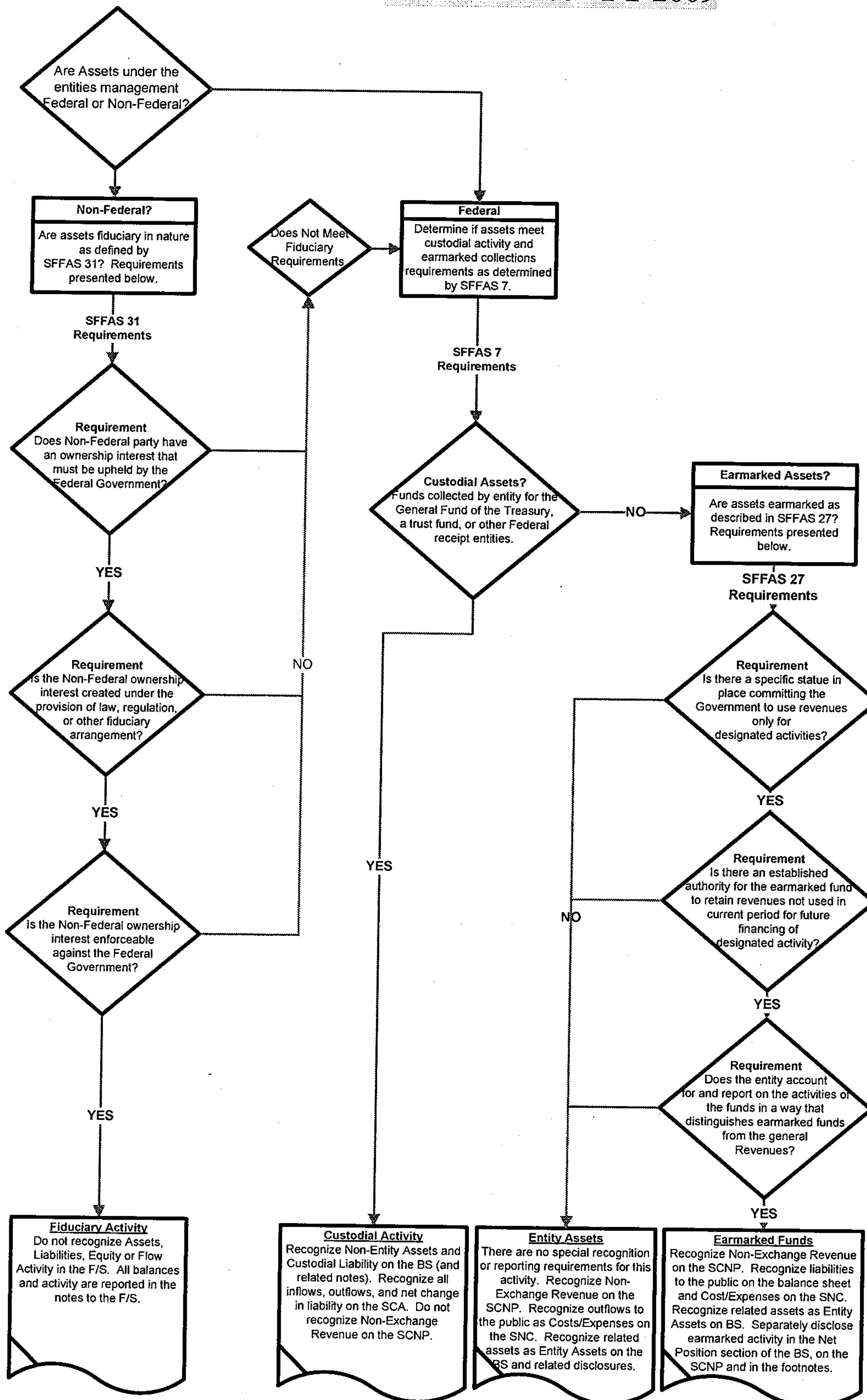
As noted above, the accounting treatment of federal assets and accounting events may fall under guidance related to custodial activity, earmarked funds, and/or may be considered to be non-exchange revenue resulting from general agency operations. This is true in both FY 2008 and FY 2009. In addition, the dedicated collection disclosure requirements established by SFFAS 7 require additional disclosure related certain activity through FY 2008.

Decision trees for FY 2008 and FY 2009 are presented below. A discussion of the applicability of the various accounting models to specific types of disgorgement transactions is presented in Sections 4.2 and 4.3.

Decision Tree - FY 2008



Decision Tree - FY 2009



4.2 Penalties to be Deposited in the General Fund of the Treasury

As shown below, the accounting treatment of penalties assessed by the SEC and expected to be deposited in the General Fund of the Treasury upon receipt is relatively straightforward, as this activity falls clearly within the definitions of federal non-exchange revenue and custodial activity.

The application of the specific requirements for treatment as fiduciary, custodial or earmarked is presented below.

1) *Fiduciary: Do non-federal parties have a legally enforceable claim to the amounts collected? (applicable FY 2009)*

No. The amounts are expected to be to be deposited in the General Fund of the Treasury upon receipt. Non-federal parties do not have an ownership interest that the federal government must uphold and therefore the activity is not Fiduciary as defined by SFFAS 31.

2) *Custodial: Will amounts collected be transferred to another federal agency upon receipt?*

Yes. The amounts are expected to be to be deposited in the General Fund of the Treasury upon receipt, **thus treatment as custodial activity is appropriate.**

3) *Earmarked:*

3a) Are amounts retained required to be used only for designated activities, benefits or purposes?

No. The Commission does not retain these collections.

3b) Does the Commission have explicit authority to retain revenues not used in the current period for future use to finance the designated activities, benefits, or purposes?

No. The Commission does not retain these collections.

3c) A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguish the earmarked fund from the Government's general revenues.

No. The funds are deposited in the General Fund of the Treasury and thus are commingled with other general revenues of the federal government. The collection activities must meet all elements of the earmark criteria to be considered earmarked. This activity does not meet the three criteria required for earmarked reporting, and thus is not earmarked.

4) *Dedicated Collections: Do the disgorgement collections meet the definition of Dedicated Collections? (applicable through FY 2008)*

No. These funds are not retained by the SEC and non-federal entities do not have an ownership interest. As shown on the FY 2008 decision tree, the Dedicated Collections reporting requirement is not applicable to collections deemed to be custodial. In FY 2009, the Dedicated Collections reporting requirement no longer exists.

Conclusion: Penalties that are expected to be deposited in the General Fund of the Treasury upon receipt are custodial. The SEC currently reports this activity as custodial, thus no changes are needed in FY 2008 or FY 2009.

4.3 Amounts Expected to be Distributed to Harmed Investors

The accounting treatment of disgorgements and penalties expected to be distributed to harmed investors must take into account the accounting guidance established by SFFAS 27, SFFAS 31 and SFFAC 4.

4.3.1 Amounts to be Distributed to Harmed Investors – FY 2008 Reporting

The application of the specific requirements for treatment as fiduciary, custodial, earmarked or dedicated collections is presented below for FY 2008.

1) *Fiduciary:*

(The fiduciary accounting model established by SFFAS 31 is not applicable in FY 2008)

2) *Custodial: Will amounts collected be transferred to another federal agency upon receipt?*

No. Amounts may be transferred to the General Fund of the Treasury at a later date if the Commission determines that distribution to harmed investors is not feasible. However, this determination has not been made at the time the funds are received. Thus, collections expected to be distributed to harmed investors are not reported as custodial. The clarification of the custodial definition presented in SFFAS 31 confirms that collections on behalf of non-federal parties are not custodial activity.

3) *Earmarked:*

3a) Are amounts retained required to be used only for designated activities, benefits or purposes?

Yes. The Commission may not use these collections to finance operations. Congress, through legislation, has directed that these funds are to be used to benefit investors harmed by violators of securities and the majority of these collections will be forwarded to harmed investors. Amounts not forwarded to harmed investors will be deposited in the General Fund of the Treasury.

3b) Does the Commission have explicit authority to retain revenues not used in the current period for future use to finance the designated activities, benefits, or purposes?

Yes. The Commission may hold amounts collected across fiscal years until the decision is made to regarding disposition of the collections.

