



441 G St. N.W.  
Washington, DC 20548

November 15, 2018

The Honorable Jay Clayton  
Chairman  
United States Securities and Exchange Commission

**Financial Audit: Securities and Exchange Commission’s Fiscal Years 2018 and 2017  
Financial Statements**

Dear Mr. Clayton:

This report transmits the GAO auditor’s report on the results of our audits of the fiscal years 2018 and 2017 financial statements of the United States Securities and Exchange Commission (SEC) and its Investor Protection Fund (IPF),<sup>1</sup> which is incorporated in the enclosed *U.S. Securities and Exchange Commission Fiscal Year 2018 Agency Financial Report*.

As discussed more fully in the auditor’s report that begins on page 51 of the enclosed agency financial report, we found

- the financial statements of SEC and its IPF as of and for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- SEC maintained, in all material respects, effective internal control over financial reporting for SEC and for IPF as of September 30, 2018; and
- no reportable noncompliance for fiscal year 2018 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The Accountability of Tax Dollars Act of 2002 requires that SEC annually prepare and submit audited financial statements to Congress and the Office of Management and Budget.<sup>2</sup> The Securities Exchange Act of 1934, as amended in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires SEC to annually prepare and submit a complete set of audited financial statements for IPF to Congress.<sup>3</sup> In accordance with the authority conferred by the Chief Financial Officers Act of 1990, as amended

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<sup>1</sup>IPF, which was established in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), funds the activities of SEC’s whistleblower award program under that section and the SEC Office of Inspector General Employee Suggestion Program established under section 966 of the Dodd-Frank Act. Pub. L. No. 111-203, §§ 922(a), 966, 124 Stat. 1376, 1844, 1912-13 (July 21, 2010), *classified at* 15 U.S.C. §§ 78d-4(e), 78u-6(b), (g). IPF is a separate SEC fund and its financial statements present SEC’s financial activity associated with these programs. Accordingly, IPF’s financial transactions are also included in SEC’s overall financial statements.

<sup>2</sup>Pub. L. No. 107-289, § 2, 116 Stat. 2049-50 (Nov. 7, 2002), *amending* 31 U.S.C. § 3515.

<sup>3</sup>Dodd-Frank Act, § 922(a), 124 Stat. 1844 (July 21, 2010), *adding* § 21F(g)(5) of the Securities Exchange Act of 1934, *classified at* 15 U.S.C. § 78u-6(g)(5).

by the Government Management Reform Act of 1994,<sup>4</sup> we have audited the SEC and IPF financial statements. Section 963 of the Dodd-Frank Act further requires that (1) SEC annually submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year; (2) the SEC Chairman and Chief Financial Officer attest to SEC's report; and (3) GAO assess the effectiveness of SEC's internal control over financial reporting and evaluate, attest to, and report on SEC's assessment.<sup>5</sup> Accordingly, this report also includes our reporting in response to the requirement under section 963 of the Dodd-Frank Act.

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We are sending copies of this report to the Chairmen and Ranking 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, the report is available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have questions about this report, please contact me at (202) 512-3133 or [dalkinj@gao.gov](mailto:dalkinj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report.

Sincerely yours,



James R. Dalkin  
Director  
Financial Management and Assurance

Enclosure

(102571)

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<sup>4</sup>See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), *codified, in relevant part, as amended, at* 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), *codified, in relevant part, as amended, at* 31 U.S.C. § 3515(c).

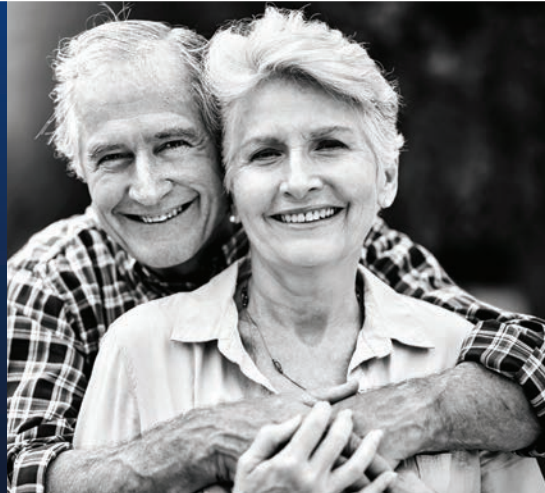
<sup>5</sup>Dodd-Frank Act, § 963(a), (b), 124 Stat. 1910 (July 21, 2010), *classified at* 15 U.S.C. § 78d-8(a), (b).

U.S. SECURITIES AND EXCHANGE COMMISSION

# Agency Financial Report

FISCAL YEAR 2018

PROTECTING  
INVESTORS



MAINTAINING  
FAIR, ORDERLY,  
AND EFFICIENT  
MARKETS



FACILITATING  
CAPITAL  
FORMATION



# MESSAGE FROM THE CHAIRMAN



Chairing the U.S. Securities and Exchange Commission is a great privilege and I am fortunate to be able to observe firsthand the incredible work done by the agency's 4,500 dedicated staff. In the pages that follow, you will find a record of their work in pursuit of the SEC's three-part mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.

The SEC recently released our Strategic Plan for 2018–2022, which outlines three goals that will guide the work of the Commission moving forward. I believe that in the body of this report, you will see we have made meaningful progress over the past year toward satisfying these goals.

The first of our goals is focusing on the long-term interests of our Main Street investors. The past year has presented many opportunities for me, my fellow Commissioners, and SEC staff to travel around the country and interact directly with these investors. Those discussions allowed us to better answer the question we ask ourselves every day: how does our work benefit the retail investor? Each proposal or action we take is guided by that principle. To highlight just a few examples of the progress we've made over the past year:

- We introduced our **Regulation Best Interest** proposals, which are designed to serve Main Street investors by updating and enhancing the standards governing broker-dealers and investment advisers to bring them in line with what Main Street investors would expect.
- Our **Retail Strategy Task Force**, launched last year, continued its work in developing proactive, targeted initiatives to identify misconduct impacting retail investors.
- The Office of Investor Education and Advocacy launched a **multimedia campaign** warning investors of common hallmarks of fraud.
- Our efforts in the **municipal bond market**, a largely retail market, are bringing greater transparency to trading and better equip investors to make informed decisions about municipal securities.



Our second goal—to be innovative and responsive—reflects the changing nature of our markets. As technological advancements and commercial developments have changed how our securities markets operate, the SEC’s ability to remain an effective regulator requires that we continually monitor the market environment and adapt our rules, regulations, and oversight. This maxim applies to nearly every facet of what we do at the SEC, and recently drove us to establish a Cyber Unit in the Division of Enforcement, which enhances our ability to detect and investigate cyber threats and fraud by concentrating expertise in an area that has become increasingly susceptible to misconduct.

The third goal—elevating the agency’s performance through technology, data analytics, and human capital—embodies our commitment to maintaining an effective and efficient operation. We are leveraging technology, analyzing data, and promoting information-sharing and collaboration across the agency, while also maintaining the work environment that has led to our consistent high levels of employee satisfaction. Maintaining a high level of staff engagement, performance, and morale is critical to our ability to execute our mission. We are committed to investing in both new technology and human capital.

This FY 2018 Agency Financial Report also includes the results of the independent audit of our FY 2018 financial statements, which I am pleased to announce is an unmodified opinion. The financial and performance data in this report are also complete and accurate under the Office of Management and Budget guidance. As further discussed within the Management Assurances section of Management’s Discussion and Analysis, we continue to report a material weakness in cybersecurity risks. We have taken a series of substantive steps designed to better detect and prevent code vulnerabilities over this past year. During the coming year, among other projects designed to improve the security of the agency’s information systems and overall cybersecurity risk profile, the SEC will focus on the associated aspects of our system of internal control. The SEC will work to document and test—and, where appropriate, enhance—controls relating to information technology.

I am proud of what we have accomplished in the past year and look forward to building on these successes as we continually review and recalibrate our approach to accomplishing the SEC’s mission.



JAY CLAYTON

Chairman  
November 13, 2018

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## CERTIFICATE OF EXCELLENCE IN ACCOUNTABILITY REPORTING

The SEC's fiscal year 2017 Agency Financial Report received the Certificate of Excellence in Accountability Reporting from the Association of Government Accountants. This was the 12th year in a row that the SEC has won this award, which is presented to federal government agencies whose annual reports achieve the highest standards in demonstrating accountability and communicating results.





