United States Government Accountability Office

GAO

Report to the Chairman, United States Securities and Exchange Commission

November 2007

FINANCIAL AUDIT

Securities and Exchange Commission's Financial Statements for Fiscal Years 2007 and 2006

GAO

Accountability * Integrity * Reliability

GAO-08-167

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Accountability·Integrity·Reliability
Highlights

Highlights of GAO-08-167, a report to the Chairman, United States Securities and Exchange Commission

Why GAO Did This Study

Established in 1934 to enforce the securities laws and protect investors, the Securities and Exchange Commission (SEC) plays an important role in maintaining the integrity of the U.S. securities markets.

Pursuant to the Accountability of Tax Dollars Act of 2002, SEC is required to prepare and submit to Congress and the Office of Management and Budget audited financial statements. GAO agreed, under its audit authority, to perform the audit of SEC's financial statements. GAO's audit was done to determine whether, in all material respects, (1) SEC's fiscal year 2007 financial statements were reliable and (2) SEC's management maintained effective internal control over financial reporting and compliance with laws and regulations. GAO also tested SEC's compliance with certain laws and regulations.

For a fuller understanding of GAO's opinion on SEC's financial statements for fiscal years 2007 and 2006, readers should refer to the complete audit report, available by clicking on GAO-08-167 which includes information on audit objectives, scope and methodology. For more information, contact Jeanette Franzel, 202-512-9471, franzelj@gao.gov.

What GAO Found

In GAO's opinion, SEC's fiscal year 2007 and 2006 financial statements were fairly presented in all material respects. However, because of a material weakness in internal control over SEC's financial reporting process, in GAO's opinion, SEC did not have effective internal control over financial reporting as of September 30, 2007. Recommendations for corrective action will be included in a separate report. Although certain compliance controls should be improved, SEC did maintain in all material respects effective internal control over compliance with laws and regulations material in relation to the financial statements as of September 30, 2007. In addition, GAO did not find reportable instances of noncompliance with the laws and regulations it tested.

In its 2006 report, GAO reported on weaknesses in the areas of SEC's (1) recording and reporting of disgorgements and penalties, (2) information systems controls, and (3) property and equipment controls. During fiscal year 2007, SEC improved its controls over the accuracy, timeliness, and completeness of the disgorgement and penalty data and used a much improved database for the initial recording and tracking of these data. However, the processing of these data for financial reporting purposes is still done through a manual process that is prone to error. GAO found that the internal controls that compensated for the manual processing of the related accounts receivable balances in fiscal year 2006 were not effective in fiscal year 2007. This issue is included in the material weakness in SEC's financial reporting process for fiscal year 2007. Other control deficiencies included in this material weakness concern SEC's period-end closing process, accounting for transaction fee revenue, and preparation of financial statement disclosures.

GAO also identified three significant deficiencies in internal control during fiscal year 2007. Although SEC has taken steps to strengthen its information security, some of the weaknesses identified in GAO's previous audit persisted and GAO found new weaknesses during this year's audit. Therefore, GAO is reporting information security as a significant deficiency as of September 30, 2007. In addition, GAO continued to identify the same weaknesses in controls over property and equipment and therefore considers this area a significant deficiency as of September 30, 2007. GAO also identified a new significant deficiency concerning SEC's accounting for budgetary transactions.

In commenting on a draft of this report, SEC's Chairman emphasized SEC's commitment to enhance its controls in all operational areas and to ensure reliability of financial reporting, soundness of operations, and public confidence in SEC's mission.

Contents

Abbreviations

FMFIA	Federal Managers' Financial Integrity Act
OMB	Office of Management and Budget
SEC	United States Securities and Exchange Commission
SRO	self-regulatory organizations

United States Government Accountability Office
Washington, DC 20548

November 16, 2007

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission

Dear Mr. Cox:

This report presents our opinion on whether the financial statements of the Securities and Exchange Commission (SEC) for the fiscal years ended September 30, 2007, and 2006 are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. This report also presents (1) our opinion on the effectiveness of SEC's internal control over financial reporting and compliance as of September 30, 2007, and (2) the results of our evaluation of SEC's compliance with selected laws and regulations during 2007.

The Accountability of Tax Dollars Act of 2002 requires that SEC prepare and submit to Congress and the Office of Management and Budget (OMB) audited financial statements. We decided, under our audit authority, to audit SEC's financial statements. We conducted this audit in accordance with U.S. generally accepted government auditing standards and OMB guidance.

We are sending copies of this report to the Chairman and Ranking Minority Members of the Senate Committee on Banking, Housing, and Urban Affairs; the Senate Committee on Homeland Security and Governmental Affairs; the House Committee on Financial Services; and the House Committee on Oversight and Government Reform. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, and other interested parties. In addition, this report will be available at no charge on our Web site at http://www.gao.gov.

This report was prepared under the direction of Jeanette M. Franzel, Director, Financial Management and Assurance, who can be reached at (202) 512-9471 or franzelj@gao.gov. If I can be of further assistance, please call me at (202) 512-5500.

Sincerely yours,

David M. Walker
Controller General
of the United States

To the Chairman of the United States Securities and Exchange Commission

In our audits of the United States Securities and Exchange Commission (SEC) for fiscal years 2007 and 2006, we found

- the financial statements as of and for the fiscal years ended September 30, 2007, and 2006, including the accompanying notes, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles;
- SEC did not have effective internal control over financial reporting; although certain compliance controls should be improved, SEC had effective control over compliance with laws and regulations that could have a direct and material effect on the financial statements as of September 30, 2007; and
- no reportable noncompliance with laws and regulations we tested.

The following sections discuss in more detail these conclusions as well as our conclusions on Management's Discussion and Analysis and other supplementary information. They also present information on the objectives, scope, and methodology of our audit and our discussion of SEC management's comments on a draft of this report.

Opinion on Financial Statements

SEC's financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, SEC's assets, liabilities, net position, net costs, changes in net position, budgetary resources, and custodial activity as of, and for the fiscal years ended, September 30, 2007, and September 30, 2006. However, misstatements may nevertheless occur in other financial information reported by SEC and may not be prevented or detected because of the internal control deficiencies described in this report.

As disclosed in footnote 1.C. to SEC's financial statements, in fiscal year 2007, SEC changed its method of accounting for user fees collected in excess of current-year appropriations.

Opinion on Internal Control

Because of the material weakness[1] and significant deficiencies[2] in internal control discussed below, SEC did not maintain effective internal control over financial reporting as of September 30, 2007, and thus did not have reasonable assurance that misstatements material in relation to the financial statements would be prevented or detected on a timely basis. Although certain compliance controls should be improved, SEC maintained, in all material respects, effective internal control over compliance with laws and regulations as of September 30, 2007, that provided reasonable assurance that noncompliance with laws and regulations that could have a direct and material effect on the financial statements would be prevented or detected on a timely basis. Our opinion on internal control is based on criteria established under 31 U.S.C. § 3512(c)(d), commonly referred to as the Federal Managers' Financial Integrity Act (FMFIA) and the Office of Management and Budget (OMB) Circular No. A-123, *Management Accountability and Control.*

During this year's audit, we identified significant control deficiencies in SEC's financial reporting process, which taken collectively, result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. Therefore, we considered the combination of the following control deficiencies to collectively constitute a material weakness in SEC's financial reporting process:

- period-end financial reporting process,
- disgorgements and penalties accounts receivable,
- accounting for transaction fee revenue, and
- preparing financial statement disclosures.

In addition to the material weakness discussed above, we identified three significant deficiencies in internal control, which although not material

[1]A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

[2]A significant deficiency is a control deficiency, or combination of deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

weaknesses, represent significant deficiencies in the design or operation of internal control. Although we are considering these issues separately from the material weakness described above, they nevertheless adversely affect SEC's ability to meet financial reporting and other internal control objectives. These deficiencies concern

- information security controls,
- property and equipment, and
- accounting for budgetary resources.

In our prior year audit,[3] we reported on weaknesses we identified in the areas of SEC's (1) recording and reporting of disgorgements and penalties, (2) information systems controls, and (3) property and equipment controls.[4] During fiscal year 2007, SEC improved its controls over the accuracy, timeliness, and completeness of the disgorgement and penalty data and used a much improved database for the initial recording and tracking of these data. However, the processing of these data for financial reporting purposes is still done through a manual process that is prone to error. We found that the internal controls that compensated for the manual processing of the related accounts receivable balances in fiscal year 2006 were not effective in fiscal year 2007. This issue is included in the material weakness in SEC's financial reporting process for fiscal year 2007.

SEC continues to make progress in resolving the information security weaknesses. Previously identified weaknesses, though, still need to be

[3]GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Year 2006 and 2005*, GAO-07-134 (Washington, D.C.: Nov. 15, 2006).

[4]In our previous report, we considered those weaknesses to be reportable conditions. Reportable conditions involved matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control, and could adversely affect an agency's ability to meet key control objectives. In May 2006, the American Institute of Certified Public Accountants issued Statement on Auditing Standards (SAS) 112, and subsequently made conforming changes to the Statements on Standards for Attestation Engagements (AT 501). The new standards eliminated the term reportable condition and introduced new definitions for the terms "significant deficiency" and "material weakness." Under these new standards, the auditor is required to communicate control deficiencies that are considered to be significant deficiencies or material weaknesses in internal controls.

addressed, along with new weaknesses we found during this year's audit. Therefore, we consider information security to be a significant deficiency as of September 30, 2007. In addition, we continued to identify the same weaknesses in controls over property and equipment during this year's audit, and therefore, we considered this area to be a significant deficiency as of September 30, 2007.

Although SEC had one material weakness and three significant control deficiencies in internal control, SEC's financial statements were fairly stated in all material respects for fiscal years 2007 and 2006. However, the weaknesses in internal control noted above may adversely affect decisions by SEC management that is based, in whole or in part, on information that is inaccurate because of this weakness. In addition, unaudited financial information reported by SEC, including performance information, may also contain misstatements resulting from these weaknesses.

We will be reporting additional details concerning the material weakness and the significant deficiencies separately to SEC management, along with recommendations for corrective actions. We will also be reporting less significant matters involving SEC's system of internal controls separately to SEC management.

Material Weakness

Financial Reporting Process

During this year's audit, we found control deficiencies in SEC's period-end financial reporting process, in its calculation of accounts receivable for disgorgements and penalties, in its accounting for transaction fee revenue, and in preparing its financial statement disclosures. We believe these control deficiencies, collectively, constitute a material weakness.