3c) Is there a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguish the earmarked fund from the Government's general revenues.

Yes. The collections are maintained in a unique Treasury Fund Symbol and segregated from the regular operating funds of the Commission.

4) Dedicated Collections: Do the disgorgement collections meet the definition of Dedicated Collections?

No. SFFAS 7 states that special accountability is required when a reporting entity is responsible for funds collected and held to accomplish a specific purpose. Disgorgements expected to be distributed to the public would meet this definition. However, SFFAS 27 states that dedicated collection disclosure requirements do not apply to activity classified as earmarked. Since the activity meets the definition of earmarked (see question 3 above), dedicated collection reporting requirements do not apply. The remaining dedicated collection provisions of SFFAS 7 are rescinded effective FY 2009.

Conclusion: Amounts expected to be distributed to harmed investors should be reported as earmarked in FY 2008. The dedicated collections disclosures presented in Notes 1T and 16 of the FY 2007 Performance and Accountability Report (PAR) will be replaced by appropriate earmarked funds disclosures in FY 2008. Additional disclosures should be added to Note 1T and/or Note 16 to ensure that the nature of these collections and distributions is clear.

FASAB addressed the activity subject to dedicated collections disclosures established in SFFAS 7 in two related documents, SFFAS 27 and SFFAS 31. FASAB expected that these two documents would collectively address all dedicated collections as defined by SFFAS 7 and originally intended that these two documents would be drafted, completed and published at approximately the same time. However, as noted above, the fiduciary document was delayed due to accounting issues unrelated to the SEC. As a result, the accounting standards related to the earmarked funds portion of dedicated collections were effective a full year prior to the publication of the document that defined the fiduciary activity portion of dedicated collections.

(SFFAS 27 was effective for FY 2006, which began October 1, 2005; SFFAS 31 was published October 24, 2006) The appropriate accounting model for SEC's disgorgement and related activity hinged to a large extent on whether this activity would be fiduciary per federal accounting definitions. The proper accounting treatment for this portion of dedicated collections can only be determined by reviewing these two standards as a whole.

Based on review of the accounting guidance now available, the collections should be reported as SEC activity and the associated flow activity must be reported in SEC financial statements. In FY 2007 and prior, this activity was presented in the Statement of Custodial Activity, based on the SFFAS 7 definition of "Custodial" as "collections on behalf of other agencies." The SEC interpreted "other agencies" to include non-federal parties. SFFAS 31 has clarified this definition and clearly states that the "other agencies" discussed in SFFAS 7 referred only to "other federal agencies." SFFAS 31 also states that the custodial definition is not amended by SFFAS 31. Thus, in FY 2008, the SEC should report a change in accounting principle as a result of this new information. In FY 2008, the flow activity related to amounts to be distributed to harmed investors should be reported on the Statement of Changes in Net Position and the Statement of Net Cost.

4.3.2 Amounts to be Distributed to Harmed Investors – FY 2009 and Future

The application of the specific requirements for treatment as fiduciary, custodial, earmarked or dedicated collections is presented below for fiscal year 2009.

1) *Fiduciary: Do non-federal parties have a legally enforceable claim to the amounts collected?*

No. Fiduciary activity is defined by SFFAS 31 as the collection or receipt, and the management, protection, accounting, investment and disposition by the federal government of cash or other assets in which non-federal individuals or entities have an ownership interest that the federal government must uphold. Non-federal parties must have an ownership interest in cash or other assets held by the federal entity under provision of law, regulation, or other fiduciary arrangement. The ownership interest must be enforceable against the federal government. Judicial remedies must be available for the breach of the fiduciary obligation. (SFFAS 31, paragraph 10) Further, the non-federal ownership interest must exist at the time the federal government takes custody of the assets, as indicated by paragraph 11 of SFFAS 31, which states that "Fiduciary activities are initiated by fiduciary collections," and "Fiduciary collections are an inflow to a Federal entity ...of cash or other assets that are and remain the property of non-federal parties."

Under current law, harmed investors have an expectation that amounts collected will be forwarded to harmed investors. This expectation does not create an ownership interest in the underlying assets. The government retains the sole authority to make unilateral decisions regarding the distribution, or non-distribution, of collections.

Further, SEC Rule 1106 specifically states that investors have no standing to intervene, participate or challenge orders regarding the establishment or distribution of fair funds, outside of the opportunity to comment on proposed disgorgement plans. The SEC's actions in ordering the disgorgement of these assets are intended to ensure that violators of securities laws do not benefit financially from the illegal activity. Congress has provided legislative direction for the distribution of disgorgement and certain related penalty collections. However, the funds collected are not intended to be "restitution" to harmed investors and those harmed investors have no inherent rights to these assets outside of government actions.

2) *Custodial: Will amounts collected be transferred to another federal agency upon receipt?*

No. Amounts may be transferred to the General Fund of the Treasury at a later date if the Commission determines that distribution to harmed investors is not feasible. However, this determination has not been made at the time the funds are received. Thus, collections expected to be distributed to harmed investors are not reported as custodial.

3) *Earmarked:*

3a) *Are amounts retained required to be used only for designated activities, benefits or purposes?*

Yes. The Commission may not use these collections to finance operations. Congress, through legislation, has directed that these funds are to be used to the extent possible to benefit investors harmed by violators of securities and the majority of these collections will be forwarded to harmed investors. Amounts that cannot economically be distributed to harmed investors and other deminimus balances may be deposited in the General Fund of the Treasury.

3b) *Does the Commission have explicit authority to retain revenues not used in the current period for future use to finance the designated activities, benefits, or purposes?*

Yes. The Commission may hold amounts collected across fiscal years until the decision is made to regarding disposition of the collections.

3c) *A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguish the earmarked fund from the Government's general revenues.*

Yes. The collections are maintained in a unique Treasury Fund Symbol and segregated from the regular operating funds of the Commission.

4) *Dedicated Collections:*

(Not applicable in FY 2009 and following)

Conclusion: This activity should be reported as earmarked in FY 2009 and following years. As noted above, in FY 2008 and future years, the flow activity related to amounts to be distributed to harmed investors should be reported on the Statement of Changes in Net Position and the Statement of Net Cost.

4.4 Summary of Conclusions

Penalties and certain disgorgements expected to be deposited in the General Fund of the Treasury upon collection will continue to be recognized as custodial activity. Disgorgements and related penalties expected to be distributed to harmed investors will be recognized as earmarked activity. The Earmarked Model will result in a more prominent disclosure of these disgorgement activities on the face of the SEC's financial statements. This presentation will reflect the fact that the Sarbanes-Oxley Act of 2002 and other legislation expanded the SEC's mission to include consideration of the impact of securities law violations on investors.

For FY 2008 reporting, the dedicated collections disclosures related to disgorgement activities established by SFFAS 7 will be replaced by recognition and disclosure of earmarked funds. The Balance Sheet presentation of assets and certain liabilities should continue, as well as the presentation of flow activity on the Statement of Custodial Activity for penalties collected for deposit into the General Fund of the Treasury.

The following presentation changes should be made in FY 2008 related to disgorgements and related penalties expected to be forwarded to harmed investors. Pro forma financial statements are presented in Appendix I.

A. Recognition of non-exchange revenue on the Statement of Changes in Net Position (SCNP) for disgorgement and related penalty amounts ordered, net of allowance for doubtful accounts. This amount will be presented as "Earmarked" Activity, in a separate column and not commingled with Earmarked Activity resulting from transaction, registration and related fees.
B. Recognition of expense on the Statement of Net Cost (SNC) when a Plan of Distribution is approved by the Commission. For clarity, this expense will be reported separately from the operating expenses of the Commission.
C. Recognition of other transactions, including the transfer of miscellaneous amounts to the General Fund of the Treasury (SCNP), interest earned on investments (SCNP), and administrative fees (SNC).
D. Recognition of Cumulative Results of the Operations in the Net Position section of the Balance Sheet. Net Position related to this activity will result from the net transactions recognized on the SCNP and SNC, and will offset related asset balances. The existing Fiduciary Liability reported on the Balance Sheet will be reversed. A liability will be established for amounts payable under approved distribution plans.