# INTRODUCTION

The SEC's fiscal year (FY) 2018 Agency Financial Report (AFR) provides detailed financial and performance information that enables the President, Congress, and the public to assess the agency's accomplishments and understand its financial and operational picture. In lieu of a combined Performance and Accountability Report, the SEC will also publish an Annual Performance Report (APR) to provide a more in-depth review of strategic goals and performance results. The APR will be included in the FY 2020 Congressional Budget Justification Report available in 2019.

The FY 2018 AFR satisfies the requirements contained in the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, and contains three main sections and supplemental appendices.

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## Management's Discussion and Analysis

Provides a high-level overview of the SEC—its history, mission, and organizational structure—and the agency's FY 2018 overall performance as related to its strategic goals and primary initiatives. Also in this section are management's assurances on internal controls and the agency's forward-looking information.

## Financial Section

Contains audited financial statements, accompanying notes, and required supplementary information, as well as the independent auditor's report on these statements and management's response to that report. Also included are comparative financial statements and accompanying notes for the Investor Protection Fund.

## Other Information

Details the agency's compliance with, and commitment to, specific regulations. Included in this section are performance and management analyses and recommendations from the Office of Inspector General and the SEC's response to that information in accordance with the Reports Consolidation Act of 2000; a detailed explanation of any significant erroneous payments and overpayments recaptured as required by the Improper Payments Information Act of 2002, as amended; and a table displaying recent inflationary adjustments made to civil monetary penalties in accordance with the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended.

## Appendices

Offers additional resources related to the agency and this report: a glossary of terms, frequently used acronyms and abbreviations, biographies, and contact information.



Electronic copies of this AFR and prior year budget reports are available at [SEC.gov/about/secreports.shtml](https://www.sec.gov/about/secreports.shtml).



# MANAGEMENT'S DISCUSSION AND ANALYSIS

This section provides a high-level overview of the agency, its FY 2018 program and financial performance, and forward-looking information.

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## Mission, Vision, Values, and Goals

Explains the SEC's mission, vision, values, and three strategic goals, as set forth in the agency's Strategic Plan.

## History and Purpose

Provides background on the SEC and its responsibility to oversee the nation's securities markets and certain primary participants.

## Organizational Structure and Resources

Lists the SEC's office locations, organizational structure, and employment statistics, and summarizes the 10 major programs by responsible divisions and offices.

## Year in Review

Summarizes efforts made by the SEC in pursuit of its strategic goals in FY 2018.

## Looking Forward

Details specific areas that the SEC will continue to focus on as part of its regulatory and oversight responsibilities.

## Financial Highlights

Provides an overview of the SEC's financial information, including an analysis of the financial data presented in the audited financial statements, the limitations of the financial statements, and the sources and uses of the SEC's funds.

## Performance Highlights

Discusses the SEC's strategic and performance planning framework; the process used to verify and validate the performance results; the FY 2018 performance results by strategic goal; and key performance accomplishments.

## Management Assurances and Compliance with Other Laws

Provides management's assessment and assurances on the SEC's internal controls under the Federal Managers' Financial Integrity Act of 1982, and on the compliance of the SEC's financial systems with federal requirements under the Federal Financial Management Improvement Act of 1996. It also addresses the SEC's compliance with the Federal Information Security Modernization Act of 2014 and other laws and regulations.

## Our Mission

To protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.

## Our Vision

To promote capital markets that inspire public confidence and provide a diverse array of financial opportunities to retail and institutional investors, entrepreneurs, public companies and other market participants.

## Our Values

### INTEGRITY

We inspire public confidence and trust by adhering to the highest ethical standards.

### EXCELLENCE

We are committed to excellence in pursuit of our mission on behalf of the American public.

### ACCOUNTABILITY

We embrace our responsibilities and hold ourselves accountable to the American public.

### TEAMWORK

We recognize that success depends on a skilled, diverse, coordinated team committed to the highest standards of trust, hard work, cooperation, and communication.

### FAIRNESS

We treat investors, market participants, and others fairly and in accordance with the law.

### EFFECTIVENESS

We strive for innovative, flexible, and pragmatic regulatory approaches that achieve our goals and recognize the ever-changing nature of our capital markets.

## Strategic Goals and Strategic Initiatives



### STRATEGIC GOAL 1

Focus on the long-term interests of our Main Street investors.

Strategic Initiative 1.1: Enhance our understanding of the channels retail and institutional investors use to access our capital markets to more effectively tailor our policy initiatives.

Strategic Initiative 1.2: Enhance our outreach, education, and consultation efforts, including in ways that are reflective of the diversity of investors and businesses.

Strategic Initiative 1.3: Pursue enforcement and examination initiatives focused on identifying and addressing misconduct that impacts retail investors.

Strategic Initiative 1.4: Modernize design, delivery, and content of disclosure so investors, including in particular retail investors, can access readable, useful, and timely information to make informed investment decisions.

Strategic Initiative 1.5: Identify ways to increase the number and range of long-term, cost-effective investment options available to retail investors, including by expanding the number of companies that are SEC-registered and exchange-listed.



## STRATEGIC GOAL 2

Recognize significant developments and trends in our evolving capital markets and adjust our efforts to ensure we are effectively allocating our resources.

Strategic Initiative 2.1: Expand market knowledge and oversight capabilities to identify, understand, analyze, and respond effectively to market developments and risks.

Strategic Initiative 2.2: Identify, and take steps to address, existing SEC rules and approaches that are outdated.

Strategic Initiative 2.3: Examine strategies to address cyber and other system and infrastructure risks faced by our capital markets and our market participants.

Strategic Initiative 2.4: Promote agency preparedness and emergency response capabilities.



## STRATEGIC GOAL 3

Elevate the SEC's performance by enhancing our analytical capabilities and human capital development.

Strategic Initiative 3.1: Focus on the SEC's workforce to increase our capabilities, leverage our shared commitment to investors, and promote diversity, inclusion, and equality of opportunity among the agency's staff.

Strategic Initiative 3.2: Expand the use of risk and data analytics to inform how we set regulatory priorities and focus staff resources, including developing a data management program that treats data as an SEC-wide resource with appropriate data protections, enabling rigorous analysis at reduced cost.

Strategic Initiative 3.3: Enhance our analytics of market and industry data to prevent, detect, and prosecute improper behavior.

Strategic Initiative 3.4: Enhance the agency's internal control and risk management capabilities, including developing a robust and resilient program for dealing with threats to the security, integrity, and availability of the SEC's systems and sensitive data.

Strategic Initiative 3.5: Promote collaboration within and across SEC offices to ensure we are communicating effectively across the agency, including through evaluation of key internal processes that require significant collaboration.

## History and Purpose

Prior to the Great Crash of 1929, there was little support for federal regulation of the securities markets. This was particularly obvious during the post-World War I surge of securities activity. Proposals that the federal government require financial disclosure and prevent the fraudulent sale of stock were never seriously pursued.



We have sought to put forward the rule of fair play in finance and industry.

—Former President Franklin D. Roosevelt during a speech to Congress two days after signing the Securities Exchange Act of 1934



Tempted by promises of “rags to riches” transformations and easy credit, most investors gave little thought to the systemic risk that arose from widespread abuse of margin financing and unreliable information about the securities in which they were investing. During the 1920s, approximately 20 million shareholders took advantage of post-war prosperity and set out to make their fortunes in the stock market. It is estimated that one-half of the \$50 billion in new securities offered during this period became worthless.

When the stock market crashed in October 1929, public confidence in the markets plummeted. Investors and banks lost great sums of money in the ensuing Great Depression, and restoring faith in the capital markets was essential to economic recovery. Congress held hearings to identify problems and search for solutions.

Based on those hearings, Congress passed the Securities Act of 1933<sup>1</sup> (Securities Act)—the first federal law to regulate the issuance of securities—followed by the Securities Exchange Act of 1934<sup>2</sup> (Exchange Act).

The SEC was established to regulate and enforce this legislation.