Period-End Financial Reporting Process:

SEC's financial management system does not conform to the systems requirements of OMB Circular No. A-127, *Financial Management Systems*. Specifically, Circular No. A-127 requires that financial management systems be designed to provide for effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. Circular No. A-127 further states that financial systems must have common data elements, common transaction processing, consistent internal controls, and efficient transaction entry, and that reports produced by the systems shall provide financial data that can be traced directly to the general ledger accounts.

SEC's period-end financial reporting process for recording transactions, maintaining account balances, and preparing financial statements and disclosures are supported to varying degrees by a collection of automated systems that are not integrated or compatible with its general ledger system. These automated systems' lack of integration and compatibility require that extensive compensating manual and labor-intensive accounting procedures, involving large spreadsheets and numerous posting and routine correcting journal entries, dominate SEC's period-end financial reporting process. Some of SEC's subsidiary systems, such as that for property and equipment and for disgorgements and penalties, do not share common data elements and common transaction processing with the general ledger system. Therefore, intermediary information processing steps, including extensive use of spreadsheets, manipulation of data, and manual journal entries, are needed to process the information in SEC's general ledger. This processing complicates review of the transactions and greatly increases the risk that the transactions are not recorded completely, properly, or consistently, ultimately affecting the reliability of the data presented in the financial statements. Our identification this year of errors in SEC's calculation of disgorgement and penalty accounts receivable, discussed below, illustrates this risk.

The risk to data reliability is further increased because basic controls over electronic data, such as worksheet and password protection, change history, and controls over data verification, such as control totals and record counts, were not consistently used during the data processing between the source systems and the general ledger. In addition, currently, SEC's general ledger has several unconventional posting models and other limitations that prevent proper recording of certain transactions. As a result, SEC's year-end reporting process requires extensive routine correcting journal entries to correct errors created by incorrectly posted transactions in its general ledger. We also noted that SEC's documentation used to crosswalk individual accounts to the financial statement line items contained an incorrect routing to a line item on SEC's Statement of Budgetary Resources for SEC's year-end financial statement preparation process, which caused a material error in SEC's draft financial statements. Also, SEC did not have detailed written documentation of its methodologies and processes for preparing financial statements and disclosures, increasing the risk of inconsistent and improper reporting and the risk that disruptions and error may arise when staff turnover occurs.

Disgorgements and Penalties Accounts Receivable:

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

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

Accounting for Transaction Fee Revenue:

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

[5]A disgorgement is the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible. A penalty is a monetary payment from a violator of securities law that SEC obtains pursuant to statutory authority. A penalty is fundamentally a punitive measure, although penalties occasionally can be used to compensate harmed investors.

each month end, SEC estimates and records an amount receivable for fees payable by the SROs to SEC for activity during the month of September. At September 30, 2007, SEC estimated this receivable amount at $100.6 million. Based on information SEC received in mid-October concerning the actual volume of transactions, the amount of claims receivable at September 30, 2007, should have been $74.4 million. In previous years, SEC made adjustments to reflect the actual volume of transactions; however, SEC does not have written procedures to help ensure that this adjustment is made as a routine part of its year-end financial reporting process. We proposed, and SEC posted, the necessary audit adjustment to correct the amount of transaction fee revenue for fiscal year 2007.

Statement on Auditing Standards No.1, *Codification of Auditing Standards and Procedures*, which explains the accounting requirements for subsequent events, requires that events or transactions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements should be considered for adjustment to or disclosure in the financial statements through the date that the financial statements are issued. In addition, the concept of consistency in financial reporting provides that accounting methods, including those for determining estimates, once adopted, should be used consistently from period to period unless there is good cause to change.

Preparing Financial Statement Disclosures:

In our review of SEC's year-end draft financial statement disclosures, we noted numerous errors including misstated amounts, improper break out of line items, and amounts from fiscal year-end 2006 incorrectly brought forward as beginning balances for fiscal year 2007. For example, in its disclosure for *Custodial Revenues and Liabilities*, SEC improperly excluded approximately $320 million in collections. In another example, for its disclosure on *Fund Balance with Treasury*, SEC misclassified approximately $90 million into incorrect line items. Also, in its disclosure for *Fiduciary Assets and Liabilities*, SEC's beginning balances for Fund Balance with Treasury and for Liability for Fiduciary Activity were each misstated by $8.9 million due to errors in carrying forward ending balances from September 30, 2006. SEC revised the financial statement disclosures to correct the errors that we noted. We believe the cause of these and numerous other errors in the disclosures is due mainly to the lack of a documented timeline and process for completing the fiscal year 2007 financial statements and disclosures, including review of the disclosures. In addition, the cumbersome and complicated nature of SEC's financial reporting process discussed above did not allow SEC finance staff sufficient time to carry out thorough and complete reviews of the disclosures in light of the November 15 reporting deadline.[6]

Significant Deficiencies

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

Information Security

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

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

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

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

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

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

Property and Equipment

SEC's property and equipment consists of general-purpose equipment used by the agency; capital improvements made to buildings leased by SEC for office space; and internal-use software development costs for projects in development and production. SEC acquired approximately $27 million dollars in property and equipment during fiscal year 2007.

Similar to our last year's audit, during the course of testing fiscal year 2007 additions, we noted numerous instances of inaccuracies in recorded acquisition costs and dates for property and equipment purchases, as well as unrecorded property and equipment purchases, and errors in amounts capitalized and amortized for internal-use software projects. In addition, errors were carried forward from the previous year. These systemic errors did not materially affect the balances reported for property and equipment or the corresponding depreciation/amortization expense amounts in SEC's financial statements for fiscal year 2007; however, these conditions evidence a significant deficiency in control over the recording of property and equipment that affects the reliability of its recorded balances for property and equipment. Specifically, SEC lacks a process that integrates controls over capitalizing and recording property and equipment purchases. For example, SEC does not have a formalized, documented process for comparing quantity and type of item received against the corresponding order for property purchases. In addition, SEC does not have sufficient oversight of the recording of acquisition dates and values of the capitalized property. Further, SEC's lack of an integrated financial management system for accounting for property and equipment, as discussed above, requires compensating procedures, which were not effective, to ensure that manual calculations, such as those for depreciation and amortization, are accurate. Until it has a systemic process that incorporates effective controls over receiving, recording, capitalizing, and amortizing property and equipment purchases, SEC will not have sufficient assurance over the accuracy and completeness of its reported balances for property and equipment.

Accounting for Budgetary Resources

For fiscal year 2007, SEC incurred $877 million in obligations, which represents legal liabilities against funds available to SEC to pay for goods and services ordered. At September 30, 2007, SEC reported that the amount of budgetary resources obligated for undelivered orders was $255 million, which reflects obligations for goods or services that had not been delivered or received as of that date. In our testing of undelivered order transactions for this year's audit, we identified several concerns over SEC's accounting for obligations and undelivered orders. Specifically, we found numerous instances in which SEC (1) recorded obligations prior to having documentary evidence of a binding agreement for the goods or services, (2) recorded invalid undelivered order transactions due to an incorrect posting configuration in SEC's general ledger, and (3) made errors in recording new obligations and deobligations due to the use of incorrect accounts and by posting incorrect amounts in the general ledger.

The majority of exceptions related to these issues, amounting to approximately $76 million, were corrected by SEC through adjusting journal entries. While the remaining uncorrected amounts did not materially affect the balances on the Statement of Budgetary Resources at September 30, 2007, ineffective processes that caused these errors constitute a significant deficiency in SEC's internal control over recording and reporting of obligations, and puts SEC at risk that the amounts recorded in the general ledger and reported on SEC's Statement of Budgetary Resources are misstated. Specifically, SEC's general ledger is not configured to properly post related entries, thereby resulting in the need to routinely correct entries. Extensive reviews of the budgetary transactions, along with significant adjusting journal entries, are needed to compensate for the system limitations. The errors in recording new obligations and deobligations that we found in our audit indicate a lack of effective review over those transactions. Further, SEC does not have policies or internal controls to prevent recording of obligations that are not valid. Recording obligations prior to having documentary evidence of a binding agreement for the goods and services is a violation of the recording statute,[7] and may result in funds being reserved unnecessarily and therefore made unavailable for other uses should the agreement not materialize. In addition, early recording of obligations may result in charging incorrect fiscal year funds for an agreement executed in a later fiscal year.

Compliance with Laws and Regulations

Our tests for compliance with selected provisions of laws and regulations disclosed no instances of noncompliance that would be reportable under U.S. generally accepted government auditing standards or OMB audit guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

SEC's Management's Discussion and Analysis and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We do not express an opinion on this information. However, we compared this information for consistency with

[7] 31 U.S.C. § 1501(a)(1).

the financial statements and discussed the methods of measurement and presentation with SEC officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance. However, because of the internal control weaknesses noted above, misstatements may occur in related performance information.

Objectives, Scope, and Methodology

SEC management is responsible for (1) preparing the financial statements in conformity with U.S. generally accepted accounting principles; (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of FMFIA are met; and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles; and (2) management maintained effective internal control, the objectives of which are the following:

- Financial reporting: Transactions are properly recorded, processed, and summarized to permit the timely and reliable preparation of financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition.
- Compliance with applicable laws and regulations: Transactions are executed in accordance with (1) laws governing the use of budgetary authority, (2) other laws and regulations that could have a direct and material effect on the financial statements, and (3) any other laws, regulations, or governmentwide policies identified by OMB audit guidance.

We are also responsible for (1) testing compliance with selected provisions of laws and regulations that could have a direct and material effect on the financial statements and for which OMB audit guidance requires testing and (2) performing limited procedures with respect to certain other information appearing in SEC's Performance and Accountability Report. In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;

- assessed the accounting principles used and significant estimates made by SEC management;

- evaluated the overall presentation of the financial statements;

- obtained an understanding of SEC and its operations, including its internal control related to financial reporting (including safeguarding of assets) and compliance with laws and regulations (including execution of transactions in accordance with budget authority);

- obtained an understanding of the design of internal controls related to the existence and completeness assertions relating to performance measures as reported in Management's Discussion and Analysis, and determined whether the internal controls have been placed in operation;

- tested relevant internal controls over financial reporting and compliance with applicable laws and regulations, and evaluated the design and operating effectiveness of internal control;

- considered SEC's process for evaluating and reporting on internal control and financial management systems under the FMFIA; and

- tested compliance with selected provisions of the following laws and their related regulations:

  - the Securities Exchange Act of 1934, as amended;
  - the Securities Act of 1933, as amended;
  - the Antideficiency Act;
  - laws governing the pay and allowance system for SEC employees;
  - the Prompt Payment Act; and
  - the Federal Employees' Retirement System Act of 1986.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We did not test compliance with all laws and regulations applicable to SEC. We limited our tests of compliance to those required by OMB audit guidance and other laws and regulations that had a direct and material effect on, or that we deemed applicable to, SEC's financial statements for the fiscal year ended September 30, 2007. We caution that noncompliance may occur and not be detected by these tests and that this testing may not be sufficient for other purposes.