For FY 2009 reporting, the reporting model established in FY 2008 will continue. As SEC activity is not fiduciary, no accounting changes are needed when SFFAS 31 becomes effective.

In addition, the Commission must address the inconsistencies between the definition of fiduciary activity established by SFFAS 31 and the prevalent assumption that disgorgement related collections are not assets of the federal government. These situations are discussed in Section 3.4 above. To resolve these inconsistencies, the SEC will:

(a) Re-evaluate the determination that these funds are Qualified Settlement Funds in accordance with IRS regulations.
(b) Re-evaluate the decision to recognize this activity in a Deposit Fund. Movement of this activity to a special receipt fund would resolve several issues, including recognition of budgetary transactions, consistency between budgetary and proprietary transactions, and inclusion in the *Financial Report of the United States Government*.
(c) Re-evaluate the relationship with the Bureau of Public Debt, and ensure that the authority to invest these amounts in interest-bearing securities continues.

5 Accounting Changes - Application of SFFAS 21

SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting*, addresses financial statement treatment of accounting changes and errors that affect prior period financial statements. SFFAS 21 defines a change in accounting principle as a change from one generally accepted accounting principle to another one that can be justified as preferable. Changes in accounting principles also include those occasioned by the adoption of new federal financial accounting standards. On the other hand, errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared.

For FY 2008, the change in accounting presentation for disgorgements and related penalties expected to be distributed to harmed investors should be treated as a change in accounting principle. The previous custodial presentation was based on the terminology published in SFFAS 7, which was not clarified until publication of SFFAS 31. This is the guidance that the SEC relied upon for establishing an appropriate accounting model for implementation of the Sarbanes-Oxley Act of 2002. Further, FASAB intended for the guidance on earmarked funds presented in SFFAS 27 and the guidance on fiduciary reporting presented in SFFAS 31 to collectively address significantly all "dedicated collections" addressed in SFFAS 7. The early drafts of the fiduciary standard included a definition of fiduciary that differs significantly from the final document. At the time SFFAS 27 was issued (December 28, 2004), the SEC reasonably believed that disgorgements and related penalties expected to be distributed to harmed investors would be covered by the upcoming fiduciary standard. Now that both standards are published, the most appropriate accounting treatment of this activity can be determined within the context of complete FASAB guidance on the subject.

In addition, SFFAC 5, published in December 2007, provides a clear definition of federal entity assets. This definition supports the conclusion that disgorgements and related penalties expected to be distributed to harmed investors are assets of the federal government.

This change results from new knowledge not previously available, and thus should be treated as a change in accounting principle rather than as a correction of an error.

No changes in accounting are expected in FY 2009.

6 Approvals

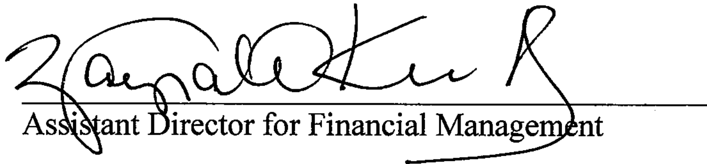
The document is recommended by:

6-03-08

Branch Chief - Financial Reporting and Policy

Date

The document is concurred by:

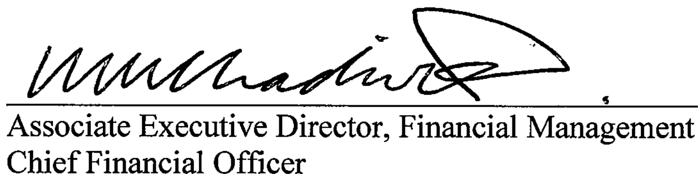


6/3/2008

Assistant Director for Financial Management

Date

The document is approved by:



6/3/2008

Associate Executive Director, Financial Management
Chief Financial Officer

Date

Office of General Counsel Review

This document was reviewed by the Office of the General Counsel of the Securities and Exchange Commission. We support the adoption of the accounting methodologies discussed in this paper.

Signature Date

Name and Title

Auditor Review

This document was reviewed by the Government Accountability Office. We support the adoption of the accounting methodologies discussed in this paper.

Signature Date

Name and Title

Contact Information

For questions or concerns regarding this document, please direct all correspondence to the following:

William Fleming
flemingw@sec.gov
Office of Financial Management
Financial Statements
202-551-7827

Appendix A: SEC Rules of Practice

The Sarbanes Oxley Act of 2002 and related rules, establish the legal framework and conditions for the distribution of disgorgements and penalties to investors harmed by violations of securities laws. Fair Fund provisions of the SEC *Rules of Practice and Rules on Fair Fund and Disgorgement Plans* are quoted below.

Rule 1100. Creation of Fair Fund.

In any agency process initiated by an order instituting proceedings in which the Commission or the hearing officer issues an order requiring the payment of disgorgement by a respondent and also assessing a civil money penalty against that respondent, the Commission or the hearing officer may order that the amount of the disgorgement and of the civil money penalty, together with any funds received by the Commission pursuant to 15 U.S.C. 7246(b), be used to create a fund for the benefit of investors who were harmed by the violation.

Rule 1101. Submission of Plan of Distribution; Contents of Plan.

(a) *Submission.* The Commission or the hearing officer may, at any time, order any party to submit a plan for the administration and distribution of funds in a Fair Fund or disgorgement fund. Unless ordered otherwise, the Division of Enforcement shall submit a proposed plan no later than 60 days after the respondent has turned over the funds or other assets pursuant to the Commission's order imposing disgorgement and, if applicable, a civil money penalty and any appeals of the Commission's order have been waived or completed, or appeal is no longer available.

(b) *Contents of Plan.* Unless otherwise ordered, a plan for the administration of a Fair Fund or a disgorgement fund shall include the following elements:

(1) Procedures for the receipt of additional funds, including the specification of any account where funds will be held, the instruments in which the funds may be invested; and, in the case of a Fair Fund, the receipt of any funds pursuant to 15 U.S.C. 7246(b), if applicable;

(2) Specification of categories of persons potentially eligible to receive proceeds from the fund;

(3) Procedures for providing notice to such persons of the existence of the fund and their potential eligibility to receive proceeds of the fund;

(4) Procedures for making and approving claims, procedures for handling disputed claims, and a cut-off date for the making of claims;

(5) A proposed date for the termination of the fund, including provision for the disposition of any funds not otherwise distributed;

(6) Procedures for the administration of the fund, including selection, compensation, and, as necessary, indemnification of a fund administrator to oversee the fund, process claims, prepare accountings, file tax returns, and, subject to the approval of the Commission, make distributions from the fund to investors who were harmed by the violation; and

(7) Such other provisions as the Commission or the hearing officer may require.

Rule 1102. Provisions for Payment.

(a) *Payment to Registry of the Court or Court-appointed Receiver.* Subject to such conditions as the Commission or the hearing officer shall deem appropriate, a plan for the administration of a Fair Fund or a disgorgement fund may provide for payment of funds into a court registry or to a court-appointed receiver in any case pending in federal or state court against a respondent or any other person based upon a complaint alleging violations arising from the same or substantially similar facts as those alleged in the Commission's order instituting proceedings.

(b) *Payment to the United States Treasury Under Certain Circumstances.* When, in the opinion of the Commission or the hearing officer, the cost of administering a plan of disgorgement relative to the value of the available disgorgement funds and the number of potential claimants would not justify distribution of the disgorgement funds to injured investors, the plan may provide that the disgorgement funds and any civil penalty shall be paid directly to the general fund of the United States Treasury.

Rule 1103. Notice of Proposed Plan and Opportunity for Comment by Non-parties.

Notice of a proposed plan of disgorgement or a proposed Fair Fund plan shall be published in the SEC Docket, on the SEC website, and in such other publications as the Commission or the hearing officer may require. The notice shall specify how copies of the proposed plan may be obtained and shall state that persons desiring to comment on the proposed plan may submit their views, in writing, to the Commission.

Rule 1104. Order Approving, Modifying, or Disapproving Proposed Plan.