These laws aim to provide investors and the markets with reliable information, clear rules for honest dealing, and specifically ensure the following:

- A company that publicly offers securities for investment dollars is forthcoming and transparent about its business, the securities it is selling, and the risks involved with investing; and
- A person who sells and trades securities does so in a fair and honest manner.

<sup>1</sup> More information about the Securities Act of 1933 can be found at [SEC.gov/about/laws/sa33.pdf](https://www.sec.gov/about/laws/sa33.pdf)

<sup>2</sup> More information about the Securities Exchange Act of 1934 can be found at [SEC.gov/about/laws/sea34.pdf](https://www.sec.gov/about/laws/sea34.pdf)

The SEC is responsible for overseeing the nation’s securities markets and certain primary participants, including broker-dealers, investment companies, investment advisers, clearing agencies, transfer agents, credit rating agencies, and securities exchanges, as well as organizations such as the Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board, and the Public Company Accounting Oversight Board. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010<sup>3</sup> (Dodd-Frank Act), the agency’s jurisdiction was

expanded to include certain participants in the derivatives markets, private fund advisers, and municipal advisers.

Each year, the SEC brings hundreds of civil enforcement actions against individuals and companies for violation of securities laws. Examples of infractions are insider trading, accounting fraud, market manipulation, and providing false or misleading information about securities and/or the issuing companies.

## SEC INVESTS IN... OUR MISSION

During World War II, one-third of the SEC's staff was called for military service, yet the agency's commitment to investors never wavered. To maintain operations, personnel at the Washington, DC, headquarters relocated to Philadelphia—and even set up temporary workstations in an empty swimming pool.



Image credit: SEC Historical Society ([www.sechistorical.org](http://www.sechistorical.org))

<sup>3</sup> More information about the Dodd-Frank Act can be found at [SEC.gov/about/laws/wallstreetreform-cpa.pdf](http://SEC.gov/about/laws/wallstreetreform-cpa.pdf)

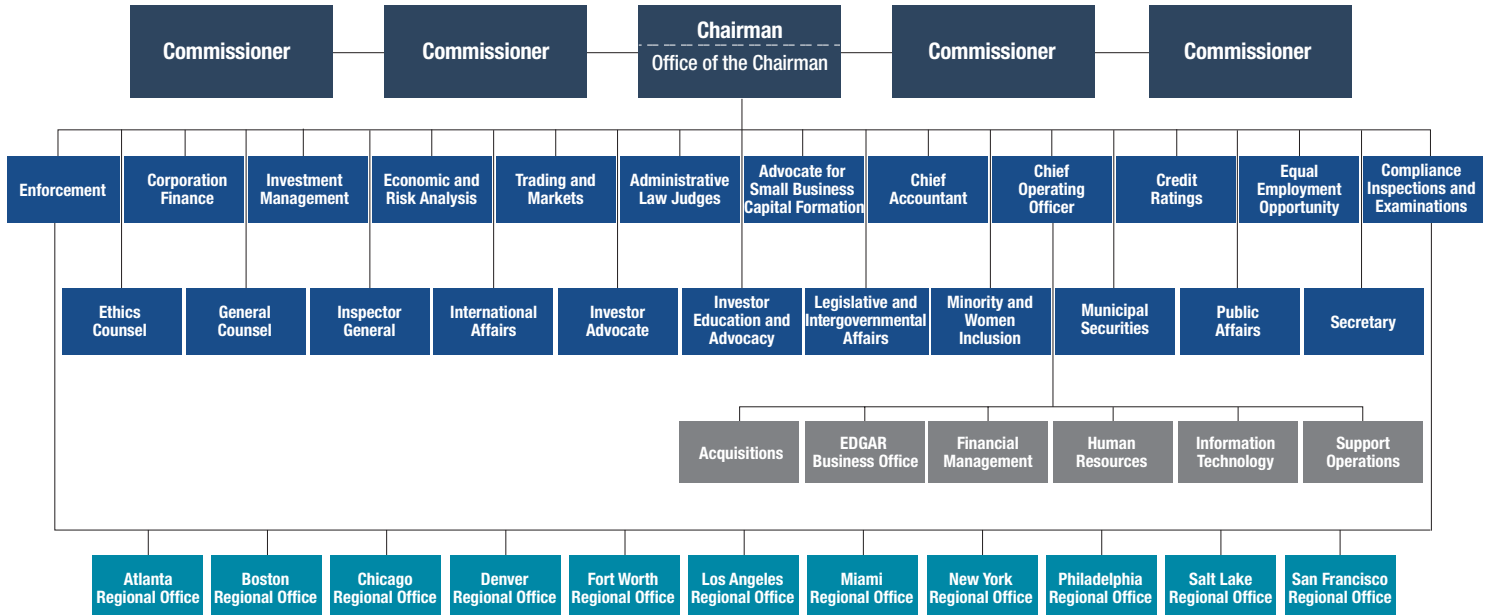


## Organizational Structure and Resources

The agency’s functional responsibilities are organized into 5 divisions and 25 offices. In FY 2018, the SEC employed 4,483 full-time equivalents (FTE), including 4,373 permanent and 110 other than permanent FTEs.

The chart below is accurate as of September 30, 2018.

Chart 1.1 | Organization Chart



The SEC is an independent federal agency led by a bipartisan, five-member Commission—one of whom is designated as the Chairman—with staggered five-year terms.

Each member of the Commission is appointed by the President and confirmed by the Senate (see *Appendix A: Chairman and Commissioner Biographies*).

The Chairman serves as the chief executive and, by law, no more than three of the Commissioners may belong to the same political party.

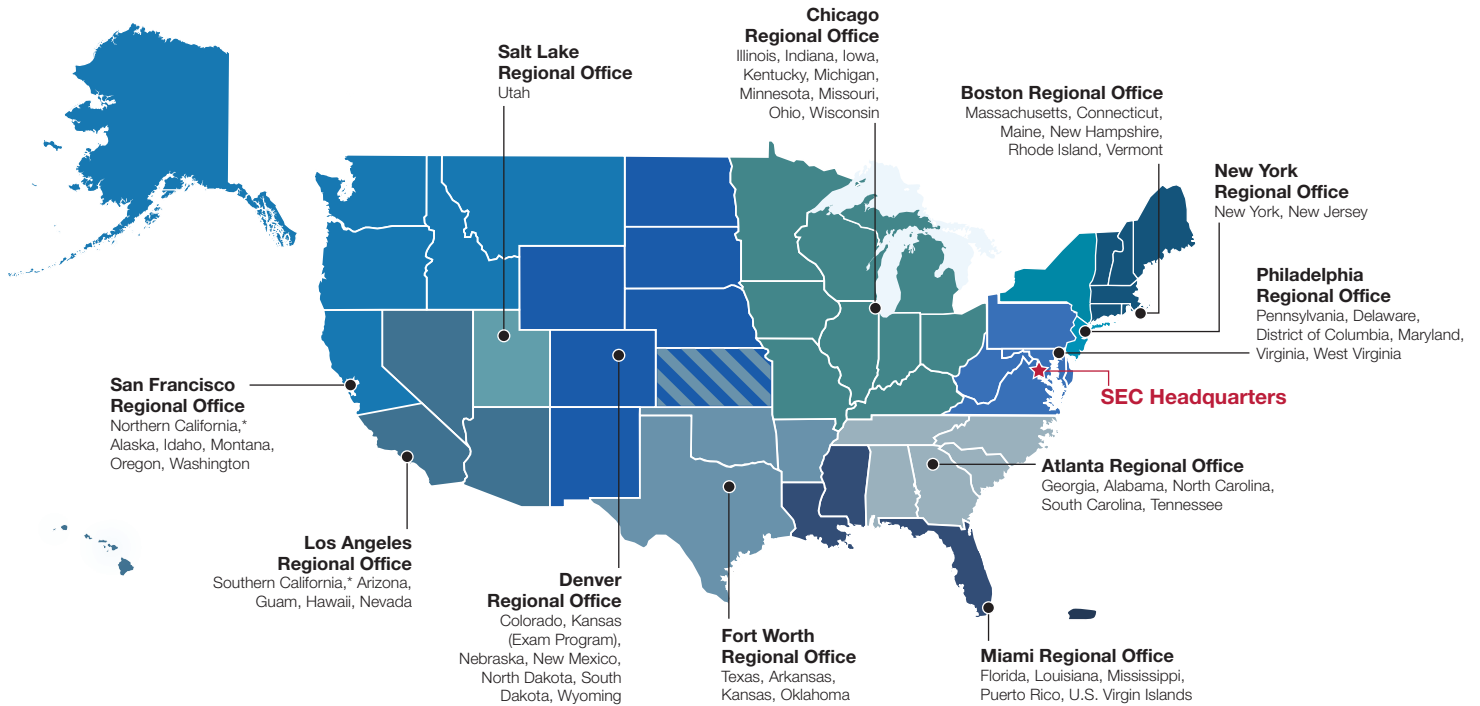
The Commission convenes on a regular basis, and meetings are open to the public and the news media unless the discussion pertains to a confidential subject, such as whether to begin an enforcement investigation.