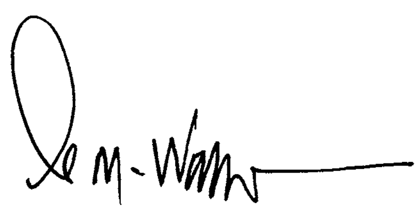
We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

SEC's management provided comments on a draft of this report. They are discussed and evaluated below and are reprinted in appendix III.

SEC Comments and Our Evaluation

In commenting on a draft of this report, SEC's Chairman said he was pleased to receive an unqualified opinion on SEC's financial statements. The Chairman discussed SEC's plans to remediate this material weakness before the end of fiscal 2008, and to address each of the findings and recommendations identified during the audit. The Chairman emphasized SEC's commitment to enhance its controls in all operational areas and to ensure reliability of financial reporting, soundness of operations, and public confidence in SEC's mission.

The complete text of SEC's comments is reprinted in appendix III.



David M. Walker
Comptroller General
of the United States
November 13, 2007

Appendix I: Management's Discussion and Analysis

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

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

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

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

- **Enforce compliance with federal securities laws**

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

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

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

- **Foster informed investment decision making**

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

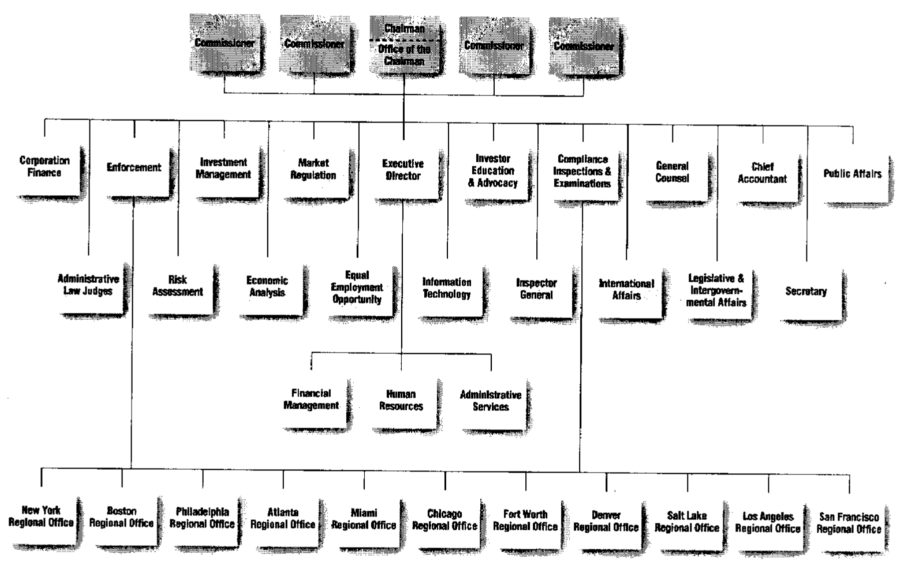
- **Maximize the use of SEC resources**

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

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

TABLE 1.1

SEC Organization Chart



Management's Discussion and Analysis 7

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

Enforcing Compliance with Securities Laws

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

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

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

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

Internet Enforcement. In 2007, the Commission and its Office of Internet Enforcement concentrated significant efforts to combat the growing threats of identity theft and account intrusions. One case resulted in the capture of $3 million in a Latvian bank account—one of the largest asset freezes in agency history. Another landmark case, brought in conjunction with the Omaha U.S. Attorney's Office, marked the first joint criminal and civil prosecution of an account intrusion.

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

Improving Disclosure for Investors

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

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

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

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

Protecting Investors in Municipal Securities. The Commission is redoubling its efforts to improve disclosure and accounting practices in this sizable market affecting millions of individual investors. The Commission entered an order sanctioning the City of San Diego for committing securities fraud by failing to disclose billions of dollars in pension and retiree health care obligations in its sale of its municipal bonds. The agency delivered a white paper to Congress outlining our recent enforcement actions and highlighting areas of possible legislative reform, in light of the growing size and importance of the municipal securities market and the significant ways in which it has changed over time. The white paper proposed, among other things, that offering documents and periodic reports provided to investors contain information similar to what is required for all other securities offerings, that information on municipal securities be made available on a more timely basis, and that municipal issuers be required to use generally accepted governmental accounting standards.

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

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

Promoting an Effective and Flexible Regulatory Environment

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

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

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

Protecting Investors in Expanding Markets

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

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

The SEC also increased efforts to formalize regulatory information-sharing arrangements with other international counterparts. These allow confidential sharing of issuer-specific information, with the ultimate goal of encouraging high-quality and consistent application of accounting standards. Additionally, the SEC finalized cooperative arrangements related to the supervision and oversight of markets and market participants, and handled over 800 requests related to enforcement investigations and cases.

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

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

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

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

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

TABLE 1.2

Performance Results Summary

KEY: LEVEL OF PERFORMANCE ATTAINED

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

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

12 2007 Performance and Accountability Report

The principal financial statements included in *Section 3: Financial Section* have been prepared to report the financial position and results of operations of the SEC, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the SEC in accordance with GAAP for Federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

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

Overview

The SEC's financial statements were prepared in conformity with U.S. GAAP and OMB Circular A-136, *Financial Reporting Requirements*. The financial statements, footnotes, and auditor's opinion appear in Section 3 of this Performance and Accountability Report. A summary of the SEC's major financial activities in FY 2007 and FY 2006 is presented below.

Balance Sheet and Net Position

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

TABLE 1.3

Condensed Balance Sheet

As of September 30, 2007 and September 30, 2006

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

Assets

Fund Balance with Treasury

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

Investments

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

Accounts Receivable

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

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

Liabilities

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

Custodial Liability

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

Fiduciary Liability

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

Net Position

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

Net Cost of Operations

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

TABLE 1.4

Condensed Statement of Net Cost

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

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

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

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

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

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

Budgetary Resources and Outlays

The Statement of Budgetary Resources provides information on the budgetary resources that were made available to the SEC during the fiscal year and the status of those resources at the end of the fiscal year. The SEC receives its funding from fee revenue earned, which must be appropriated by Congress before it can be used by the Commission.

TABLE 1.5

Selected Budgetary Resources

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

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

Budgetary Resources consist of the resources available to the SEC at the beginning of the year, plus the appropriations, spending authority from offsetting collections, and other budgetary resources received during the year. Total resources decreased by $4.8 billion in FY 2007. This decrease is primarily due to a change in accounting principle related to prior year collections in excess of budgetary authority. As a result of this change, the financial statement line, *Unobligated Balance, Brought Forward, October 1,* decreased to $186.7 million from the reported $4,878 million FY 2006 ending balances of unobligated funds. The prior year collections previously reported in this line continue to be reported on the Balance Sheet in *Fund Balance with Treasury* and *Cumulative Results of Operations.* However, these amounts are no longer reported as budgetary resources of the SEC. See Note 1.C *Change in Accounting Principle* in the Financial Section for additional discussion of this accounting change. The reduction in collections of $364.9 million is a direct result of the reduction in rates, as referred to in the Net Cost of Operations.

Obligations and Outlays

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

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

Custodial Activity

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

TABLE 1.6

Condensed Statement of Custodial Activity

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

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

Collections

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

Distributions

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

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

Federal Managers' Financial Integrity Act

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

Section 2 of the FMFIA requires federal agencies to report, on the basis of annual assessments, any material weaknesses that have been identified in connection with its internal and administrative controls. The reviews that took place during FY 2007 provide qualified assurance that SEC systems and management controls comply with the requirements of the FMFIA, with the exception of a material weakness in internal control over financial reporting.

Section 4 of the FMFIA requires that agencies annually evaluate and report on whether financial management systems conform to government-wide requirements. The SEC evaluated its financial management systems for the fiscal year ending September 30, 2007 in accordance with the FMFIA and OMB Circular No. A-127, *Financial Management Systems,* as applicable. This evaluation identified system non-conformances.

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

Chairman's Assurance Statement

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

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

Chris Cox

Christopher Cox
Chairman
November 15, 2007

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

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

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

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

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

Other Reviews

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

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

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

Internal Controls over Financial Reporting

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

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

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

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

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

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

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

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

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

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

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

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

Corrective Actions Planned. Corrective actions will be taken in the short term to mitigate the control deficiencies cited by GAO. Plans are under development to implement short-term solutions to reduce intermediary information processing steps, including extensive use of spreadsheets, manipulation of data, and manual journal entries, in FY 2008. The process will be reviewed and SEC will tighten compensating controls supporting the calculation of receivable balances until automated integration is achieved. SEC will continue to replace routine manual entries and adjustments with approved posting models when feasible. For example, pro-forma SGL compliant entries for operating under a continuing resolution were recently implemented to replace manual journal entries made in the first quarter of FY 2007.

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

Financial Management System Non-conformance

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

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

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

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

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

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

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

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

Federal Information Security Management Act (FISMA)

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

Appendix II: Financial Statements

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

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

Kristine M. Chadwick
Chief Financial Officer and
Associate Executive Director, Finance

I am delighted to join Chairman Cox in presenting the Commission's FY 2007 Performance and Accountability Report (PAR). The PAR summarizes the agency's annual accomplishments, in addition to providing financial and performance information. I am pleased that the SEC sustained an unqualified audit opinion on the financial statements this year. This performance benchmark validates our efforts to ensure that the financial statements of the agency, and of the funds for which we are stewards, are fairly presented. This achievement is also a testament to the hard work and dedication of SEC staff.

In 2006, the SEC received the Association of Government Accountants' Certificate for Excellence in Accountability Reporting (CEAR) award for our FY 2006 Performance and Accountability Report. The SEC also received an industry-based award for its efforts in automating and integrating the agency's budget and performance processes. Our activity-based costing and performance-based budgeting system was used this year to produce the agency's budget submissions and Statement of Net Cost, and to provide greater detail on the agency's costs by strategic goal.