At any time after 30 days following publication of notice of a proposed plan of disgorgement or of a proposed Fair Fund plan, the Commission shall, by order, approve, approve with modifications, or disapprove the proposed plan. In the discretion of the Commission, a proposed plan that is substantially modified prior to adoption may be republished for an additional comment period pursuant to Rule 1103. The order approving or disapproving the plan should be entered within 30 days after the end of the final period allowed for comments on the proposed plan unless the Commission or the hearing officer, by written order, allows a longer period for good cause shown.

Rule 1105. Administration of Plan.

(a) *Appointment and Removal of Administrator.* The Commission or the hearing officer shall have discretion to appoint any person, including a Commission employee, as administrator of a plan of disgorgement or a Fair Fund plan and to delegate to that person responsibility for administering the plan. An administrator may be removed at any time by order of the Commission or hearing officer.

(b) *Assistance by Respondent.* A respondent may be required or permitted to administer or assist in administering a plan of disgorgement subject to such terms and conditions as the Commission or the hearing officer deems appropriate to ensure the proper distribution of the funds.

(c) *Administrator to Post Bond.* If the administrator is not a Commission employee, the administrator shall be required to obtain a bond in the manner prescribed in 11 U.S.C. 322, in an amount to be approved by the Commission. The cost of the bond may be paid for as a cost of administration. The Commission may waive posting of a bond for good cause shown.

(d) *Administrator's Fees.* If the administrator is a Commission employee, no fee shall be paid to the administrator for his or her services. If the administrator is not a Commission employee, the administrator may file an application for fees for completed services, and upon approval by the Commission or a hearing officer, may be paid a reasonable fee for those services. Any objections thereto shall be filed within 21 days of service of the application on the parties.

(e) *Source of Funds.* Unless otherwise ordered, fees and other expenses of administering the plan shall be paid first from the interest earned on the funds, and if the interest is not sufficient, then from the corpus.

(f) *Accountings.* During the first 10 days of each calendar quarter, or as otherwise directed by the Commission or the hearing officer, the administrator shall file an accounting of all monies earned or received and all monies spent in connection with the administration of the plan of disgorgement. A final accounting shall be submitted for approval of the Commission or hearing officer prior to discharge of the administrator and cancellation of the administrator's bond, if any.

(g) *Amendment.* A plan may be amended upon motion by any party or by the plan administrator or upon the Commission's or the hearing officer's own motion.

Rule 1106. Right to Challenge.

Other than in connection with the opportunity to submit comments as provided in Rule 1103, no person shall be granted leave to intervene or to participate or otherwise to appear in any agency proceeding or otherwise to challenge an order of disgorgement or creation of a Fair Fund; or an order approving, approving with modifications, or disapproving a plan of

disgorgement or a Fair Fund plan; or any determination relating to a plan based solely upon that person's eligibility or potential eligibility to participate in a fund or based upon any private right of action such person may have against any person who is also a respondent in the proceeding.

Appendix B: Federal Accounting Standards and Concepts

The determinations made in this document are dependent upon several existing accounting statements and concepts. These documents are located at FASAB's website, http://www.fasab.gov/codifica.html. *Original Pronouncements, Federal Accounting Standards Advisory Board Statements of Federal Financial Accounting Concepts and Standards as of June 30, 2007* (Original Pronouncements), contains SFFAC 1 through 4 and SFFAS 1 through 32, as well as other Interpretations, Technical Bulletins and similar guidance issued by FASAB through June 30, 2007. SFFAC 5, issued December 26, 2007, is currently presented as a standalone document at the above address.

Appendix C: Creation and Administration of Disgorgement Funds

The Commission obtains disgorgement orders and orders imposing civil monetary penalties against defendants in a wide variety of its enforcement actions. Disgorgement is a well-established, equitable remedy applied by federal district courts and is designed to deprive defendants of "ill-gotten gains." With the enactment of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990, 104 Stat. 931 (1990), the Commission has the authority to seek and impose disgorgement orders in administrative proceedings as well in federal court proceedings. In contrast to actions for restitution or damages in private actions, which are brought to compensate fraud victims for losses, disgorgement orders require defendants to give up the amount by which they were unjustly enriched.

Prior to Public Law 107–204 titled the *Sarbanes-Oxley Act of 2002*, when the Commission received payment of a penalty, it was required to transmit such money to the U.S. Treasury. Section 308(c) of Sarbanes-Oxley Act of 2002 changed the law to permit penalty sums collected to be added to disgorgement funds in certain circumstances. Section 308(c) "FAIR FUNDS FOR INVESTORS," states:

> (a) CIVIL PENALTIES ADDED TO DISGORGEMENT FUNDS FOR THE RELIEF OF VICTIMS.—If in any judicial or administrative action brought by the Commission under the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47)) the Commission obtains an order requiring disgorgement against any person for a violation of such laws or the rules or regulations thereunder, or such person agrees in settlement of any such action to such disgorgement, and the Commission also obtains pursuant to such laws a civil penalty against such person, the amount of such civil penalty shall, on the motion or at the direction of the Commission, be added to and become part of the disgorgement fund for the benefit of the victims of such violation.

Disgorgement funds set up with the addition of penalty sums authorized under this section are often referred to as "Fair Funds" due to the section 308(c) title "FAIR FUNDS FOR INVESTORS" which authorized penalties to be added to disgorgement funds.

The SEC's "Rules of Practice and Rules on Fair Fund and Disgorgement Plans" set out the internal rules concerning the set up and administration of disgorgement plans. The rules are summarized in Appendix A of this position paper.

Appendix D: Business Events Related to Enforcement Proceedings

Current business events related to Enforcement proceedings are outlined below:

1) *Management of the Receivable Balance:* During the period between establishment of a receivable for the disgorgement fund and collection of the funds (or write-off), the Commission may recognize any combination of the following accounting events:
    a. Accrual of interest receivable on outstanding balances
    b. Recognition of an allowance for uncollectible amounts
    c. Referral of outstanding debt to Treasury for collection
    d. Termination of collection efforts
    e. Discharge of the debt
    f. Write off of uncollectible amounts

2) *Collection:* When the SEC receives payment, it is applied to the appropriate receivable. Amounts eligible for potential distribution to harmed investors, including disgorgements and certain penalties and interest, are generally invested at the Bureau of Public Debt. These amounts are held in Treasury Fund Symbol (TFS) 50X6563, *Disgorgement and Penalty Amounts Held for Investors, Securities and Exchange Commission.* Amounts not intended for potential distribution to harmed investors are recorded in TFS 50 1099, *Fines, Penalties, and Forfeitures, Not Otherwise Classified,* for transfer to the General Fund of the Treasury.

3) *External Collections:* Under certain conditions, amounts collected by external entities (*i.e.*, a Federal Court, non-federal receiver, or other party) may be forwarded to the SEC. For example, if amounts collected by the SEC and by a Federal Court are intended for distribution to the same group of investors, it is more economical to combine the amounts and make a single distribution. The Commission recognizes a receivable from a federal agency (U.S. Courts) or the public, as applicable, when determination is made that amounts will be forwarded to the SEC. The investment and distribution of these funds will follow the same cycle as internally collected funds.

4) *Investment of Disgorgements and Related Balances:* Amounts held for potential distribution to harmed investors are invested in interest-bearing securities at the Bureau of Public Debt. Accounting events during this period include:
    a. Recognition of interest earned, and related accruals;
    b. Amortization of premium and/or discount on securities;
    c. Payment of taxes; and
    d. Payment of fees to the tax advisor.

    Note that amounts considered too small for investment may be held as Fund Balance with Treasury in TFS 50X6563.

5) *Distribution or Disbursements:* Disgorgements and, under certain conditions, penalties are distributed to investors harmed by the illegal activity. SEC's "*Rules of Practice And Rules on Fair Fund and Disgorgement Plans*" Rule 1101, "Submission of Plan of

Distribution" states that: "The Commission or the hearing officer may, at any time, order any party to submit a plan for the administration and distribution of funds in a Fair Fund or disgorgement fund. Unless ordered otherwise, the Division of Enforcement shall submit a proposed plan no later than 60 days after the respondent has turned over the funds or other assets pursuant to the Commission's order imposing disgorgement and, if applicable, a civil money penalty and any appeals of the Commission's order have been waived or completed, or appeal is no longer available."