## Office Locations

The SEC’s headquarters are in Washington, DC, and the agency has 11 regional offices located throughout the country. The regional offices are responsible for investigating and litigating potential violations of the securities laws. The regional offices also have enforce-

ment and examination staff to inspect regulated entities such as investment advisers, investment companies, and broker-dealers. The following chart illustrates the location of each regional office and their areas of jurisdiction.

Chart 1.2 | Headquarters and Regional Office Locations



\* Northern California includes ZIP codes 93600 and above, and 93200–93299  
 Southern California includes ZIP codes 93599 and below, except 93200–93299

## Programs

The SEC organizes its divisions and offices within the 10 major programs outlined below.

Table 1.1 | SEC Programs and Program Descriptions

ENFORCEMENT	
Division of Enforcement	Investigates and brings civil charges in federal district court or in administrative proceedings based on violations of the federal securities laws. An integral part of this program's function is seeking penalties and the disgorgement of ill-gotten gains in order to return funds to harmed investors. Also within this program is the Office of the Whistleblower, which rewards individuals who provide the agency with tips that lead to successful enforcement actions.
COMPLIANCE INSPECTIONS AND EXAMINATIONS	
Office of Compliance Inspections and Examinations	Conducts examinations of registrants such as investment advisers, investment companies, broker-dealers, self-regulatory organizations (SRO), transfer agents, and clearing agencies.
CORPORATION FINANCE	
Division of Corporation Finance	Helps investors gain access to materially complete and accurate information about companies and the securities they offer and sell, to facilitate capital formation and to deter fraud and misrepresentation in the public offering, trading, voting, and tendering of securities.
TRADING AND MARKETS	
Division of Trading and Markets	Supervises major market participants and conducts activities to maintain fair, orderly, and efficient standards that foster investor protection and confidence in the markets.
INVESTMENT MANAGEMENT	
Division of Investment Management	Seeks to minimize the financial risks to investors from fraud, mismanagement, self-dealing, and misleading or incomplete disclosure in the investment company and investment adviser segments of the financial services industry.
ECONOMIC AND RISK ANALYSIS	
Division of Economic and Risk Analysis	Provides economic analyses as part of the Commission's rulemaking process and supports its rule review, examination, and enforcement programs with data-driven, risk-based analytical methods.
GENERAL COUNSEL	
Office of the General Counsel	Serves as the chief legal officer of the Commission and provides independent legal analysis and advice to the Chairman, Commissioners, and operating divisions on all aspects of Commission activities. This office also defends the Commission in federal district courts.

Table 1.1 | *Continued from previous page*

OTHER PROGRAM OFFICES	
Office of the Chief Accountant	Establishes accounting and auditing policies, and works to improve the professional performance of public company auditors to ensure that financial statements used for investment decisions are presented fairly and have credibility.
Office of Investor Education and Advocacy	Serves investors who complain to the SEC about investment fraud or the mishandling of their investments by securities professionals; ensures the views of retail investors inform the Commission's regulatory policies and disclosure programs; and works to improve investors' financial literacy.
Office of International Affairs	Advances international regulatory, supervisory, and enforcement cooperation; promotes converged high regulatory standards worldwide; and facilitates technical assistance programs in foreign countries.
Office of Administrative Law Judges	Conducts public hearings throughout the United States in a manner similar to non-jury trials in the federal district courts. As independent adjudicators, administrative law judges issue initial decisions on allegations set out in Commission Orders Instituting Proceedings, issue subpoenas, hold prehearing conferences, and rule on motions and the admissibility of evidence.
Office of the Investor Advocate	Helps investors resolve significant problems with the SEC or with SROs, and identifies areas in which investors would benefit from changes to federal laws or to SEC regulations or SRO rules.
Office of Credit Ratings	Administers the rules of the Commission with respect to the practices of nationally recognized statistical rating organizations (NRSRO) in determining ratings; protects the users of credit ratings; promotes accuracy in credit ratings issued by NRSROs; and ensures that such ratings are not unduly influenced by conflicts of interest.
Office of Municipal Securities	Oversees the municipal securities market and administers the agency's rules pertaining to municipal securities brokers and dealers, advisors, investors, and issuers. This office also coordinates with the Municipal Securities Rulemaking Board on rulemaking and enforcement actions.
Office of the Advocate for Small Business Capital Formation	Helps small businesses and investors resolve significant problems incurred with the SEC or SROs, and analyzes the potential impact of current and proposed regulations.
AGENCY DIRECTION AND ADMINISTRATIVE SUPPORT	
Office of the Chairman	Oversees all aspects of agency operations. The Chairman and Commissioners are responsible for reviewing and approving enforcement cases and formal orders of investigation, as well as overseeing the development, consideration, and execution of policies and rules.
Office of Legislative and Intergovernmental Affairs	Serves as the liaison between the SEC and Congress, and is responsible for responding to requests from Congress for information related to agency programs and legislation affecting the SEC or its mission.
Office of the Chief Operating Officer	Provides strategic leadership and operational oversight of the SEC's core mission support activities and compliance with administrative requirements from Congress and the Executive Branch.
Office of the Ethics Counsel	Administers the Commission's Ethics Program, and interprets the SEC's Supplemental Ethics Rules as well as government-wide ethics laws, rules, and regulations.
Office of Minority and Women Inclusion	Develops standards for all agency matters relating to diversity in management, employment, and business activities.
Office of Equal Employment Opportunity	Strives to enhance access to employment opportunities for the best and brightest talent, and to foster a fair and equitable work environment in compliance with federal laws and SEC standards.

Table 1.1 | *Continued from previous page*

AGENCY DIRECTION AND ADMINISTRATIVE SUPPORT (CONTINUED)	
EDGAR Business Office	Provides direct executive-level oversight for the ongoing transformation of specific functions and programs to include business ownership of the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) and the EDGAR redesign program initiative.
Office of Public Affairs	Assists the Commission in making the work of the SEC is accessible to the public, understandable to investors, and accountable to taxpayers.
Office of the Secretary	Reviews all documents issued by the Commission; schedules and coordinates Commission meetings; prepares and maintains records of Commission actions; and receives and tracks filings in administrative proceedings.
Office of Financial Management	Oversees the agency's financial systems and internal controls over financial reporting; prepares financial statements and reports; manages the formulation and execution of the SEC's annual budget; and coordinates the agency's performance and cost reporting.
Office of Information Technology	Maintains responsibility for the Commission's infrastructure operations and engineering; user support; program management; capital planning; cybersecurity; and enterprise architecture.
Office of Human Resources	Assists with recruitment, staffing, organizational development, leadership and employee development, compensation and benefits administration, position classification, workforce planning, and labor relations.
Office of Acquisitions	Provides advice on acquisition planning, development, and sourcing; awarding contracts and interagency agreements; and ensures contract terms and conditions are met through timely contract closeouts and de-obligation of funds.
Office of Support Operations	Processes requests under the Freedom of Information Act and the Privacy Act; maintains all agency records in accordance with the Federal Records Act; oversees the security and safety of SEC facilities; and manages property, equipment, and overall building operations.
INSPECTOR GENERAL	
Office of Inspector General	Conducts audits of the SEC's programs and operations, and investigates allegations of misconduct by staff or contractors. This is an independent office whose mission is to detect fraud, waste, and abuse, and promote integrity, economy, efficiency, and effectiveness throughout the agency's programs and overall operations.

As shown in the Statements of Net Cost on page 59, the SEC presents its costs of operations by the programs outlined above, consistent with the presentation used by the agency in submitting its budget requests.