The SEC is committed to effective and efficient management of its resources. During FY 2007, the SEC took a number of important steps to ensure the integrity of enforcement-related disgorgements and penalties data; held extensive training sessions on internal control issues with process owners; and drafted documentation of key processes, risks and controls.

The agency undertook a comprehensive review of the financial reporting process, and overlaid identified deficiencies with compensating controls. A material weakness in internal control, and system non-conformances were identified. The SEC will develop and execute a corrective action plan to remedy the control design deficiencies in FY 2008 and continue to evaluate and strengthen controls throughout the year. We will also develop a plan to achieve greater integration of budget, performance and financial management systems, addressing the system non-conformances as well as facilitating better performance management and decision making. I look forward to another productive year in FY 2008 to continue the same high level of financial management that resulted in our past successes.

Sincerely,

Kristine M. Chadwick
Chief Financial Officer and
Associate Executive Director, Finance
November 15, 2007

Financial Section 45

U.S. SECURITIES AND EXCHANGE COMMISSION

Balance Sheet

As of September 30, 2007 and 2006

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
ASSETS		
Intragovernmental:		
Fund Balance with Treasury (Notes 1.H, 2, 3 and 16)	$5,888,039	$5,178,893
Investments (Notes 1.I, 2, 4 and 16)	3,602,511	3,674,528
Accounts Receivable (Notes 1.J, 2, 5 and 16)	155	154,506
Advances and Prepayments (Note 1.K)	1,198	
Total Intragovernmental	9,491,903	9,007,927
Accounts Receivable, Net (Notes 1.J and 5)	138,693	177,491
Advances and Prepayments (Note 1.K)	902	974
Property and Equipment, Net (Notes 1.L and 6)	98,280	103,631
Total Assets	$9,729,778	$9,290,023
LIABILITIES		
Intragovernmental:		
Accounts Payable (Notes 1.M and 7)	$ 6,153	$ 14,527
Employee Benefits (Notes 1.N and 7)	2,699	2,687
Unfunded FECA and Unemployment Liability (Notes 1.O and 7)	1,109	992
Total Intragovernmental	9,961	18,206
Accounts Payable (Notes 1.M and 7)	43,096	47,608
Accrued Payroll and Benefits (Notes 1.M and 7)	18,176	18,149
Accrued Leave (Notes 1.P and 7)	35,296	32,974
Registrant Deposits (Notes 1.Q, 2 and 7)	61,689	57,464
Actuarial FECA Liability (Notes 1.O, 7 and 8)	5,080	4,813
Fiduciary Liability (Notes 1.T, 2, 7 and 16)	3,615,760	3,834,662
Custodial Liability (Notes 1.S, 2, 7 and 15)	63,614	71,545
Other Accrued Liabilities (Notes 7 and 9)	23,338	42,480
Total Liabilities	$3,876,010	$4,127,901
Commitments and Contingencies (Notes 7 and 11)		
NET POSITION		
Unexpended Appropriations—Other Funds	—	9,201
Cumulative Results of Operations—Other Funds	5,853,768	5,152,921
Total Net Position	$5,853,768	$5,162,122
Total Liabilities and Net Position	$9,729,778	$9,290,023

The accompanying notes are an integral part of these financial statements.

U.S SECURITIES AND EXCHANGE COMMISSION

Statement of Net Cost

For the fiscal years ended September 30, 2007 and 2006

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
COSTS BY STRATEGIC GOAL AND OBJECTIVE (Notes 1.B and 12)		
Enforce compliance with federal securities laws		
Total Gross Cost	$ 529,454	$ 579,076
Promote healthy capital markets through an effective and flexible regulatory environment		
Total Gross Cost	79,704	77,263
Foster informed investment decision making		
Total Gross Cost	135,917	135,856
Maximize the use of SEC resources		
Total Gross Cost	97,466	96,728
Total Entity		
Total Gross Program Cost	842,541	888,923
Less: Earned Revenue Not Attributed to Programs (Note 13)	1,507,750	1,882,619
Net (Income) from Operations (Note 17)	$ (665,209)	$ (993,696)

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Changes in Net Position

For the years ended September 30, 2007 and 2006

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balance	$5,152,921	$4,133,526
Budgetary Financing Sources:		
Appropriations Used	9,201	—
Appropriations Not Available	—	(1,151)
Other Financing Sources:		
Imputed Financing (Note 10)	26,437	26,850
Total Financing Sources	35,638	25,699
Net Income from Operations—Other Funds	665,209	993,696
Net Change—Other Funds	700,847	1,019,395
Cumulative Results of Operations	5,853,768	5,152,921
UNEXPENDED APPROPRIATIONS		
Beginning Balance	9,201	9,791
Budgetary Financing Sources:		
Unexpended Appropriations—Used	(9,201)	—
Appropriations Not Available	—	(590)
Total Unexpended Appropriations	—	9,201
Net Position, End of Period—Other Funds	$5,853,768	$5,162,122

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Budgetary Resources

For the years ended September 30, 2007 and 2006

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
BUDGETARY RESOURCES		
Unobligated Balance, Brought Forward, October 1	$ 4,878,061	$ 3,840,573
Change in Accounting Principle (Note 1.C)	(4,691,392)	—
Unobligated Balance, Brought Forward, October 1, Revised (Note 1.C)	186,669	3,840,573
Recoveries of Prior Year Unpaid Obligations	23,030	32,410
Budget Authority:		
Spending Authority from Offsetting Collections:		
Earned		
Collected	1,538,749	1,903,648
Change in Receivables from Federal Sources	(131)	(63)
Change in Unfilled Customer Orders without Advance Received	(663)	663
Subtotal	1,537,955	1,904,248
Temporarily Not Available Pursuant to Public Law	(781,047)	—
Permanently Not Available	—	(1,740)
Total Budgetary Resources	$ 966,607	$ 5,775,491
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct (Note 14)	$ 876,274	$ 896,911
Reimbursable (Note 14)	321	519
Unobligated Balance Available:		
Realized and Apportioned for Current Period	6,068	14,978
Unobligated Balance Not Available	83,944	4,863,083
Total Status of Budgetary Resources	$ 966,607	$ 5,775,491
CHANGE IN OBLIGATED BALANCE		
Obligated Balance, Net		
Unpaid Obligations, Brought Forward, October 1	$ 230,102	$ 235,702
Less: Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(794)	(194)
Total Unpaid Obligated Balance, Net	229,308	235,508
Obligations Incurred, Net	876,595	897,430
Less: Gross Outlays	(829,006)	(870,620)
Less: Recoveries of Prior Year Unpaid, Obligations, Actual	(23,030)	(32,410)
Change in Uncollected Customer Payments from Federal Sources	793	(600)
Obligated Balance, Net, End of Period		
Unpaid Obligations	254,660	230,102
Less: Uncollected Customer Payments from Federal Sources	—	(794)
Total Unpaid Obligated Balance, Net, End of Period (Note 11)	$ 254,660	$ 229,308
NET OUTLAYS		
Net Outlays:		
Gross Outlays	$ 829,006	$ 870,620
Offsetting Collections	(1,538,749)	(1,903,648)
Distributed Offsetting Receipts	(1,105)	51,294
Net Outlays/(Net Collections)	$ (710,848)	$ (981,734)

The accompanying notes are an integral part of these financial statements.

U.S. SECURITIES AND EXCHANGE COMMISSION

Statement of Custodial Activity

For the years ended September 30, 2007 and 2006

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
REVENUE ACTIVITY		
Sources of Cash Collections:		
Disgorgement and Penalties	$496,386	$1,804,043
Other	138	90
Net Collections	496,524	1,804,133
Accrual Adjustments	(7,931)	(23,967)
Total Custodial Revenue (Notes 1S, 15 and 16)	$488,593	$1,780,166
DISPOSITION OF COLLECTIONS		
Amounts Transferred to:		
Department of the Treasury	$176,761	$ 122,030
Other	319,763	1,682,103
Net Disbursements	496,524	1,804,133
Change in Liability Accounts	(7,931)	(23,967)
Total Disposition of Collections (Notes 1S, 15 and 16)	$488,593	$1,780,166
NET CUSTODIAL ACTIVITY	$ —	$ —

The accompanying notes are an integral part of these financial statements.

50 2007 Performance and Accountability Report

NOTE 1. Summary of Significant Accounting Policies

A. Reporting Entity

The United States Securities and Exchange Commission (SEC) is an independent agency of the United States established pursuant to the Securities Exchange Act of 1934. The SEC's mission is to protect investors; maintain fair, orderly, and efficient securities markets; and facilitate capital formation. The SEC works with the Congress, other Executive Branch departments and agencies, self-regulatory organizations (SROs) (e.g., stock exchanges and the Financial Industry Regulatory Authority (FINRA)), the Public Company Accounting Oversight Board (PCAOB), state securities regulators, and many other organizations in support of the agency's mission.

These financial statements report on the SEC's four strategic goals as performed by six major program areas: Compliance Inspections and Examinations; Corporation Finance; Enforcement; Investment Management; Market Regulation; and Other Offices. These programs promote the public interest by, among other activities: promoting compliance through inspections and examinations of regulated entities; facilitating capital formation through full disclosure; enforcing the federal securities laws; regulating investment companies and investment advisors; overseeing the operations of the nation's securities markets and participants; promoting technological innovation in the securities markets; encouraging international regulatory and enforcement cooperation; and educating and assisting investors.

B. Basis of Presentation and Accounting

The accompanying financial statements present the financial position, net cost of operations, changes in net position, budgetary resources, and custodial and fiduciary activities of the SEC's core business activities as required by the Accountability of Tax Dollars Act of 2002. They may differ from other financial reports submitted pursuant to Office of Management and Budget (OMB) directives for the purpose of monitoring and controlling the use of SEC budgetary resources. The SEC's books and records serve as the source of the information presented in the accompanying financial statements. Assets, liabilities, revenues, and costs have been classified in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those from or to other federal entities. Intragovernmental earned revenues are collections or accruals of revenue from other federal entities, and intragovernmental costs are payments or accruals to other federal entities.