SEC's Enforcement section determines if it is feasible to distribute funds collected to harmed investors. This feasibility determination includes consideration of the total amount of funds collected versus the total number of harmed investors. Under the Sarbanes-Oxley Act of 2002, all disgorgement and civil penalty collections are available to be invested and distributed to the harmed investors provided there is at least $1 of disgorgements ordered. In cases where Enforcement decides that distribution is not feasible and/or economical, collections are transferred to TFS 50 1099 for transfer to the General Fund of the Treasury. Otherwise, amounts collected remain invested (or in Fund Balance with Treasury) until distributed or transferred to the General Fund.

SEC's "Rules of Practice And Rules on Fair Fund and Disgorgement Plans" Rule 1102. section (b) Payment to the United States Treasury Under Certain Circumstance states: "When, in the opinion of the Commission or the hearing officer, the cost of administering a plan of disgorgement relative to the value of the available disgorgement funds and the number of potential claimants would not justify distribution of the disgorgement funds to injured investors, the plan may provide that the disgorgement funds and any civil penalty shall be paid directly to the general fund of the United States Treasury."

FY 2007 disgorgement distributions included $176.8 million transferred to the General Fund of the Treasury and $580.5 million distributed to harmed investors. In 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. It is important to note that under no circumstances do the funds revert to the SEC for use in its operations.

Appendix E: Federal Asset Classification

Standards promulgated by FASAB are authoritative for federal financial reporting, however, all relevant facts must be addressed in the application of these requirements. Specifically, there are several situations where other parties appear to have concluded that certain disgorgement related collections are not assets of the federal government. These conclusions include the inclusion of this activity in deposit funds; the omission of related transactions from the *Budget of the United States Government* and *Financial Report of the United States Government*; and the payment of federal income taxes on interest income earned by the Funds.

The following table addresses relevant federal financial reporting statements and concepts as well as other arguments proposed for consideration in determining whether disgorgements and penalties expected to be distributed to harmed investors should be classified as federal assets.

	Requirements	Case Against Classification as a Federal Asset	Case for Classification as a Federal Asset	SEC Conclusion
Definition of an Asset – Concepts Statement 5				
1.	A federal entity asset is defined as a resource that embodies economic benefits or services that the federal government controls. *(SFFAC 5)*	The SEC does not keep these resources for day to day operations (payment of salaries and expenses).	The federal government, through Congress and the SEC, has total control over access to the resources. At any time prior to the approval of a distribution plan, the government may make unilateral decisions regarding distribution (or non-distribution) of these assets to non-federal parties.	Disgorgement and related collections meet the definition of an asset of the Federal Government established by SFFAC 5.
Fiduciary Activity Classification Criteria				
2.	Federal parties have an ownership interest that the federal government must uphold. *(SFFAS 31)*	The funds are intended for distribution to harmed investors, thus will eventually be owned by the public.	At the time of collection, the public does not have an ownership interest in the disgorgements and related penalties. The federal government's objective in ordering and collecting these funds is carry out the enforcement-related objective of ensuring that violators of securities laws do not profit by their actions. The government has no contractual or	The public does not have an ownership interest in the disgorgement collections, thus the SEC does not have a fiduciary relationship with non-federal parties as defined by SFFAS 31

	Requirements	Case Against Classification as a Federal Asset	Case for Classification as a Federal Asset	SEC Conclusion
			fiduciary responsibility at this point.	
3.	The ownership interest must be enforceable against the federal government, and "judicial remedies" must be available for the breach of the fiduciary obligation. *(SFFAS 31)*	These criteria are not significant when all other factors are considered.	SEC Rules of Practice state clearly that no party has standing to object to SEC decisions regarding distributions. Further, SFFAS 31 is GAAP in its entirety. Federal agencies may not disregard sections deemed inconvenient.	The criteria for classification as Fiduciary Activity are not met. SFFAS 31 does not apply.
Earmarked Funds Classification Criteria				
4.	***Definition:*** Specifically identified revenues and other financing sources are required by statute to be used for designated activities *(SFFAS 27)*	These collections cannot be used to fund SEC operations. The bulk of these funds will be distributed to harmed investors, and any remainder will be deposited in the General Fund of the Treasury.	"Designated activities" are not limited to payment of salaries and expenses. In fact, many (or possibly most) earmarked funds at federal agencies are designated for federal activities other than normal day to day agency operations. The program to distribute disgorgements to harmed investors is established by federal law, and could be considered to be a "designated activity" as defined by SFFAS 27.	Since distribution to the public may be considered to be a "designated activity," the Earmarked Funds definition may apply if other criteria are met.
5.	***Criteria:*** The three required criteria for an earmarked fund are as follows: (a) Statute committing the use of funds for designated activities; (b) Authority to retain funds to finance designated activities; (c) Report on receipts, uses, and retention of financing sources *(SFFAS 27)*	(a) These collections cannot be used to fund SEC operations, thus they do not meet the criteria regarding designated activities. (b) The SEC cannot retain these funds for use in operations, thus they do not meet the criteria regarding authority to retain funds. (c) The SEC is not required to report to the public regarding these funds, or perform any special reporting outside	(a) As noted above, "designated activities" are not limited to salaries and expenses, but include any program or activity authorized by Congress. (b) The funds can be, and are, retained across fiscal years for the purpose intended by Congress, specifically eventual distribution to harmed investors. (c) The activity is accounted for in a Treasury Fund Symbol distinct from other SEC operations and	The three criteria for Earmarked Funds Reporting are applicable to disgorgement and related collections.

	Requirements	Case Against Classification as a Federal Asset	Case for Classification as a Federal Asset	SEC Conclusion
		of normal government-wide reporting requirements.	activities. Use of a unique Fund Symbol ensures separate reporting on this activity in government-wide reporting.	
6.	***Distinct from Fiduciary Activities***: Differs from fiduciary activities in that earmarked funds are Government-owned. *(SFFAS 27)*	The funds are intended for distribution to harmed investors, thus will eventually be owned by the public.	The public has no ownership interest in the collections prior to the approval of a distribution plan. "Government ownership" is determined by reference to the definition of an asset in SFFAC 5, and the definition of fiduciary per SFFAS 31.	The funds are government owned.
Other Factors				
7.	The Division of Enforcement has determined that disgorgement and penalty collections that are held for distribution to harmed investors are Qualified Settlement Funds (QSF) in accordance with the IRS definition.	Federal Agencies are not subject to the payment of income taxes. The fact that income taxes are paid on these funds indicates non-federal ownership.	The IRS definition of QSF is unrelated to the definition of fiduciary. Further, IRS regulations are not included in the hierarchy of authoritative sources for Generally Accepted Accounting Principles.	The payment of income taxes by a federal agency is unusual, and it may be necessary to revisit this decision. However, IRS rules and definitions have no bearing on the application of GAAP for purposes of federal financial reporting.
8.	The disgorgement amounts are presently held in Treasury Fund Symbol (TFS) 50X6563, *Disgorgement and Penalty Amounts Held for Investors, Securities and Exchange Commission*. This TFS is designated by OMB and the Department of Treasury as a "deposit fund."	Per OMB Circular A-11, Deposit Funds are used to hold funds not owned by the federal government. Further, amounts in deposit funds are not subject to appropriations or included in the President's budget. Thus, presentation of these funds as federal assets may violate federal spending rules.	SFFAS 31 specifically states that the use of a deposit fund to account for a specific activity does not impact the determination of whether an activity is fiduciary. Rules government spending authority and budget presentation are established by OMB, primarily in Circular A-11. Rules governing federal financial reporting are established by SFFAS. OMB has designated a deposit fund for this activity, and the SEC is complying with Circular A-11 requirements	SEC will consult with OMB regarding the decision to use a deposit fund for this activity. The SEC's compliance with Circular A-11 is not impacted by the application of SFFAS for federal financial reporting.