# YEAR IN REVIEW

In FY 2018, the SEC launched various initiatives designed to address the evolving nature of our markets and serve the long-term interests of our Main Street investors. It is through this lens—serving the long-term interests of our Main Street investors—that we pursue our mission and assess our efforts.

Below we summarize important FY 2018 initiatives, grouping them in three areas: (1) increasing our engagement with investors and other market participants; (2) focusing on the long-term interests of our Main Street investors in our rulemaking, education, compliance, and enforcement efforts; and (3) facilitating capital formation, efficiency, and market resiliency, including by modernizing our processes and rules.

Our report then discusses our enterprise risk and cybersecurity efforts. These are important areas for all organizations, and the SEC is no exception.

The report closes with a discussion of the approximately 4,500 women and men of the SEC. Our people are our assets, and they are our connection to our investors. Approximately 41 percent of our people work outside of Washington, DC, in one of our 11 regional offices. These offices tailor their efforts to the needs of the regions they serve. Across the SEC, we recognize the importance of our capital markets to the U.S. economy and millions of diverse households. Our people are skilled and dedicated. They accomplish a great deal with the resources at their disposal and they are proud to serve.

## Increasing Engagement with Investors and Other Market Participants

To fulfill our responsibility to American investors and markets, it is essential that the SEC maintain an

open line of communication with investors and other market participants. In FY 2018, the SEC substantially increased its engagement with both groups. These interactions have enabled us to improve our work and better focus our resources and efforts.

### Engagement with Main Street Investors

In FY 2018, the SEC reached out directly to Main Street investors from around the country through town halls, outreach tours, new digital tools, involving them in qualitative research, and other methods.

In a first-of-its-kind event, on June 13, 2018, the full Commission—all five Commissioners—and SEC leadership met with more than 400 members of the public during an investor town hall at the Georgia State University College of Law in Atlanta, Georgia. This event, organized by the SEC's Office of the Investor Advocate (OIAD) and Atlanta Regional Office, marked the first time the full Commission met with Main Street investors outside of Washington, DC. During the main session of the town hall meeting, Commissioners provided a range of information to investors and answered questions from attendees. Chairman Clayton, Commissioners, and other SEC leaders also participated in break-out sessions with smaller groups of investors to hear their views on specific investor-oriented topics such as combating fraud. The following day, the agency's Investor Advisory Committee hosted a meeting at the same location, providing another opportunity for the public to engage with the Commission.

This event kicked off the SEC's "Tell Us" campaign, which included additional roundtable meetings with retail investors in Houston, Miami, Washington, DC, Philadelphia, Denver, and Baltimore. At these round-

## SEC INVESTS IN... OUR HEROES

Honoring, celebrating, and supporting American service men and women is not just our duty: It is our privilege.

Developing customized materials, tools, programs, and initiatives to help members of the military invest wisely and avoid fraud are a few examples of how the SEC supports these heroes, their families, and their futures.

To learn more about these efforts, visit [Investor.gov/military](https://www.investor.gov/military).



tables, the Chairman and staff heard from individual investors about their experiences with, and expectations for, financial professionals. These discussions will particularly help to inform staff as they continue work on the proposed Regulation Best Interest, which will raise the standard of care investment professionals owe Main Street investors to meet investor expectations. Regulation Best Interest is discussed in greater detail below.

To complement these open discussions, the agency also developed a new “Tell Us” website and feedback flyer specifically designed for Main Street investors. The website and flyer highlight key questions concerning the proposed disclosures in a straightforward manner, providing investors an avenue for providing feedback to the SEC without needing to write a formal letter.

The agency spearheaded U.S. efforts for World Investor Week, a global initiative promoted by the International Organization of Securities Commissions (IOSCO) to raise awareness about the importance of investor education and protection. As part of the

initiative, SEC staff organized outreach events around the country with the U.S. Commodity Futures and Trading Commission (CFTC), the Financial Industry Regulatory Authority (FINRA), and the North American Securities Administrators Association (NASAA) to promote key investor education messages.

The SEC also conducted investor research and surveys in FY 2018 in order to better understand how investors interact with markets. The agency conducted eight surveys and four rounds of qualitative research involving focus groups and one-on-one interviews.

In addition to these events, day-in and day-out, the SEC staff engages with individual investors as well as with investor groups to promote awareness of the SEC’s work and to solicit feedback.

### Engagement with Market Participants

Our capital markets are far different today than they were a decade ago. They are increasingly global and highly data dependent. Investments are channeled through intermediaries and vehicles, such as mutual



funds and exchange-traded funds (ETF), to a much greater extent. Our markets also are ever-changing, and the pace of that change has increased. It is essential that the SEC understand the markets of today and continually prepare for and adjust to market developments. As a result, engagement with those who participate in our markets extensively, including public and private companies, institutional investors, broker-dealers, and auditors, as well as those who monitor and oversee markets, including U.S. and foreign authorities, elected officials, and academics, is essential.

In FY 2018, the SEC held numerous public roundtables at which SEC staff engaged with market participants on some of the most salient issues affecting our markets today in an open forum.

- In the spring, the SEC staff hosted a roundtable on market structure for thinly-traded securities, both equities and exchange-traded products. The panelists discussed the challenges faced by participants in the market for thinly-traded exchange-listed securities, including small- and medium-sized companies looking to enter our public markets and potential actions to address those concerns.
- In the early fall, the Division of Trading and Markets hosted a roundtable on combating retail investor fraud. This event focused on the types of fraudulent and manipulative schemes that currently target retail investors. Specifically, panels focused on the ability of authorities and market participants to combat retail investor fraud, and whether the regulation of certain products and practices should be enhanced.

In July, the Chairman announced that SEC staff will host a roundtable in early FY 2019 to hear from investors, issuers, and other market participants about the proxy process and rules. The proxy process is central to investors' participation in corporate governance at U.S. public companies. The roundtable will focus on key aspects of the U.S. proxy system, including proxy

voting mechanics and technology, the shareholder proposal process, and the role and regulation of proxy advisory firms.

In addition to events of this type, leadership in our divisions and offices, as well as our dedicated staff, are open to hearing from and meeting with market participants. If there are areas where our markets are not working as they should or can be improved, please reach out to us. In particular, please identify how we can improve our markets for the long-term interests of our Main Street investors. Please refer to [SEC.gov](https://www.sec.gov) for contact information.

### Targeting the Long-Term Interests of Our Main Street Investors

Accurate, timely, clear, and actionable information is essential to a fair and well-functioning marketplace. This principle—broad access to good information as the linchpin of markets—is confirmed by decades of experience and analysis. The SEC's mandate embodies this principle, and we have a responsibility to ensure that our market participants—including, in particular, our Main Street investors—have access to the information and advice they need to make decisions that are right for them.

Our Main Street investors, whether they participate in our markets directly or through an intermediary such as an investment adviser or broker-dealer, now more than ever have a substantial responsibility to fund their own retirement and other financial needs. The Commission recognizes that as a result of increased life expectancy and a shift from defined benefit plans (pensions) to defined contributions (401(k)s and IRAs), the interests and needs of our Main Street investors have changed. We are responding to that change. We are working to ensure that Main Street investors understand, and have access to, a range of investment opportunities and related advice.

We also are keenly aware that there are some who seek to take advantage of our Main Street investors. Over 50 percent of our staff is dedicated to compliance and enforcement. These individuals are committed to removing bad actors from our markets, deterring fraud and other misconduct, and when investors are harmed, employing our resources promptly to limit losses and return ill-gotten gains.

### Aligning Professional Obligations with Investor Expectations: The Regulation Best Interest Rule Proposals

In April 2018, the Commission proposed for public comment a significant rulemaking package designed to serve Main Street investors that would (1) require broker-dealers to act in the best interest of their retail customers, (2) reaffirm and in some cases clarify the fiduciary duty owed by investment advisers to their clients, and (3) require both broker-dealers and investment advisers to clarify for all retail investors the type of financial professional they are, and disclose key facts about their relationship.

Broker-dealers and investment advisers both provide investment advice to retail investors, but have different relationships and are subject to different regulatory regimes. However, it has long been recognized that many investors do not have a firm grasp of the important differences between broker-dealers and investment advisers—from differences in the variety of services that they offer and how investors pay for those services, to the regulatory frameworks that govern their relationship. This investor confusion could cause investor harm if investors fail to select the type of service that is appropriate for their needs, or if conflicts of interest are not adequately understood and addressed.