The financial statements and accompanying notes are prepared in conformity with U.S. generally accepted accounting principles (GAAP) and presented in accordance with the form and content guidelines established by OMB in Circular A-136, *Financial Reporting Requirements*. Certain information, including the Statement of Net Cost (SNC) and *Note 4. Investments*, is presented differently than the SEC's FY 2006 Performance and Accountability Report to conform with reporting requirements in OMB A-136. The format used to present the SNC has changed to better align costs by major program as prescribed by OMB A-136. The new format presents strategic goals that align directly with the major goal(s) and output(s) described in the SEC's strategic and performance budgets required by Government Performance Results Act (GPRA).

Effective for FY 2007, the Statement of Financing (SOF) is presented as a note per OMB's authority under SFFAS No. 7, Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting, and will no longer be considered a Basic Statement. The Statement of Financing will now be displayed in Note 17 and referred to as "Reconciliation of Net Cost of Operations (proprietary) to Budget." The FY 2006 Statement of Financing is also shown in this note.

Transactions are recorded on the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash.

C. Change in Accounting Principle

The SEC changed its method of accounting for user fees collected in excess of current-year appropriations. This change is reflected in external reports resulting in a change in the Unobligated Balance, Brought Forward in the Statement of Budgetary Resources (SBR).

Starting in FY 2007, the current year offsetting collections that are not available for immediate obligation, but may be available for future use, will be reflected as Temporarily Not Available Pursuant to Public Law. An adjustment was made to the Unobligated Balance, Brought Forward from October 1 to reflect the cumulative effect on the historical offsetting collections. The offset to this adjustment is reflected in the Unobligated Balance Not Available line item.

D. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results will invariably differ from those estimates.

E. Intra- and Inter-Agency Relationships

The SEC does not have transactions among its own operating units, and therefore, intra-entity eliminations are not necessary. The SEC has certain oversight responsibilities with respect to the Financial Accounting Standards Board (FASB); the Securities Investor Protection Corporation (SIPC) (See *Note 11. Commitments and Contingencies*); and the PCAOB; however, these entities are not subject to consolidation.

F. Fund Accounting Structure

The SEC's financial activities are accounted for by Treasury Account Fund symbol, summarized as follows:

- ***General Fund*** (X0100) includes the appropriated general funds used to carry out the SEC's missions and functions and revenues collected by the SEC in excess of appropriated funds for FY 2005 through 2007 (See *Note 3. Fund Balance with Treasury*).
- ***Salaries and Expenses*** (0100) includes the appropriated general funds used to carry out the SEC's missions and functions for FY 2002 through 2004.
- ***Deposit and Suspense Funds*** (X6563, F3875 and F3880) carry disgorgement, penalties, and interest collected and held on behalf of harmed investors, registrant monies held temporarily until earned by the SEC, and collections awaiting disposition or reclassification.
- ***Miscellaneous Receipt Accounts*** (1099 and 3220) hold non-entity receipts and accounts receivable from SEC custodial and fiduciary activities that cannot be deposited into funds under SEC control. These include amounts received pursuant to enforcement cases that are to be sent to the Treasury.

The SEC does not have lending or borrowing authority, except as discussed in *Note 11. Commitments and Contingencies*. The SEC has custodial and fiduciary responsibilities, as described in *Note 15. Custodial Revenues and Liabilities* and *Note 16. Fiduciary Assets and Liabilities*.

G. Entity/Non-Entity Assets

Assets that an agency is authorized to use in its operations are entity assets. Assets that are held by the SEC on behalf of another federal agency or a third party, and are not available for the agency's use, are non-entity assets. The SEC's non-entity assets include the following: (i) fiduciary assets, representing disgorgement, penalties, and interest collected and held or invested by the SEC pending distribution to harmed investors; (ii) custodial accounts receivable in respect of disgorgement, penalties, and interest owed by securities law violators; and (iii) registrant deposits, representing excess filing fees remitted by registrants.

H. Fund Balance with Treasury

Fund Balance with Treasury includes certain funds held on behalf of third parties. These include registrant deposits, representing excess filing fees remitted by registrants, and uninvested fiduciary assets, representing disgorgement, penalties, and interest held by the SEC pending distribution to harmed investors.

All SEC banking activity is conducted in accordance with directives issued by the Treasury, Financial Management Service (FMS). All revenue and receipts are deposited in commercial bank accounts maintained by the FMS or wired directly to a Federal Reserve Bank. The Treasury processes all disbursements made by the SEC. All monies maintained in commercial bank accounts are transferred to the Federal Reserve Bank on the next business day following the day of deposit.

I. Investments

The SEC invests fiduciary assets in short-term Treasury securities, whenever practicable. Once these funds are collected, they are generally transferred to the SEC's deposit fund account and invested in short-term market-based Treasury bills through a facility provided by the Treasury, Bureau of the Public Debt (BPD), pending their distribution to investors. Interest earned is added to the funds available for distribution to investors.

J. Accounts Receivable and Allowance for Uncollectible Accounts

Both entity and non-entity accounts receivable consist of amounts due primarily from the public. Entity accounts receivable are amounts that will be retained by the SEC upon collection. These generally include claims arising from: (i) securities transaction fees paid by exchanges, (ii) filing fees paid by registrants, (iii) goods or services that the SEC has provided to another federal agency pursuant to an inter-agency agreement, (iv) host reimbursement of SEC employee travel, (v) requests pertaining to Freedom of Information Act (FOIA), and (vi) employee-related debt. Entity accounts receivable represent a small portion of the SEC's business activities because agency fee legislation generally requires payment of filing fees at the time of filing, and SRO transaction fees are payable to the SEC twice a year—in March for the period September through December, and in September for the period January through August. Accordingly, the year-end accounts receivable accrual generally represents only fees payable by the SROs to the SEC for activity during the month of September.

Non-entity accounts receivable are amounts that will not be retained by the SEC upon collection. These mainly include disgorgement, penalties, and interest assessments. These accounts receivable are recognized when the SEC is designated in an order of the Commission or a court to collect the assessed disgorgement, penalties, and interest. SEC maintains a custodial responsibility over these non-entity accounts receivable. When collected, these funds are either transferred to the Treasury, or they are held for future distribution to harmed investors.

The SEC is also party to orders directing the court or a receiver to collect the disgorgement, penalties, and interest assessed against violators of federal securities laws. These orders are not recognized as accounts receivable by the SEC because the debts are payable to another party. However, these debts are subject to change based on future orders issued by the presiding court that could result in the SEC recognizing a receivable at a later date. The SEC's policy is to record a receivable in those cases at the point in time when the debtor is required, as a result of a court order or other legally binding instrument, to remit funds to the SEC.

The allowance for uncollectible amounts and the related provision for estimated losses for disgorgement and penalties and FOIA accounts receivable is based on an analysis of the collectibility of individual account balances for the largest debts and on historical collection data to determine on a percentage basis the value of gross accounts receivable that are likely to be collected by the SEC. This percentage is applied to the remaining disgorgement and penalties and FOIA accounts receivable to reflect the balances at their estimated net realizable value. The allowance for uncollectible amounts and the related provision for estimated losses for filing fees and other accounts receivable is based on historical collection data to determine on a percentage basis the value of gross accounts receivable that are likely to be collected by the SEC; and no allowance for uncollectible amounts and the related provision for estimated losses has been established for Due for Reimbursable Agreements and Exchange Fees, as these gross accounts receivable are deemed to represent their net realizable value. In addition, the SEC does not recognize interest as accounts receivable, unless a court or administrative order specifies the amount of pre-judgment interest.

K. Advances and Prepayments

The SEC may prepay amounts in anticipation of receiving future benefits; the benefits include training and supplemental health benefits for SEC employees. These payments are expensed when the goods have been received or services have been performed. The SEC may also advance funds to its personnel for travel costs, and these amounts are expensed when the travel takes place.

L. Property and Equipment, Net

The SEC's property and equipment consists of software and general purpose equipment used by the agency; capital improvements made to buildings leased by the SEC for office space; and internal-use software development costs for projects in development. Property and equipment purchases and additions are stated at cost. Property and equipment acquisitions that do not meet the capitalization criteria, normal repairs, and maintenance are charged to expense as received or incurred by the SEC.

Property and equipment are depreciated over their estimated useful lives using the straight-line method of depreciation. Property and equipment are removed from the SEC's asset accounts in the period of disposal, retirement, or removal from service. Any difference between the book value of the property and equipment and amounts realized is recognized as a gain or loss in the same period that the asset is removed.

M. Liabilities

The SEC records liabilities for amounts that are likely to be paid as the result of events that have occurred as of September 30, 2007 and 2006. The SEC's liabilities consist of routine operating accounts payable, accrued payroll and benefits, registrant deposit accounts, and fiduciary and custodial liabilities associated with monetary sanctions imposed on violators of securities laws.

Fiduciary and custodial liabilities represent the largest portion of the SEC's liabilities. Custodial liabilities arise in respect of accounts receivable for disgorgement, penalties, and interest assessed against securities law violators. The SEC records a custodial liability for the net amount of such receivables, after taking into account the estimated allowance for doubtful accounts. When the SEC collects this revenue, it is either transferred to the Treasury or it is held by the SEC in a fiduciary capacity on behalf of harmed investors to whom the SEC intends to return the funds. Fiduciary liabilities arise when the SEC collects disgorgement, penalties, and interest from securities law violators which will be returned to harmed investors. When collected, fiduciary receipts are held in Fund Balance with Treasury or invested in Treasury securities pending distribution to harmed investors, and an equal and offsetting fiduciary liability for assets held by the SEC at the Treasury is reported as a non-entity liability on the balance sheet.

The SEC recognizes liabilities covered by three types of resources: realized budgetary resources; unrealized budgetary resources that become available without further Congressional action; and cash and amounts held in Fund Balance with Treasury that do not require the use of a budgetary resource. Realized budgetary resources include obligated balances that fund existing liabilities and unobligated balances at September 30, 2007 and 2006. Unrealized budgetary resources represent fee collections in excess of amounts appropriated for current fiscal year spending. These resources are used to cover liabilities when appropriation language makes these unrealized budgetary resources available in the fiscal year without further Congressional action.

N. Employee Retirement Systems and Benefits

SEC employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they were hired by the federal government. The FERS was established by enactment of Public Law 99-335. Pursuant to this law, the FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees who are rehired after a break in service of more than one year and who had five years of federal civilian service prior to 1987 are placed in the CSRS offset retirement system or may elect to join the FERS.