	Requirements	Case Against Classification as a Federal Asset	Case for Classification as a Federal Asset	SEC Conclusion
			for deposit funds. The application of SFFAS requirements for federal financial reporting has no bearing on compliance with budgetary spending controls.	
9.	The majority of the amounts held in TFS 50X6563 are invested in U.S. Treasury Securities issued by the Bureau of Public Debt (BPD). These amounts are reported in the *Financial Report of the United States Government* as investments held by the public.	The U.S. Department of the Treasury, BPD considers these funds to be public (non-federal) assets.	The BPD treatment is based entirely on the fact that these assets are included in a deposit fund. Re-evaluation of the Treasury Fund Symbol type above would also lead to re-evaluation of the BPD decision that the investments should be classified as "with the public" for purposes of governmentwide reporting.	Treasury and the BPD should be involved in any decision to change the Treasury Fund Symbol type to ensure that investment of funds collected can continue. However, BPD treatment has no bearing on the application of SFFAS.
10.	At a minimum, disgorgements and related penalties should be treated as fiduciary activity when the distribution plan is approved.	Since the funds will be owned by the public at some future point (i.e., approval of the distribution plan), the collections should be treated as fiduciary treatment at some point.	SFFAS 31 addresses situations where the government takes possession of assets owned by non-federal parties. SFFAS paragraph 11 states "Fiduciary activities are initiated by fiduciary collections." Thus, the non-federal ownership interest must exist at the beginning of the relationship. A variety of liabilities arise during the normal course of federal agency operations. The establishment of a liability related to funds previously collected does not create a fiduciary relationship.	Fiduciary accounting only applies when the non-federal ownership interest exists at the time of inflow of assets to the government. This condition has not been met, thus the assets can not be considered fiduciary at any later point. The SEC will record liabilities to the public, expenses and payments in accordance with transactions documented in the USSGL.

Appendix F: Reporting and Disclosure Requirements

Earmarked Activity

SFFAS 27 reporting and disclosure requirements are found in paragraphs 19 through 26 for component entities. These requirements are summarized in the following chart, along with the suggested treatment by the SEC.

	Reporting Requirements	Treatment by SEC
a.	Earmarked non-exchange revenue and other financing sources, including appropriations, and net cost of operations should be shown separately on the Statement of Changes in Net Position.	All 50X6563 Fund activity will be "Earmarked." Distributions to harmed investors and payments of fees to fund administrators will be reported as costs on the Statement of Net Cost. Non-exchange revenue and transfers to Treasury are reported on the Statement of Changes of in Net Position. Income taxes paid to the IRS would be reported as contra-revenue on the SCNP.
b.	The portion of cumulative results of operations attributable to earmarked funds should be shown separately on both the Statement of Changes in Net Position and the Balance Sheet.	Fund 50X6563 will now have cumulative results of operations for the difference between the non-exchange revenue recognized and expenses.
c.	This standard does not require earmarked funds to be separately shown on the Statement of Net Cost.	Distributions to harmed investors will be presented separately from SEC's other operating costs.
d.	The reporting entity should disclose all earmarked funds for which it has program management responsibility by either a list, by official title, or a statement indicating where the information can be obtained.	This information will be presented in Note 1.
e.	The following information should be disclosed for earmarked funds	
e.1	Condensed information about assets and liabilities showing investments in Treasury securities, other assets, liabilities due and payable, other liabilities, cumulative results of operations and net position.	This information will be presented in the Notes to the Financial Statements.
e.2	Condensed information on gross cost, exchange revenue, net cost, non-exchange revenues and other financing sources, and change in net position.	This information will be presented in the Notes to the Financial Statements.
e.3	This information may be presented separately on the face of the entity's basic financial statements or disclosed in the accompanying	This information will be presented in the Notes to the Financial Statements.

	Reporting Requirements	Treatment by SEC
	notes. Information for funds not presented individually may be aggregated, but must be provided even if the aggregate total is immaterial. The total cumulative results of operations shown in the note disclosure should agree with the cumulative results of operations for earmarked funds shown on the face of the component entity's basic financial statements.	
f.	A description of each fund's purpose, how the entity accounts for and reports the fund, and its authority to use those revenues and other financing sources.	Include in Note 1.
g.	The sources of revenue or other financing for the period and an explanation of the extent to which they are inflows of resources to the Government or the result of intra-governmental flows.	Include in Note 1.
h.	Any change in legislation during or subsequent to the reporting period and before the issuance of the financial statements that significantly changes the purpose of the fund or that redirects a material portion of the accumulated balance.	Normally this would not be applicable.
i.	The total cumulative results of operations of all earmarked funds shown in the note disclosure should agree with the cumulative results of operations of earmarked funds shown on the face of the component entity's Balance Sheet and the Statement of Changes in Net Position.	Note that all cumulative results would now be Earmarked.
j.	A note disclosure should provide a general description of earmarked funds and an explanation of how the federal government as a whole could provide the resources represented by the earmarked funds' balance in Treasury securities	This information will be presented in the Notes to the Financial Statements.

Appendix G: Sample Posting Models – Custodial Activity

Event No. 1: Money Ordered

C402

To record an accrual of revenue reported on the Statement of Custodial Activity or on the custodial footnote that is collected by an agency to be deposited directly into a General Fund receipt account.
Comment: Also post USSGL TC-C404. For amounts deposited into a General Fund receipt account but not reported on the Statement of Custodial Activity or on the custodial footnote, see USSGL TC-C420. See USSGL TCF124 for the preclosing adjusting entry recorded at yearend.
Reference: USSGL implementation guidance; Miscellaneous Receipts; General Fund Receipt Account Guide

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1340		Interest Receivable
Debit	1360		Penalties, Fines, and Administrative Fees Receivable
Credit		5310	Interest Revenue - Other
Credit		5320	Penalties, Fines, and Administrative Fees Revenue

C404

To record contra-revenue in the amount of revenue accrued and establish a custodial liability.
Comment: Also post USSGL TC-C402.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	5991		Accrued Collections for Others - Statement of Custodial Activity
Credit		2980	Custodial Liability

Event No. 2: Bad Debt Allowance

D424

To record in a General Fund receipt account, the accrued estimated uncollectible nonexchange revenue reported on the Statement of Custodial Activity or on the custodial footnote.

Comment: See USSGL TC-D402 for other than revenue reported on the Statement of Custodial Activity or on the custodial footnote. Reverse USSGL TC-C404.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	5319		Contra Revenue for Interest Revenue - Other
Debit	5329		Contra Revenue for Penalties, Fines, and Administrative Fees
Credit		1349	Allowance for Loss on Interest Receivable
Credit		1369	Allowance for Loss on Penalties, Fines, and Administrative Fees Receivable

Also, reverse TC C404,

Budgetary Entry			
	None		
Proprietary Entry			
Debit	2980		Custodial Liability
Credit		5991	Accrued Collections for Others - Statement of Custodial Activity

Event No. 3: Collection of Funds

C143 To record the collection of receivables of custodial revenue from a non-federal source that is deposited to a miscellaneous receipt account.
Comment: If a collection is reported on the Statement of Custodial Activity or the custodial footnote, also post USSGL TCs-D584 and D586 (if related to tax revenue); If a collection is not reported on the Statement of Custodial Activity nor on the custodial footnote, also post USSGL TC-D585; If a collection was not previously accrued, see
USSGL TCs-C141 or C147; See USSGL TC-F124 for the preclosing adjusting entry recorded at yearend.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1010		Fund Balance With Treasury
Credit		1340	Interest Receivable
Credit		1360	Penalties, Fines, and Administrative Fees Receivable

Event No. 4: Write-Off of Account Receivable

D406

To record the writeoff of penalties, fines, and administrative fees receivable.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1369		Allowance for Loss on Penalties, Fines, and Administrative Fees Receivable
Credit		1360	Penalties, Fines, and Administrative Fees Receivable

D416

To record the writeoff of interest receivable.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1349		Allowance for Loss on Interest Receivable
Credit		1340	Interest Receivable

Event No. 5: Transfer Funds Collected to Treasury

F124

To record the closing of General Fund receipt accounts associated with fund balance at yearend.
Comment: See USSGL TC-C142 and TC-C147 for the original transaction.
Reference: USSGL implementation guidance; General Fund Receipt Account Guide

Budgetary Entry			
	None		
Proprietary Entry			
Debit	2980		Custodial Liability
Credit		1010	Fund Balance With Treasury