Our proposals would work together to better align the standards of conduct and mandated disclosures for broker-dealers and investment advisers with what

investors expect of these financial professionals, while preserving investor access and investor choice.

In an effort to improve upon our proposals, SEC staff organized a series of seven roundtables around the country to speak directly with Main Street investors about how these proposals can best bring their relationship with their investment professional in-line with their expectations. These candid, experience-based conversations were incredibly valuable and will inform our work moving forward.

Staff will continue to refine these proposals in FY 2019.

### Empowering Main Street Investors through Information and Education

The SEC promotes informed investment decision-making through education initiatives aimed at providing Main Street investors with a better understanding of our capital markets and the opportunities and risks associated with the array of investment choices presented to them. Our Office of Investor Education and Advocacy (OIEA) spearheads these efforts, and participation extends throughout our divisions and offices.

In FY 2018, the SEC conducted over 150 in-person investor education events focused toward various segments of the population, including senior citizens, military personnel, younger investors, and affinity groups. In addition to in-person education events, we developed informative, innovative, and accessible educational initiatives.

A primary focus of our educational efforts is preventing fraud. Unfortunately, it does not cost much to finance a scam, and it often is easy for bad actors to reach their targets, particularly over the internet. If our investors know that, as well as some of the hallmarks of fraud and key questions to ask before they invest or provide personal information, they are less likely to become victims.

We use a variety of channels to deliver this message to investors. For example, we created a website to educate the public about emerging initial coin offering (ICO) scams and demonstrate how easy it is for bad actors to engineer this type of fraud—[HoweyCoins.com](http://HoweyCoins.com). This mock website promoted a fictional ICO and was created in-house, very quickly, with few resources. It attracted over 100,000 people within its first week. We also published a variety of investor alerts and bulletins to warn Main Street investors about other possible schemes, including celebrity endorsements, self-directed individual retirement accounts, the risks in using credit cards to purchase an investment, and the potential harm and annoyance resulting from sharing their personal contact information with online investment promoters.

We also continued to promote our national public service campaign, “Before You Invest, Investor.gov.” This initiative encourages investors to research the background of their investment professional. Our experience demonstrates that working with unlicensed promoters who have a history of misconduct greatly increases the risk of fraud and losses. In May 2018, we supplemented this information service with a new online search tool, the SEC Action Lookup for Individuals (SALI). This tool enables investors to find out if the individual or firm he or she is dealing with has been sanctioned as a result of SEC action. We are encouraged by the fact that unique page views on [Investor.gov](http://Investor.gov) increased by 45 percent compared to FY 2017.

As an example of our regional efforts, the San Francisco Regional Office has conducted extensive outreach to California teachers through its Teacher Investment Outreach Initiative. This project seeks to help teachers make informed decisions on investment portfolio options, fees, and risk. Regional staff, many of whom have personal connections to the teaching



community, created this initiative in response to learning about the limitations of the investment options offered to public school teachers under the defined contribution portion of their retirement plans.

More videos and other educational content are planned for the future, and we encourage investors who see signs of fraud or other misconduct to contact us. Our tips, complaints, and referrals portal can be accessed at [Investor.gov/contact-us](http://Investor.gov/contact-us), and our investor hotline is 800-732-0330.

### Protecting Main Street Investors and Improving Investment Options by Promoting Compliance

Our registered entities, including broker-dealers, investment advisers, investment companies, municipal advisors, national securities exchanges, clearing agencies, and transfer agents, provide many of the services that are essential to our markets and our investors. Ensuring that these entities act in compliance with our laws and rules, and are appropriately focused on operational integrity and resiliency, is one of the SEC’s most important functions.

During FY 2018, the SEC conducted over 3,150 examinations. We achieved a 17 percent coverage ratio for investment advisers, representing an increase of 11 percent from FY 2017, even though the number of registered investment advisers increased by approximately 5 percent. Our Office of Compliance Inspec-

tions and Examinations (OCIE) used a risk-based strategy to set examination priorities that incorporated an analysis of the causes of investor harm and indicia of entity-level and market risk. We also continued to leverage data analysis to identify potentially problematic activities and firms, as well as to determine how best to scope those examinations of those activities and firms. We intend to set priorities and allocate resources in a similar manner in FY 2019.

In conjunction with our examination activities, we published a number of risk alerts to inform registered firms and investors of common compliance issues we observed. This year, OCIE risk alerts addressed topics ranging from municipal advisor examinations, to fee and expense compliance issues for investment advisers. We believe publishing these alerts sharpens the identification and correction of deficient practices, maximizes the impact of our examination program and better protects the interests of Main Street investors. For example, by focusing on the proper disclosure and calculation of fees charged to investors, and conflicts of interest of financial professionals, we have eliminated improper fees and conduct, and enhanced the long-term interests of our Main Street investors.

### [Pursuing Enforcement Matters that are Meaningful to Main Street Investors](#)

The ongoing efforts made by the Division of Enforcement (ENF) to deter misconduct and punish securities law violators are critical to safeguarding millions of investors and instilling confidence in the integrity of the U.S. markets. The nature and quality of the SEC's enforcement actions during the last year speak volumes to the hard work of the women and men of the agency. The following section highlights the work of three investor oriented enforcement initiatives over the past year: the Retail Strategy Task Force, the Cyber Unit, and the Share Class Selection Disclosure Initiative.

At the close of FY 2017, the SEC announced the formation of a Retail Strategy Task Force, which has two primary objectives: first, to develop data-driven,

analytical strategies for identifying adverse practices in the securities markets that harm retail investors and generating enforcement matters in these areas; and second, to collaborate within and beyond the SEC on retail investor advocacy and outreach. All of these initiatives directly impact the lives of Main Street investors and involve collaboration between many divisions and offices. New data-driven approaches are anticipated to yield significant efficiencies in lead generation and in resource allocation by targeting enforcement efforts where the risk to Main Street investors is the most significant.

During FY 2018, the Task Force has undertaken a number of lead-generation initiatives built on the use of data analytics. The Task Force has also investigated several retail investor-focused cases and trained ENF staff on such investigations.

At the end of FY 2017, ENF announced the creation of a Cyber Unit to combat cyber-related threats, which are among the greatest risks facing our securities markets. In its first year, the Cyber Unit led investigations that resulted in several emergency actions to stop ongoing frauds against retail investors that involved ICOs, as well as charges against a bitcoin-denominated platform and its operator for running an unregistered securities exchange and defrauding users of that exchange. The SEC also brought an action involving an illegal unregistered ICO. After being contacted by Commission staff, the company halted the ICO, refunded investor proceeds, and cooperated with the staff's investigation.

The SEC brought several actions in this fiscal year involving public companies that claimed to change their businesses to focus on blockchain-related technology. Often, these announcements were followed by price spikes and, in some cases, improper efforts to profit from the market reaction. For example, the SEC charged a company, its CEO, and three affiliates for illegally distributing and selling unregistered securities to take advantage of the price spike resulting from the

company's announcement of a purported acquisition of a cryptocurrency website. The SEC also suspended trading in eight companies based on concerns about public companies and their claimed blockchain- or cryptocurrency-related businesses.

Beyond ICOs and cryptocurrency, the Cyber Unit also led important investigations that resulted in SEC actions involving cyber-related manipulations, account takeovers, and other cyber-related trading violations. The cases brought by the SEC in FY 2018 included charges for allegedly scheming to manipulate the price of a stock by making a phony regulatory filing, and for hacking into over 100 online customer brokerage accounts and making unauthorized trades to manipulate stock prices and profit from the artificial prices.

In FY 2018, ENF expanded its efforts to identify advisers who received undisclosed compensation in the form of 12b-1 fees. Based on these investigations, the SEC brought a significant number of enforcement actions against advisers who selected more expensive mutual fund share classes for investors when cheaper alternatives were available. The SEC announced a Share Class Selection Disclosure Initiative in February 2018, which enables the efficient return of money to harmed investors and clients while offering investment advisers a streamlined process for remediating their misconduct.