The SEC's financial statements do not report CSRS or FERS assets or accumulated plan benefits that may be applicable to its employees as they are reported by the U.S. Office of Personnel Management (OPM). While the SEC reports no liability for future payments to employees under these programs, the federal government is liable for future payments to employees through the various agencies administering these programs. The SEC does not fund post-retirement benefits such as the Federal Employees Health Benefit Program (FEHB) and the Federal Employees Group Life Insurance Program (FEGLI). The SEC is also not required to fully fund the CSRS pension liabilities. Instead, the financial statements of the SEC recognize an imputed financing source and corresponding expense that represent the SEC's share of the cost to the federal government of providing pension, post-retirement health, and life insurance benefits to all eligible SEC employees. For the fiscal year ended September 30, 2007, the SEC made contributions based on OPM cost factors equivalent to approximately 6.74 percent and 10.87 percent of the employee's basic pay for those employees covered by CSRS and FERS, respectively. For the fiscal year ended September 30, 2006, the SEC made contributions based on OPM cost factors equivalent to approximately 6.78 percent and 10.91 percent of the employee's basic pay for those employees covered by CSRS and FERS, respectively. All employees are eligible to contribute to a thrift savings plan. For those employees participating in the FERS, a thrift savings plan is automatically established, and the SEC makes a mandatory 1 percent contribution to this plan. In addition, the SEC makes matching contributions ranging from 1 to 4 percent for FERS-eligible employees who contribute to their thrift savings plans. FERS participating employees are also covered under the Federal Insurance Contributions Act (FICA), for which the SEC contributes a matching amount to the Social Security Administration. No matching contributions are made to the thrift savings plans for employees participating in the CSRS.

O. Injury and Post-employment Compensation

Claims brought by SEC employees for on-the-job injuries are addressed under the Federal Employees' Compensation Act (FECA) administered by the United States Department of Labor (DOL). The DOL bills each agency annually as its claims are paid, but payment on these bills is deferred for two years to allow for funding through the budget process. Similarly, SEC employees who are terminated without cause may receive unemployment compensation benefits under the unemployment insurance program also administered by the DOL, which bills each agency quarterly for paid claims.

P. Annual, Sick, and Other Leave

Annual leave and compensatory time are accrued as earned and the accrual is reduced when leave is taken. Each fiscal quarter an adjustment is made so that the balances in the accrued leave accounts reflect current leave balances and pay rates. No portion of this liability has been obligated. Funding will be obtained from future financing sources to the extent current or prior year funding is not available to pay for leave earned but not taken. Sick leave and other types of non-vested leave are expensed as used.

Q. Revenue and Other Financing Sources

The SEC's revenue and financing sources include exchange revenues, which are generated from arm's length transactions, and non-exchange revenues, which arise from the government's ability to demand payment. The SEC's exchange revenues consist of mainly fees collected from SROs and registrants. The SEC's non-exchange revenue consists of amounts collected in enforcement proceedings from violators of securities laws.

The SEC's funding is through primarily the collection of securities transaction fees from SROs, and securities registration, tender offer, merger, and other fees from registrants. The SEC's fee rates are established by law and are applied to volumes of activity reported by SROs or to filings submitted by registrants. When received, these fees are recorded as exchange revenue. The SEC is permitted by law to include these amounts in its obligational authority or to offset its expenditures and liabilities upon collection up to authorized limits. All amounts remitted by registrants in excess of the fees for specific filings are recorded as liabilities in deposit accounts until earned by the SEC from registrant filings or returned to the registrant pursuant to SEC policy, which calls for the return of registrant deposits when an account is dormant for six months.

The SEC also recognizes revenue from enforcement proceedings that result in the assessment of disgorgement, penalties, and interest against violators of federal securities laws. This activity is recognized as non-exchange revenue and presented on the Statement of Custodial Activity. When the SEC collects this revenue, it is either transferred to the Treasury or it is held by the SEC in a fiduciary capacity on behalf of harmed investors to whom the SEC intends to return the funds. An equal and offsetting liability for the fiduciary assets held by the SEC is reported on the Balance Sheet. The SEC does not record fiduciary assessments collected and held by another government entity, such as a court registry, or a non-government entity, such as a receiver.

R. Budgets and Budgetary Accounting

The SEC is subject to certain restrictions on its use of statutory fees. All fee revenues are deposited in a designated account at the U.S. Department of the Treasury (Treasury). However, the SEC may use funds from this account only as authorized by Congress, made available by OMB apportionment, and upon issuance of a Treasury warrant. Revenue collected in excess of appropriated amounts is restricted for use by the SEC.

Fees other than the restricted excess fees can be used for SEC operations subject to an annual Congressional limitation of $867.5 million and $888.7 million for the budget FYs 2007 and 2006, respectively. Funds appropriated but not used in a given fiscal year are maintained in a designated account for use in future periods, as appropriated by the Congress.

Each fiscal year, the SEC receives its appropriation through Category A apportionments, which are quarterly distributions of budgetary resources made by OMB. The SEC also receives a small amount of Category B funds for reimbursable activity which are exempt from quarterly apportionment.

S. Custodial Activities

The Statement of Custodial Activity presents the sources and disposition of SEC custodial activity that consists of primarily disgorgement, penalties, and interest assessed against violators of securities laws. When collected, the funds are either returned to the Treasury or held for future distribution to harmed investors as discussed in *Note 1. J. Accounts Receivable and Allowance for Uncollectible Accounts.*

T. Fiduciary Activities

Fiduciary activities represent the receipt, management, accounting, and disposition by the SEC of cash or other assets in which harmed investors will ultimately have an ownership interest, pursuant to an approved distribution plan and disbursement order, that the SEC must uphold. The SEC also recognizes an equal and offsetting liability for these assets. See *Note 1.M. Liabilities.*

The SEC's fiduciary assets consist 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 as fiduciary assets by the SEC pending distribution to harmed investors pursuant to an approved distribution plan. The SEC does not record fiduciary asset amounts collected and held by another government entity, such as a court, or a non-governmental entity, such as a receiver.

NOTE 2. Non-Entity Assets

SEC non-entity assets consist entirely of public assets. At September 30, non-entity assets consisted of the following:

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Public:		
Registrant Deposits (Fund Balance with Treasury)	$ 61,689	$ 57,464
Fiduciary Assets (Fund Balance with Treasury, Investments, and Accounts Receivable)	3,615,760	3,834,662
Custodial Assets (Accounts Receivable)	63,614	71,545
Securities Transaction Fee Refund (Fund Balance with Treasury)	-	8,901
Total Non-Entity Assets	$3,741,063	$3,972,572

56 2007 Performance and Accountability Report

NOTE 3. Fund Balance with Treasury

Fund balances with Treasury, by type of fund, as of September 30, are as follows:

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Fund Balance:		
General Funds	$ 5,817,111	$ 5,107,369
Other Funds	70,928	71,524
Total Fund Balance with Treasury	$5,888,039	$5,178,893
Status of Fund Balance with Treasury		
Unobligated Balance		
Available	6,068	14,978
Unavailable	83,944	4,863,083
Obligated Balance not yet Disbursed	254,660	229,308
Non-Budgetary Fund Balance with Treasury	5,543,367	71,524
Total Fund Balance with Treasury	$5,888,039	$5,178,893

Starting in FY 2007 the SEC changed its method of accounting for the user fees collected in excess of the current year appropriations. This change in accounting principle resulted in a change in the Status of Fund Balance with Treasury in the FY 2006 Unavailable amount to be recorded as a Non-Budgetary Fund Balance with Treasury transaction in the current year. Refer to *Note 1.C. Change in Accounting Principle* and *Note 1.R. Budgets and Budgetary Accounting*.

NOTE 4. Investments

At September 30, 2007, investments consist of the following:

(DOLLARS IN THOUSANDS)	COST	AMORTIZATION METHOD	AMORTIZED (PREMIUM) DISCOUNT	INVESTMENT NET	MARKET VALUE DISCLOSURE
Non-Marketable Market Based Securities	$3,588,309	S/L	$14,202	$3,602,511	$3,605,239

At September 30, 2006, investments consist of the following:

(DOLLARS IN THOUSANDS)	COST	AMORTIZATION METHOD	AMORTIZED (PREMIUM) DISCOUNT	INVESTMENT NET	MARKET VALUE DISCLOSURE
Non-Marketable Market Based Securities	$3,652,749	S/L	$21,779	$3,674,528	$3,676,439

The SEC invests these funds in Overnight and Short-Term Market-Based Treasury Bills. Interest earned on investments of qualified settlement funds is subject to income tax under Section 468B(b) of the Internal Revenue Code.

Treasury Bills are securities traded in the primary and secondary U.S. Treasury market. Originally, Treasury Bills are auctioned directly by the U.S. government in the primary U.S. Treasury market and are subsequently traded among investors in the secondary U.S. Treasury market. In accordance with GAAP, SEC records the value of its investments in U.S. Treasury Bills at cost and amortizes the discount on a straight line basis through the maturity date of these securities. The market value is determined by the secondary U.S. Treasury market and represents the value an individual investor is willing to pay for these securities, at a given point in time.

NOTE 5. Accounts Receivable, Net

At September 30, 2007, accounts receivable consisted of the following:

(DOLLARS IN THOUSANDS)	GROSS RECEIVABLES	ALLOWANCE	NET RECEIVABLES
Non-Entity Intragovernmental Assets:			
Interest on Investments	$ 155	$ —	$ 155
Subtotal Intragovernmental Assets	155	—	155
Entity Non-Intragovernmental Assets:			
Exchange Fees	74,422	—	74,422
Filing Fees	355	11	344
Other	318	5	313
Non-Entity Assets:			
Disgorgement and Penalties	329,584	265,974	63,610
FOIA	6	2	4
Subtotal Non-Intragovernmental Assets	404,685	265,992	138,693
Total	$404,840	$265,992	$138,848

At September 30, 2006, accounts receivable consisted of the following:

(DOLLARS IN THOUSANDS)	GROSS RECEIVABLES	ALLOWANCE	NET RECEIVABLES
Entity Intragovernmental Assets:			
Due for Reimbursable Agreements	$ 131	$ —	$ 131
Non-Entity Intragovernmental Assets:			
Disgorgement and Penalties	154,375	—	154,375
Subtotal Intragovernmental Assets	154,506	—	154,506
Entity Non-Intragovernmental Assets:			
Exchange Fees	105,416	—	105,416
Filing Fees	232	5	227
Other	305	2	303
Non-Entity Assets			
Fines and Penalties	247,631	176,086	71,545
Subtotal Non-Intragovernmental Assets	353,584	176,093	177,491
Total	$508,090	$176,093	$331,997

The SEC writes off debts that are two or more years old by removing the amount of the debts from the gross accounts receivable and any related allowance for doubtful accounts. Refer to *Note 1.J. Accounts Receivable and Allowance for Uncollectible Accounts* for methods used to estimate allowances.