Appendix H: Sample Posting Models – Earmarked Activity

Note – The entries below include budgetary transactions related to the collection and distribution of funds. These budgetary entries would not be applicable to collections maintained in a Treasury Fund Symbol classified as a Deposit Fund. Rules governing funds management are established by OMB in Circular A-11, *Preparation, Submission and Execution of the Budget.*

Event No. 1: Money Ordered

C420
To record accrued revenue or other financing sources without budgetary impact.
Comment: Receivables from non-Federal sources are not budgetary resources until collected. For Federal and non- Federal receivables reported in a General Fund receipt account, also post USSGL TC-C405. See USSGL TC-F124 for the preclosing adjusting entry recorded at yearend.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1360		Penalties, Fines, and Administrative Fees Receivable
Credit		5310	Interest Revenue - Other
Credit		5320	Penalties, Fines, and Administrative Fees Revenue

Event No. 2: Bad Debt Allowance

D402
To record an allowance for a reduction in revenue from non-Federal sources when realization is not probable (less likely than not).
Comment: This transaction includes tax return allowance and price redetermination but not bad debt. See USSGL TC-D424 for custodial revenue. Reverse this transaction when collected.
Reference: USSGL implementation guidance; FASAB SFFAS No. 7, "Accounting for Revenue and Other Financing Sources"

Budgetary Entry			
	None		
Proprietary Entry			
Debit	5319		Contra Revenue for Interest Revenue - Other
Debit	5329		Contra Revenue for Penalties, Fines, and Administrative Fees

Credit		1349	Allowance for Loss on Interest Receivable
Credit		1369	Allowance for Loss on Penalties, Fines, and Administrative Fees Receivable

Event No. 3: Collection of Funds

A195
To record the collection of revenue for non-revolving trust and special funds that were previously accrued.
Comment: See USSGL TC-C422 for accrual entry and USSGL TC-A186 if not accrued.

Budgetary Entry			
Debit	4114		Appropriated Trust or Special Fund Receipts
Credit		4394	Receipts Unavailable for Obligation Upon Collection
Credit		4450	Unapportioned Authority
Credit		4620	Unobligated Funds Exempt From Apportionment
Proprietary Entry			
Debit	1010		Fund Balance With Treasury
Credit		1340	Interest Receivable
Credit		1360	Penalties, Fines, and Administrative Fees Receivable

Event No. 4: Write-Off of Account Receivable

D406
To record the writeoff of penalties, fines, and administrative fees receivable.

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1369		Allowance for Loss on Penalties, Fines, and Administrative Fees Receivable
Credit		1360	Penalties, Fines, and Administrative Fees Receivable

D416
To record the writeoff of interest receivable.

Budgetary Entry			
	None		
Proprietary Entry			

Debit	1349		Allowance for Loss on Interest Receivable
Credit		1340	Interest Receivable

Event No. 5: Investment of Collected Funds

B124
To record the purchase of Federal securities acquired at par value.
Comment: Also post USSGL TC-B129 if accrued interest is purchased.
Reference: USSGL implementation guidance; FACTS II, Investments in Treasury and Agency Securities

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1610		Investments in U.S. Treasury Securities Issued by the Bureau of the Public Debt
Credit		1010	Fund Balance With Treasury

B128
To record the purchase of Federal securities acquired at a discount.
Comment: Also post USSGL TC-B129 if accrued interest is purchased.
Reference: USSGL implementation guidance; FACTS II, Investments in Treasury and Agency Securities

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1610		Investments in U.S. Treasury Securities Issued by the Bureau of the Public Debt
Credit		1010	Fund Balance With Treasury
Credit		1611	Discount on U.S. Treasury Securities Issued by the Bureau of the Public Debt

Event No. 6: Distribution Plan Established

E108
To record the accrued liabilities other than payroll and benefits at the end of the accounting period for unpaid estimated costs incurred.
Comment: If funded by a direct appropriation, also post USSGL TC-B134. Reverse accruals at the beginning of the next accounting period.

Budgetary Entry			
Debit	4610		Allotments - Realized Resources
Debit	4620		Unobligated Funds Exempt From Apportionment
Debit	4801		Undelivered Orders - Obligations, Unpaid
Credit		4901	Delivered Orders - Obligations, Unpaid
Proprietary Entry			
Debit	6100		Operating Expenses/Program Costs
Credit		2190	Other Liabilities With Related Budgetary Obligations

Note – In a Deposit Fund, the liability account used should be 2400, *Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections*, as this is the only liability account available in a deposit fund. In any other fund type if there is no related budgetary obligation, account 2990 *Other Liabilities With Related Budgetary Obligations*, would be applicable.

Event No. 7: Distribute Invested Funds (Investments Liquidated)

C120
To record the maturity of Federal securities acquired at par value.
Reference: USSGL implementation guidance; FACTS II, Investments in Treasury and Agency Securities

Budgetary Entry			
	None		
Proprietary Entry			
Debit	1010		Fund Balance With Treasury
Credit		1610	Investments in U.S. Treasury Securities Issued by the Bureau of the Public Debt

C124
To record the maturity of Federal securities acquired at a discount.
Comment: At maturity an entry is made to complete the amortization of a discount. Refer to USSGL TC-E117 for the amortization transaction. The budgetary entry shows the purchase discount is realized as a budgetary resource when the security matures. Special and trust funds use USSGL account 4114. If budgetary resources were previously anticipated, revolving funds credit USSGL account 4070 and special and trust funds credit USSGL account 4120. Also post USSGL TC-A122 if authority was previously anticipated and apportioned or USSGL TCA123 if authority was previously anticipated in programs exempt from apportionment.
Reference: USSGL implementation guidance; FACTS II, Investments in Treasury and Agency Securities

Budgetary Entry			
Debit	4114		Appropriated Trust or Special Fund Receipts
Debit	4273		Interest Collected From Treasury
Credit		4070	Anticipated Collections From Federal Sources
Credit		4120	Appropriations Anticipated - Indefinite
Credit		4394	Receipts Unavailable for Obligation Upon Collection
Credit		4450	Unapportioned Authority
Credit		4510	Apportionments
Credit		4620	Unobligated Funds Exempt From Apportionment
Proprietary Entry			
Debit	1010		Fund Balance With Treasury
Debit	1611		Discount on U.S. Treasury Securities Issued by the Bureau of the Public Debt
Credit		1610	Investments in U.S. Treasury Securities Issued by the Bureau of the Public Debt
Credit		1613	Amortization of Discount and Premium on U.S. Treasury Securities Issued by the Bureau of the Public Debt

Event No. 8: Distribute Invested Funds (Distribution)

B110
To record a confirmed disbursement schedule.
Comment: Clearing from unpaid to paid.

Budgetary Entry			
Debit	4901		Delivered Orders - Obligations, Unpaid
Credit		4902	Delivered Orders - Obligations, Paid
Proprietary Entry			
Debit	2190		Other Liabilities With Related Budgetary Obligations
Credit		1010	Fund Balance With Treasury

Appendix I: Pro Forma Financial Statements

A sample Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position are provided below which illustrate the presentation of earmarked activity for disgorgements and related penalties expected to be distributed to harmed investors. Changes are indicated by a "C" in the left hand column.