### Key Capital Formation Initiatives

The SEC took meaningful steps during FY 2018 to encourage capital formation for emerging companies seeking to enter our public capital markets, while maintaining and, in many cases, enhancing investor understanding and protections.

As a result of the July 2017 expansion of the draft registration statement submission process to all first-time registrants and newly public companies conducting an initial public offering (IPO) within one year, the Division of Corporation Finance (CF) has received

draft submissions for more than 40 IPOs, and from more than 75 existing reporting companies, that have utilized the expanded accommodation. The expanded accommodation has given companies more control over their offering schedules, and has limited their exposure to market volatility and competitive harm without diminishing investor protection.

Additionally, in June 2018, the Commission voted to adopt amendments to the "smaller reporting company" definition that expand the number of companies that can qualify for certain existing scaled disclosure requirements. The new definition recognizes that a one-size regulatory structure for public companies does not fit all, and will allow approximately 1,000 additional companies to benefit from smaller reporting company status. The amended definition should benefit both smaller companies by making the option to join our public markets more attractive, and Main Street investors, who will have more investment options.

### Improving Fixed Income Markets

The SEC recognized the need to broaden its review of market structure to include specifically the efficiency, transparency, and effectiveness of U.S. fixed income markets. With large numbers of Baby Boomers retiring every month and needing investment options, fixed income products, which are viewed as a stable place to store hard-earned money, attract more and more Main Street investors; however, many of those investors may not appreciate that fixed income products are part of markets that differ significantly from the better-known equities markets.

To tackle these issues, the SEC created the Fixed Income Market Structure Advisory Committee on November 15, 2017. The committee's objective is to provide the Commission with diverse perspectives on the structure and operations of the U.S. fixed income markets, as well as advice and recommendations on matters related to fixed income market structure.



## Streamlining and Improving the Regulation of ETFs

In June 2018, the Commission proposed for public comment a new rule to replace the process of individually-issued orders for exemptive relief for ETFs. The proposal is designed to create a consistent, transparent, and efficient regulatory framework for new ETF products and facilitate greater competition and innovation among ETFs. The ETF market, which has a volume of \$3.4 trillion, currently operates under more than 300 individually issued exemptive orders that have varied over time in wording and terms. Today, before a fund sponsor may begin offering an ETF, it must obtain an order from the Commission under the Investment Company Act. This may result in delay and cost for new sponsors. Adopting a final ETF rule promises to enable staff to focus more time and attention on novel or unusual ETF products instead of routine ETFs.

## Increasing Access to Research

The agency is working to promote research and provide investors greater access to it. In May 2018, the Commission proposed rules and amendments that are intended to reduce obstacles to providing research on investment funds in furtherance of the Fair Access to Investment Research Act of 2017. The proposed rules seek to harmonize the treatment of investment fund research with research on other public entities by establishing a safe harbor for a broker or dealer to publish or distribute research reports on investment funds under certain conditions. Overall, these proposed rules aim to promote expanded research on mutual funds, ETFs, registered closed-end funds, business development companies, and similar covered investment funds and provide investors with greater access to research to aid them in making investment decisions.

## Retrospective Review

With respect to rulemaking, the SEC continues to leverage its robust processes for obtaining public input and performing rigorous economic analyses of our rules at both the proposing and adopting stages. These efforts are critical to identifying the benefits and costs

of regulatory actions, including situations where a rule's effects may not be consistent with expectations.

The Commission also reviews its rules retrospectively, listening to investors and others about where rules are, or are not, functioning as intended. The Division of Economic and Risk Analysis (DERA) often plays a critical part in this process. For example, during FY 2018, DERA staff produced papers addressing questions about the effects of changes in trading rules and about information access across markets.

In August, the Commission voted to adopt amendments to simplify and update disclosure requirements. These amendments were part of a larger initiative by CF to review disclosure requirements applicable to issuers and consider ways to improve the requirements for the benefit of investors and issuers.

## Enterprise Risk and Cybersecurity

Cybersecurity at the SEC continued to be a top priority in FY 2018. Staff worked continuously to improve the security of SEC networks and systems, with a particular focus on mission critical systems, as well as systems dealing with sensitive market and other data involving sensitive personally identifiable information (PII). As noted by the Chairman earlier this year, a review by the Office of the General Counsel into the agency's 2016 Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system intrusion identified a number of areas of improvement—including with respect to IT governance and oversight, security controls, risk awareness related to sensitive data, incident response, and reliance on legacy systems—and much work remains to be done. To that end, and recognizing that no system can ever be entirely safe from a cyber intrusion, the agency has a number of uplift efforts underway. The SEC has contracted with multiple private-sector vendors and has continued to partner on cybersecurity efforts with other government agencies.

For example, on a technical level, efforts include the deployment of enhanced security capabilities, additional penetration testing and code reviews,

investment in new technologies and experienced cybersecurity personnel, and acceleration of the transition of certain legacy information technology systems to modern platforms. The agency has also focused closely on its cybersecurity risk governance structure. This has resulted in, among other things, the establishment of a senior-level cybersecurity working group and the creation of a new position, the Chief Risk Officer (currently filled on an acting basis), to coordinate the SEC's efforts to identify, monitor, and mitigate risks across divisions and offices. In furtherance of risk mitigation efforts, the Commission has amended forms that either requested, or enabled filers to submit, sensitive PII. Moreover, return copies of test filings are no longer stored within the EDGAR system. The staff also continues to explore alternatives to the current approach, including the possibility of implementing a new electronic disclosure solution.

### The People of the SEC

None of the incredible work described above would have been achieved without the dedicated mission-facing attorneys, accountants, examiners, and economists of the SEC, whose work in turn is made possible thanks to the important behind-the-scenes work of the agency's administrative and operations personnel, including within the centralized support offices under the chief operating officer and in a division or office's internal business operations. The agency's supervisors and program managers also play a critical role in ensuring effective and efficient operations and activities.

The SEC is proud to consistently rank high in the Federal Employee Viewpoint Survey (FEVS). After six years of continual improvement, our 2018 survey results demonstrate additional gains in some of the most important drivers of employee engagement and organizational health:

- Employee Engagement Index (+1 percentage point) is now at 78 percent positive
- Global Satisfaction Index (+1 percentage point) is now at 82 percent positive
- Leader Effectiveness Index (+2 percentage points) is now at 71 percent positive
- Overall FEVS Average (+1 percentage point) is now at 74 percent

In addition, we continue to rank among the top federal agencies with respect to employee participation in the FEVS. In 2018, the SEC's response rate was 76 percent, an impressive 36 percent points higher than the government-wide average of 40 percent.

From top leadership to front-line teams, the SEC is harnessing the power of the FEVS data to drive discussions about topics that are important to employees. Drill-down reports are used as a starting point to engage in constructive dialogue around areas for improvement. And, among other metrics, the data from two of the FEVS indices will be used to measure progress toward the agency's new Strategic Plan goals.





# LOOKING FORWARD

America's historic approach to our capital markets has produced a remarkably deep pool of capital with unprecedented participation. This dynamic has contributed substantially to the growth of the U.S. economy and the elevation of economic conditions globally. To place this historic achievement in perspective, note that the United States has approximately 4.4 percent of the world's population, yet the U.S. markets are the primary home to 54 of the world's 100 largest publicly traded companies, and U.S. households have over \$22.4 trillion invested in the world's equity markets.

It is our obligation to preserve, foster, and build on this history—and history and experience demonstrate our work is never complete: markets change, and risks to our markets and investors will continue to emerge.

We know we must continuously assess whether we are focused on the right areas and doing the right things, keeping the long-term interests of our Main Street investors top of mind.

Below we summarize a number of forward-looking initiatives we are pursuing. As always, we welcome feedback and guidance from all interested parties on areas in need of focus and how we can best allocate our resources. Please refer to [SEC.gov](https://www.sec.gov) for contact information.

## Serving Main Street Investors

ENF will maintain its prioritization on protecting investors from both traditional threats and those that stem from advances in our markets and technology.

## SEC INVESTS IN... YOUR FEEDBACK

We cannot focus on the long-term interests of Main Street investors if we don't know what those interests are—not what we *think* they are; what investors *Tell Us* they are.

In FY 2018, the Chairman, Commissioners, and a number of senior SEC officials traveled across the nation to speak directly with investors who were invited to "Tell Us" about their current investment experiences.