NOTE 6. Property and Equipment, Net

At September 30, 2007, property and equipment consisted of the following:

CLASS OF PROPERTY (DOLLARS IN THOUSANDS)	DEPRECIATION/ AMORTIZATION METHOD	CAPITALIZATION THRESHOLD FOR INDIVIDUAL PURCHASES	CAPITALIZATION THRESHOLD FOR BULK PURCHASES	SERVICE LIFE (YEARS)	ACQUISITION VALUE	ACCUMULATED DEPRECIATION/ AMORTIZATION	BOOK VALUE
Furniture	S/L	$ 15	$ 50	5	$ 9,975	$ 4,227	$ 5,748
Equipment	S/L	$ 15	$500	3	48,509	37,866	10,643
Software	S/L	$300	$300	3–5	68,119	47,117	21,002
Leasehold Improvements	S/L	$300	N/A	10	74,167	13,280	60,887
Total					$200,770	$102,490	$ 98,280

At September 30, 2006, property and equipment consisted of the following:

CLASS OF PROPERTY (DOLLARS IN THOUSANDS)	DEPRECIATION/ AMORTIZATION METHOD	CAPITALIZATION THRESHOLD FOR INDIVIDUAL PURCHASES	CAPITALIZATION THRESHOLD FOR BULK PURCHASES	SERVICE LIFE (YEARS)	ACQUISITION VALUE	ACCUMULATED DEPRECIATION/ AMORTIZATION	BOOK VALUE
Furniture	S/L	$ 15	$ 50	5	$ 8,569	$ 2,165	$ 6,404
Equipment	S/L	$ 15	$500	3	37,155	25,788	11,367
Software	S/L	$300	$300	3–5	58,828	36,032	22,796
Leasehold Improvements	S/L	$300	N/A	10	69,104	6,040	63,064
Total					$173,656	$ 70,025	$103,631

NOTE 7. Liabilities Not Covered by Budgetary Resources

At September 30, liabilities consisted of the following:

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Liabilities Not Covered by Budgetary Resources		
Intragovernmental		
Unfunded FECA and Unemployment Liability	$ 1,109	$ 992
Total Intragovernmental Liabilities	1,109	992
Other Accrued Liabilities—Recognition of Lease Liability	16,865	27,641
Accrued Leave	35,296	32,974
Actuarial FECA Liability	5,080	4,813
Total Liabilities Not Covered by Budgetary Resources	58,350	66,420
Liabilities Not Requiring Budgetary Resources		
Registrant Deposits	61,689	57,464
Custodial Liability	63,614	71,545
Fiduciary Liability	3,615,760	3,834,662
Total Liabilities Not Requiring Budgetary Resources	3,741,063	3,963,671
Liabilities Covered by Budgetary Resources		
Intragovernmental		
Accounts Payable	6,153	14,527
Employee Benefits	2,699	2,687
Total Intragovernmental Liabilities	8,852	17,214
Accounts Payable	43,096	47,608
Accrued Payroll and Benefits	18,176	18,149
Other	6,473	14,839
Total Liabilities Covered by Budgetary Resources	76,597	97,810
Total Liabilities	$3,876,010	$4,127,901

SEC's liabilities include amounts that will never require the use of a budgetary resource. These liabilities consist of registrant deposit accounts; accounts receivable for disgorgement, penalties, and interest assessed against securities laws violators; and invested and uninvested fiduciary assets held by the SEC on behalf of harmed investors.

NOTE 8. Actuarial FECA Liability

The FECA provides income and medical cost protection to covered federal civilian employees harmed on the job and for those who have contracted a work-related occupational disease, and dependents of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits under the FECA for the SEC's employees are administered by the DOL and, ultimately, are paid by the SEC.

The SEC's estimate is based on the DOL's model for estimating the FECA actuarial liability for federal agencies not specified in the DOL's FECA model. The model considers the average amount of benefit payments incurred by the SEC for the past three fiscal years, multiplied by the medical and compensation liability to benefits paid (LBP) ratio for the whole FECA program, estimated at approximately 11 times the annual payments. To capture variability, the model estimates the liability using three sets of LBP ratios, summarized as follows:

For FY 2007, the LBP ratios were as follows:

LBP CATEGORY	MEDICAL	COMPENSATION
Highest	9.50%	12.20%
Overall Average	8.00%	11.80%
Lowest	7.20%	11.50%

For FY 2006, the LBP ratios were as follows:

LBP CATEGORY	MEDICAL	COMPENSATION
Highest	9.70%	12.80%
Overall Average	8.00%	11.90%
Lowest	7.10%	11.40%

For FY 2007 and 2006, the SEC used the overall average LBP ratios to calculate the $5.1 million and $4.8 million FECA actuarial liabilities for those years, respectively.

NOTE 9. Leases

The SEC has the authority to negotiate long-term leases for office space. At September 30, 2007, the SEC leased office space at 18 locations under operating lease agreements that expire between 2008 and 2021. The SEC paid $85,497 thousand and $80,958 thousand for rent for FY 2007 and 2006, respectively. Under existing commitments, the minimum lease payments through FY 2012 and thereafter are as follows:

FISCAL YEAR (DOLLARS IN THOUSANDS)	MINIMUM LEASE PAYMENTS
2008	$ 80,848
2009	78,566
2010	76,692
2011	76,595
2012	67,723
2013 and thereafter	403,683
Total Future Minimum Lease Payments	$784,107

The total future minimum lease payments summarized above include a liability the SEC has recognized for office space leased in Washington, D.C. and New York. During FY 2006, the SEC moved into new office space and vacated old office space in Washington, D.C. While the SEC is marketing the old office space for potential tenants, the SEC is responsible for the remaining $1,909 thousand of lease payments that end in FY 2008.

FISCAL YEAR (DOLLARS IN THOUSANDS)	REQUIRED LEASE PAYMENTS		
	NEW YORK	WASHINGTON, D.C.	TOTAL
2008	$ 2,722	$1,909	$ 4,631
2009	2,722	—	2,722
2010	2,722	—	2,722
2011	2,469	—	2,469
2012	1,192	—	1,192
Total Future Estimated Lease Payments	$11,827	$1,909	$13,736

During FY 2005, the SEC also entered into a lease agreement for new office space in New York. With respect to its prior New York office space, the SEC and U.S. General Services Administration (GSA) entered into separate agreements with the lessor. The GSA has agreed to rent the office space from the lessor for the next five years of the SEC's lease. At that time, the GSA has the option to renew the agreement for the remaining 15 months of the SEC's lease. As part of the SEC's agreement with the lessor, the SEC was responsible for the estimated $18 million difference between its annual lease liability and the annual lease liability negotiated by the GSA with the lessor. As of FY 2007, the SEC is responsible for the remaining $11,827 thousand of lease payments that end in FY 2012.

In FY 2006, the SEC recorded an additional six months of rent expense totaling approximately $4.4 million and recorded a reduction to the liability for six months totaling $0.3 million. In FY 2007, the SEC recorded a reduction to the liability totaling $10.7 million. For FY 2007 and 2006, the SEC recognized an unfunded liability of $16.9 million and $27.6 million, respectively to cover the three lease obligations (See *Note 7. Liabilities Not Covered by Budgetary Resources*).

NOTE 10. Imputed Financing

The SEC recognizes an imputed financing source and corresponding expense to represent its share of the cost to the federal government of providing pension and post-retirement health and life insurance benefits (Pension/Other Retirements Benefits (ORB)) to all eligible SEC employees. For September 30, 2007 and 2006, the components of the imputed financing sources and corresponding expenses were as follows:

PENSION/ORB CATEGORY (DOLLARS IN THOUSANDS)	FY 2007	FY 2006
CSRS	$ 6,113	$ 6,956
FERS	1,386	1,269
FEHB	18,838	18,525
FEGLI	89	93
Other	11	7
Total Pension/ORB	$26,437	$26,850

NOTE 11. Commitments and Contingencies

A. Commitments

The Securities Investor Protection Act of 1970 (SIPA), as amended created the SIPC to provide certain financial protections to customers of insolvent registered securities brokers, dealers, firms, and members of national securities exchanges for up to $500,000 per customer. The SIPA authorizes the SIPC to create a fund to maintain all moneys received and disbursed by the SIPC. The SIPA also gives the SIPC the authority to borrow funds from the SEC in an amount not to exceed in the aggregate $1 billion in the event that the SIPC fund is or may appear insufficient for purposes of the SIPA. If necessary, these funds would be made available to the SEC through the purchase by the Treasury of notes or other obligating instruments issued by the SEC. Such notes or other obligating instruments would bear interest at a rate determined by the Secretary of the Treasury. As of September 30, 2007, the SEC had not loaned any funds to the SIPC, and there are no outstanding notes or other obligating instruments issued by the SEC.

In addition to future lease commitments discussed in *Note 9. Leases*, the SEC is obligated for the purchase of goods and services that have been ordered, but not yet received. For FY 2007, net obligations for all of SEC's activities were $254,660 thousand and of this amount $80,731 thousand were delivered and unpaid. For FY 2006, net obligations for all of SEC's activities were $229,308 thousand and of this amount $89,507 thousand were delivered and unpaid.

B. Contingencies

Contingent liabilities are recognized when a past event or exchange transaction has occurred, a future outflow or other sacrifice of resources is probable, and the future outflow or sacrifice of resources is measurable.

The SEC is party to various routine administrative proceedings, legal actions, and claims brought by or against it, including threatened or pending litigation involving labor relations claims, some of which may ultimately result in settlements or decisions against the federal government. As of September 30, 2007, SEC management does not owe for claims.

NOTE 12. Intragovernmental Costs and Exchange Revenue

All costs incurred during FY 2007 and 2006 were assigned to specific goals, but exchange revenue is not directly assignable to a specific goal, and is presented in total. Total intragovernmental and public costs at September 30, are summarized below.