U.S. SECURITIES AND EXCHANGE COMMISSION

Balance Sheet
As of September 30, 2009 and 2008
(Dollars in Thousands)

			FY 2009		FY 2008
	ASSETS				
	Intragovernmental:				
	Fund Balance with Treasury (Notes 1.H and 3)	$	XXX	$	XXX
	Accounts Receivable (Notes 1.J, 5 and 16)		XXX		XXX
	Advances and Prepayments (Note 1.K)		XXX		XXX
	Total Intragovernmental		XXX		XXX
	Investments (Notes 1.I, 4 and 16)		XXX		XXX
	Accounts Receivable, Net (Notes 1.J and 5)		XXX		XXX
	Advances and Prepayments (Note 1.K)		XXX		XXX
	Property and Equipment, Net (Notes 1.L and 6)		XXX		XXX
	Total Assets	$	XXX	$	XXX
	LIABILITIES				
	Intragovernmental:				
	Accounts Payable (Notes 1.M and 7)	$	XXX	$	XXX
	Employee Benefits (Notes 1.N and 7)		XXX		XXX
	Unfunded FECA and Unemployment Liability		XXX		XXX
	Other (Liability to Treasury)		XXX		XXX
	Total Intragovernmental		XXX		XXX
	Accounts Payable (Notes 1.M and 7)		XXX		XXX
	Accrued Payroll and Benefits (Notes 1.M and 7)		XXX		XXX
	Accrued Leave (Notes 1.P and 7)		XXX		XXX
	Registrant Deposits (Notes 1.Q, 2 and 7)		XXX		XXX
	Actuarial FECA Liability (Notes 1.O, 7 and 8)		XXX		XXX
C	Liability for Approved Distibution Plans (Notes 1.T, 2, 7 and 16)		XXX		XXX
	Custodial Liability (Notes 1.S, 2, 7 and 15)		XXX		XXX
	Other Accrued Liabilities (Notes 7 and 9)		XXX		XXX
	Total Liabilities		XXX		XXX
	Commitments and Contingencies (Notes 7 and 11)				
	NET POSITION				
	Unexpended Appropriations - Earmarked Funds (Fees)		XXX		XXX
	Cumulative Results of Operations - Earmarked Funds (Fees)		XXX		XXX
C	Cumulative Results of Operations - Earmarked Funds (Disgorgement)		XXX		XXX
	Total Net Position		XXX		XXX
	Total Liabilities and Net Position	$	XXX	$	XXX

U.S SECURITIES AND EXCHANGE COMMISSION

Statement of Net Cost
For the periods ended March 31, 2008 and 2007
(Dollars in Thousands)

		FY 2009	FY 2008
	Costs by Strategic Goal and Objective (Notes 1.B and 12)		
	Enforce compliance with federal securities laws		
	Total Gross Cost	$ XXX	$ XXX
	Promote healthy capital markets through an effective and flexible		
	Total Gross Cost	XXX	XXX
	Foster informed investment decision making		
	Total Gross Cost	XXX	XXX
	Maximize the use of SEC resources		
	Total Gross Cost	XXX	XXX
C	**Disgorgement Distributions, Admin Fees and Other**		
C	Total Gross Cost	XXX	XXX
	Total Entity		
	Total Gross Program Cost	XXX	XXX
	Less: Earned Revenue Not Attributed to Programs (Note 13)	XXX	XXX
	Net (Income) from Operations	$ XXX	$ XXX

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Changes in Net Position
For the period ended March 31, 2008 and 2007
(Dollars in Thousands)

		Fees FY 2009	Disgorgement FY 2009	Fees FY 2008	Disgorgement FY 2008
	CUMULATIVE RESULTS OF OPERATIONS				
	Beginning Balance	$ XXX	$ XXX	$ XXX	$ XXX
	Budgetary Financing Sources:				
	Appropriations Used	XXX		XXX	
	Other Financing Sources:				
C	Disgorgements and Penalties Assessed		XXX		XXX
C	Transfers in/out without reimbursement	XXX	XXX	XXX	XXX
	Imputed Financing (Note 10)	XXX		XXX	
	Total Financing Sources	XXX	XXX	XXX	XXX
C	Net Income from Operations	XXX	XXX	XXX	XXX
	Net Change - Other Funds	XXX	XXX	XXX	XXX
	Cumulative Results of Operations	$ XXX	$ XXX	$ XXX	$ XXX
	UNEXPENDED APPROPRIATIONS				
	Beginning Balance	XXX		XXX	
	Budgetary Financing Sources:				
	Appropriations Received	XXX		XXX	
	Appropriations Used	XXX		XXX	
	Total Unexpended Appropriations	XXX		XXX	
	Net Position, End of Period - Other Funds	$ XXX		$ XXX	

Appendix J: Pro Forma Footnote Disclosures

Footnote 1x: Significant Accounting Policies - Change in Accounting Principle

OMB Circular A-136, *Financial Reporting Requirements,* requires that Note 1, Significant Accounting Policies, contain a description of changes in generally accepted accounting principles that impact the financial statements. These disclosures should not duplicate details presented elsewhere as part of the notes to the financial statements.

The Significant Accounting Policies footnote disclosure in FY 2008 for the change in accounting policy related to the reclassification of SEC revenues to earmarked is illustrated below:

> Note 1x Change in Accounting Principle
> The SEC changed its method of accounting for disgorgements and related penalties expected to be distributed to harmed investors. Beginning in FY 2008, this activity will be recognized as earmarked activity, in accordance with the requirements of SFFAS 27, *Identifying and Reporting Earmarked Funds*. Analysis of the proper categorization of these disgorgement and penalty collections was initiated in conjunction with the review of SFFAS 31, *Accounting for Fiduciary Activities,* which becomes effective in FY 2009, for impact on the FY 2009 financial statement preparation process. This standard, in conjunction with SFFAS 27 replaces the dedicated collection reporting requirements of SFFAS 7, *Accounting for Revenue and Other Financing Sources.* As a result of this analysis, the SEC determined that the fiduciary accounting requirements established by SFFAS 31 will not apply to the SEC's disgorgements and related penalties expected to be distributed to harmed investors. Accordingly, the earmarked funds requirements are applicable to this activity. This change is considered to be a change in accounting principles since a complete understanding of federal accounting guidance for matters previously considered to be dedicated collections could only be obtained with the issuance of SFFAS 31. SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, issued in December 2007, provided further confirmation of federal ownership of the underlying assets, and thus confirmation that SFFAS 31 is not applicable to this activity.

Footnote 1x: Significant Accounting Policies – Earmarked Funds

Circular A-136 also includes a requirement for an explanation of concepts, such as Earmarked Funds, that are unique to federal financial statements. To meet these requirements, we will add a description of the change in categorization of SEC revenues to earmarked, and we will include a description of the concept of earmarked funds. We will also make reference the Earmarked Funds Note that is required to be presented in another section of the footnotes.

> The collection of disgorgements and related penalties expected to be distributed to harmed investors meets the definition of earmarked activity established by SFFAS 27. This activity consists of disgorgement, penalties, and interest assessed against securities

laws violators where the Commission, and administrative law judge, or, in some cases, a court has determined that the SEC should return such funds to harmed investors. The funds are held by the SEC pending distribution to harmed investors pursuant to an approved distribution plan.

Footnote XX: Earmarked Funds

The Earmarked Fund footnote disclosures are illustrated below.

Note XX. Earmarked Funds

The following tables provide the status of the SEC's earmarked funds as of September 30, 2009 and for the years ended September 30, 2009 and 2008.

Summary Financial Statements – Earmarked Funds
(Dollars in thousands)

	Fees FY 2009	Disgorgement FY 2009	Fees FY 2008	Disgorgement FY 2008
Balance Sheet				
Assets:				
Fund Balance with Treasury	$ XXX	$ XXX	$ XXX	$ XXX
Cash	XXX	XXX	XXX	XXX
Accounts Receivable, Net	XXX	XXX	XXX	XXX
Advances and Prepayments	XXX		XXX	
Total Assets	$ XXX	$ XXX	$ XXX	$ XXX
Total Liabilities	$ XXX	XXX		XXX
Unexpended Appropriations	XXX		XXX	
Cumulative Results of Operations	XXX	XXX	XXX	XXX
Total Liabilities and Net Position	$ XXX	$ XXX	$ XXX	$ XXX
Statement of Net Cost				
Gross Program Costs	$ XXX	$ XXX	$ XXX	$ XXX
Less Earned Revenues	XXX		XXX	
Net Cost of Operations	$ XXX	$ XXX	$ XXX	$ XXX
Statement of Changes in Net Position				
Net Position Beginning of Period	$ XXX	$ XXX	$ XXX	$ XXX
Non-Exchange Revenue	XXX	XXX	XXX	XXX
Other Financing Sources	XXX	XXX	XXX	XXX
Net Cost of Operations	XXX	XXX	XXX	XXX
Change in Net Position	XXX	XXX	XXX	XXX
Net Position End of Period	$ XXX	$ XXX	$ XXX	$ XXX