PROGRAM GOALS (DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Enforce compliance with federal securities laws		
Intragovernmental costs	$ 82,118	$ 95,152
Public costs	447,336	483,924
Subtotal—Enforce compliance with federal securities laws	529,454	579,076
Promote healthy capital markets through an effective and flexible regulatory environment		
Intragovernmental costs	12,362	12,695
Public costs	67,342	64,568
Subtotal—Promote healthy capital markets through an effective and flexible regulatory environment	79,704	77,263
Foster informed investment decision making		
Intragovernmental costs	21,081	22,323
Public costs	114,836	113,533
Subtotal—Foster informed investment decision making	135,917	135,856
Maximize the use of SEC resources		
Intragovernmental costs	15,117	15,894
Public costs	82,349	80,834
Subtotal—Maximize the use of SEC resources	97,466	96,728
Total Entity		
Intragovernmental Costs	130,678	146,064
Public Costs	711,863	742,859
Total Costs	$ 842,541	$ 888,923
Less: Exchange Revenues	1,507,750	1,882,619
Net (Income) from Operations	$(665,209)	$(993,696)

NOTE 13. Exchange Revenues

For FY 2007 and 2006, exchange revenues consisted of the following:

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Securities Transactions Fees	$1,249,019	$1,382,805
Securities Registration, Tender Offer, and Merger Fees	258,490	499,236
Other	241	578
Total Exchange Revenues	$1,507,750	$1,882,619

NOTE 14. Status of Budgetary Resources

A. Apportionment Categories of Obligations Incurred

The distinction between Category A and B funds is that Category A funds are subject to quarterly apportionment by the OMB, while Category B funds are available for use by the agency without being subject to quarterly apportionment. For FY 2007 and 2006, obligations incurred as reported on the Statement of Budgetary Resources consisted of the following:

OBLIGATIONS INCURRED (DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Direct Obligations		
Category A	$876,274	$896,911
Total Direct Obligations	876,274	896,911
Reimbursable Obligations		
Category B	321	519
Total Reimbursable Obligations	321	519
Total Obligations Incurred	$876,595	$897,430

In addition, the amounts of budgetary resources obligated for undelivered orders include $173,929 thousand and $140,595 thousand as of September 30, 2007 and 2006, respectively.

B. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the United States Government

A comparison between the Statements of Budgetary Resources and the actual FY 2007 data in the President's Budget cannot be performed as the FY 2009 President's Budget is not yet available; the comparison will be presented in next year's financial statements. A comparison between the FY 2006 Statement of Budgetary Resources and the FY 2006 data in the President's Budget is as follows:

(DOLLARS IN MILLIONS)	TOTAL BUDGETARY RESOURCES/STATUS OF BUDGETARY RESOURCES	TOTAL NEW OBLIGATIONS	TEMPORARILY NOT AVAILABLE PURSUANT TO PUBLIC LAW	UNOBLIGATED BALANCE— END OF YEAR	OBLIGATIONS INCURRED	NET OUTLAYS
SBR	$5,775	$897	$ —	$4,878	$897	$ (982)
Reconciling Items	4,861	19	1,041	4,842	19	51
Budget of the U.S. Government	$ 914	$878	$(1,041)	$ 36	$878	$(1,033)

In the past, the SEC recorded excess collections as unapportioned authority. This amount is presented on the SBR as *Unobligated Balance, Brought Forward, October 1* and as *Unobligated Balance Not Available*. This SBR presentation differs from the treatment of these balances on the Program and Financing (P&F) Statement included in the Budget of the United States, in that this amount is presented in a memorandum account on the P&F rather than as a component of agency resources.

Under a change in accounting methodology made in the third quarter, SEC will reflect the current years' excess offsetting collections as *Temporarily Not Available Pursuant to Public Law*. Accordingly, the SBR, *Unobligated Balance, Brought Forward, October 1* will appear net of excess collections resolving the reconciling items. To effect this change, an adjustment in the amount of $4,691 million was made decreasing both *Unobligated Balance, Brought Forward, October 1* and *Unobligated Balance Not Available*.

The SBR reports all obligations incurred while the President's Budget excludes expired accounts that are no longer available for new obligations. The net outlays do not agree, due to the fact that the P&F does not include Distributed Offsetting Receipts.

NOTE 15. Custodial Revenues and Liabilities

For FY 2007, the source of custodial revenues consisted of the following:

(DOLLARS IN THOUSANDS)	DISGORGEMENT AND PENALTIES	OTHER	TOTAL
Cash Collections	$ 496,386	$138	$ 496,524
Less: Refunds	—	—	—
Net Cash Collections	496,386	138	496,524
Increase/(Decrease) in Amounts to be Collected	(7,935)	4	(7,931)
Total Non-Exchange Revenues	$ 488,451	$142	$ 488,593

For FY 2007, the source of custodial liabilities consisted of the following:

(DOLLARS IN THOUSANDS)	DISGORGEMENT AND PENALTIES	FOIA	TOTAL
Gross Custodial Accounts Receivable	$ 329,584	$ 6	$ 329,590
Less: Allowance for Doubtful Accounts	(265,974)	(2)	(265,976)
Net Custodial Liability	$ 63,610	$ 4	$ 63,614

For FY 2006, the source of custodial revenues consisted of the following:

(DOLLARS IN THOUSANDS)	DISGORGEMENT AND PENALTIES	OTHER	TOTAL
Cash Collections	$1,804,043	$ 90	$1,804,133
Less: Refunds	—	—	
Net Cash Collections	1,804,043	90	1,804,133
Increase/(Decrease) in Amounts to be Collected	(23,967)	—	(23,967)
Total Non-Exchange Revenues	$1,780,076	$ 90	$1,780,166

For FY 2006, the source of custodial liabilities consisted of the following:

(DOLLARS IN THOUSANDS)	DISGORGEMENT AND PENALTIES	FOIA	TOTAL
Gross Custodial Accounts Receivable	$ 247,631	$ —	$ 247,631
Less: Allowance for Doubtful Accounts	(176,086)	—	(176,086)
Net Custodial Liability	$ 71,545	$ —	$ 71,545

NOTE 16. Fiduciary Assets and Liabilities

At September 30, 2007 and 2006, the assets held by the SEC in a fiduciary capacity and its offsetting liability consisted of the following:

FIDUCIARY ACTIVITIES (DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Assets		
Fund Balance with Treasury	$ 13,094	$ 5,759
Investments	3,602,511	3,674,528
Accounts Receivable	155	154,375
Total Assets	$3,615,760	$3,834,662
Liabilities		
Liability for Fiduciary Activity	$3,615,760	$3,834,662
Total Liabilities	$3,615,760	$3,834,662

At September 30, 2007 and 2006, the source and disposition of the SEC's fiduciary activities consisted of the following:

FIDUCIARY ACTIVITIES (DOLLARS IN THOUSANDS)	FY 2007	FY 2006
Fund Balance with Treasury		
Beginning Balance	$ 5,759	$ 207,529
Disgorgement and Penalties	321,866	1,639,914
Transfer to Investments	(314,531)	(1,841,684)
Total Fund Balance with Treasury	13,094	5,759
Investments		
Beginning Balance	3,674,528	1,768,024
Net Investments Activity—Disgorgement and Penalties	(72,017)	1,906,504
Total Investments	3,602,511	3,674,528
Accounts Receivable		
Beginning Balance	154,375	—
Net Activity—Accounts Receivable	(154,220)	154,375
Total Accounts Receivable	155	154,375
Total Assets	$3,615,760	$3,834,662
Liability for Fiduciary Activity		
Beginning Balance	$3,834,662	$1,975,553
Disgorgement and Penalties	(218,902)	1,859,109
Total Liabilities	$3,615,760	$3,834,662

NOTE 17. Reconciliation of Net Cost of Operations (Proprietary) to Budget (formerly the Statement of Financing)

(DOLLARS IN THOUSANDS)	FY 2007	FY 2006
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated:		
Obligations Incurred (Note 14)	$ 876,595	$ 897,430
Less: Spending Authority from Offsetting Collections and Recoveries	(1,560,985)	(1,936,658)
Net Obligations	(684,390)	(1,039,228)
Other Resources:		
Imputed Financing from Cost Absorbed by Others (Note 10)	26,437	26,850
Total Resources Used to Finance Activities	(657,953)	(1,012,378)
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered But Not Yet Provided	(35,123)	21,831
Resources That Finance the Acquisition of Assets Capitalized on the Balance Sheet	(31,793)	(57,658)
Net Decrease in Revenue Receivables Not Generating Resources until Collected	30,855	20,941
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(36,061)	(14,886)
Total Resources Used to Finance the Net Cost of Operations	(694,014)	(1,027,264)
COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Components Requiring or Generating Resources in Future Periods:		
Costs That Will Be Funded by Resources in Future Periods	2,322	950
Change in Lease Liability	(10,776)	5,994
Change in Unfunded Liability	385	(715)
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	(8,069)	6,229
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	35,912	26,265
Revaluation of Assets or Liabilities	950	1,071
Other Costs That Will Not Require Resources	12	3
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in Future Periods	36,874	27,339
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	28,805	33,568
Net (Income) from Operations	$ (665,209)	$ (993,696)

Appendix III: Comments from the Securities and Exchange Commission

CHRISTOPHER COX
CHAIRMAN

HEADQUARTERS
100 F STREET, NE
WASHINGTON, DC 20549

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

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November 14, 2007

The Honorable David M. Walker
Comptroller General of the United States
Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Walker:

Thank you for the opportunity to respond to the Government Accountability Office's (GAO) draft report entitled Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2007 and 2006. I would like to personally acknowledge and commend you and the GAO staff for your efforts and dedication in working with the SEC again this year to meet the reporting deadline for our audited financial statements.

I am pleased that once again the audit found that the statements and notes are presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles, and that it found no instances of reportable noncompliance with laws and regulations tested. I also appreciate the progress that you have helped the SEC make during the past year in strengthening our internal controls over financial reporting. As you know, in 2008 the agency will introduce several new technology upgrades designed to support the preparation of reliable audited financial statements. The phase-in of these new software systems is designed to eliminate the material weakness in the SEC's internal controls cited in the draft report, stemming in substantial part from the lack of integration and compatibility in the agency's legacy automated systems. The SEC intends to remediate this material weakness before the end of fiscal 2008, and to address each of the findings and recommendations identified during the audit. We will continue to work with you and your staff to enhance the SEC's controls in all operational areas, and ensure reliability of financial reporting, soundness of operations, and public confidence in the agency's mission.

If you have any questions relating to our response, please contact Kristine Chadwick, Chief Financial Officer, at (202) 551-7840.

Sincerely,

Christopher Cox
Chairman

CHAIRMANOFFICE@SEC.GOV
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(194654)

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