These insightful, candid conversations kicked-off a year of listening, and we look forward to hearing more about how we can continue to improve our markets in FY 2019.



The division will continue to address the kinds of misconduct that retail investors have unfortunately seen for decades: accounting fraud, sales of unsuitable products and the pursuit of unsuitable trading strategies, pump-and-dump frauds, and Ponzi schemes, among others. ENF will also continue its work with OIEA and OCIE through the Retail Strategy Task Force, educating investors and developing resources to strengthen its resources in investigating cases involving misconduct perpetrated against Main Street investors.

In terms of emerging threats, the Cyber Unit will move forward in its focus on ICOs, violations by gatekeepers, and cyber-related trading violations. It will also work within the agency and with law enforcement partners across the government to advance ENF's ability to investigate increasingly complex misconduct, such as by tracing digital asset transactions, tracking illicit online trading-related activity, and identifying misconduct occurring on the dark web.

### Continued Engagement with Investors and Other Market Participants

Driven by Chairman Clayton's emphasis on increasing opportunities for Main Street investors to interact with the Commission, the agency will continue its outreach efforts in FY 2019 and beyond.

OIAD plans to hold an event similar to the investor town hall in Atlanta at least annually in different cities around the country. These town halls allow both for investors to learn about topics under consideration by the Commission and for staff to receive feedback on those topics from the investors we serve. OIAD will also conduct at least three outreach tours throughout the year, during which staff will spend multiple days in a designated city, meeting with institutional and individual investors to gain insights about their unique needs and concerns. These insights will help to shape the Commission's future work.

As the Commission continues to consider the proposed Regulation Best Interest, feedback received from previous investor roundtables will help the agency in refining the proposal into a final rule that best serves the interests of retail investors.

OIEA will continue to promote the agency's "Before You Invest, Investor.gov" public service campaign. In addition, it will use feedback from customer satisfaction surveys and other research to inform investor education initiatives.

OCIE will continue to publish risk alerts to flag common concerns it observes in its examinations for both investors and registered firms. It will also publish its annual exam priorities for 2019.

### Facilitating Capital Formation

CF has several proposals on the horizon designed to encourage capital formation for emerging companies seeking to enter our public capital markets. Specifically, the Commission will look at the thresholds that trigger Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires certain registrants to provide an auditor attestation report on internal control over financial reporting, and consider amendments that would reduce the number of companies that need to provide the auditor attestation report, while maintaining appropriate investor protections.

Additionally, the Commission will consider expanding the ability of companies that are contemplating raising capital to "test the waters" by engaging in communications with certain potential investors prior to or following the filing of a registration statement for an IPO. Such communications should benefit Main Street investors, as companies are better able to effectively size and price the offering, and should benefit companies considering an IPO, as they will be able to obtain feedback in advance of an offering.

Further, the Commission will take a fresh look at the exempt offering framework to consider whether changes should be made to harmonize and streamline the framework. While Congress and the Commission have increased the options for raising capital in exempt offerings in recent years, it is important to acknowledge and critically assess the complex exemption landscape in light of our evolving capital markets. The agency will conduct a comprehensive review of the exemptive framework and solicit input from the public on how to ensure that the system as a whole is rational, accessible, and effective.

### Fresh Approaches to Old Problems

Chairman Clayton has made clear that effective rulemaking does not end with rule adoption. In that spirit, several items on the agenda for the coming year will revisit a number of rules that, in some cases, have not been touched in decades.

For example, registered investment advisers are subject to a rule governing marketing that has not changed significantly since its adoption in 1961. The Division of Investment Management (IM) is considering recommendations for modernizing this rule so that it addresses the changes in both the asset management market and technology since its adoption. IM is also considering a recommendation regarding a Commission general statement of policy on the regulatory framework for funds use of derivatives made in 1979.

Several of the capital formation proposals under consideration by CF also involve taking a fresh look at rules and other requirements that may have become outdated, such as the thresholds for Section 404(b) of the Sarbanes-Oxley Act of 2002. These and other proposals are part of an initiative by CF to

review disclosure requirements applicable to issuers to consider ways to improve the requirements for the benefit of investors and issuers.

### Cybersecurity and Other Technological Upgrades

The Commission will continue its work toward cybersecurity uplift and support agency efforts to reduce its holdings of sensitive information, modernize legacy information systems and technology, and further cultivate a cybersecurity-conscious workforce. Hardware and software upgrades are only a part of this effort: It is also critical to increase human capital for the Information Security program through the hiring of skilled cybersecurity professionals, including the addition of senior personnel in the area of network defense and security operations. The agency worked to secure funding from Congress for these new hires in the FY 2019 budget.

The agency will also continue to coordinate and partner with both other federal government bodies and external entities to identify and mitigate risks to its information technology environment and assets on a continuous basis.

Recent rulemaking decisions such as those associated with alternative trading systems and inline eXtensible Business Reporting Language (XBRL) will drive ongoing efforts to implement enhancements to the EDGAR system. These steps toward modernization will require substantial changes to the EDGAR system, which the EDGAR Business Office (EBO) will work closely with other divisions and offices to realize. EBO will also complete a “grand” functional requirements document which will serve as the building blocks for the EDGAR Redesign Program.

## Title VII

The Commission has finalized many, but not all, of the Title VII rules dictated by Congress and established under the Dodd-Frank Act. In the coming year, the agency intends to move forward with a coherent package to complete its Title VII obligations in a manner that allows for efficient implementation and internal consistency.

The agency also seeks to harmonize its ultimate securities-based swap rules with the CFTC, where appropriate, to increase effectiveness as well as reduce complexity and costs. Deliberate and constructive engagement with the CFTC is well underway.

## Interagency Cooperation

In addition to continued discussions with the CFTC regarding Title VII harmonization, the Commission's ongoing efforts to engage with fellow regulators will continue throughout the coming year.

Informed by the clear and comprehensive frame created by the Treasury Department's core principles reports, the SEC will work with other financial regulators to address the key issues in our markets in a holistic, consistent manner. This includes continuing to move forward on the proposed rule to simplify and tailor compliance requirements for the Volcker Rule.

**Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010** authorized the CFTC to regulate swaps, and the SEC to regulate security-based swaps. The agencies share authority over mixed swaps.

### SWAPS

Any agreement, contract, or transaction that is commonly known to the "trade" as a swap, excluding futures contracts, options on futures, forward contracts on nonfinancial commodities, and certain retail transactions

### SECURITY-BASED SWAPS

Swaps based on:

1. an index that is a narrow-based security index,
2. a single (non-exempt) security or loan, or
3. a financial event relating to an issuer or issuers or securities in 1 or 2 above

### MIXED SWAPS

Security-based swaps that also have a commodity component

Source: U.S. Department of the Treasury

# FINANCIAL HIGHLIGHTS

This section provides an analysis of the financial position, results of operations, and the underlying causes for significant changes in balances presented in the SEC's FY 2018 financial statements.

As described further below, the SEC's finances have several main components:

- An annual appropriation from Congress;
- Securities transaction fees, charged in accordance with Section 31 of the Securities Exchange Act, which offset the agency's annual appropriation;
- Securities registration, tender offer, and merger fees (also called filing fees), of which \$50 million is deposited into the Securities and Exchange Commission Reserve Fund (Reserve Fund) each year. The Reserve Fund may provide resources up to \$100 million to pay for SEC expenses, and are not subject to annual appropriation or apportionment;
- Disgorgement and penalties ordered and collected from violators of the securities laws, some of which are then returned to harmed investors and the balances are transferred to the Treasury; and
- The SEC Investor Protection Fund, which is funded through disgorgement and penalties not distributed to harmed investors, and which is used to make payments to whistleblowers who give tips to aid the SEC's enforcement efforts in certain circumstances, as well as to cover the expenses of the SEC Office of Inspector General's (OIG) Employee Suggestion Program.

## Sequestration Order for FY 2018

On March 1, 2013, the President issued the Sequestration Order for FY 2013, which reduced FY 2013 budget authority.

As determined by the Office of Management and Budget (OMB), for FY 2018, the sequestration order was applicable to mandatory appropriations, which included the Reserve Fund and the Investor Protection Fund, of the SEC as follows:

### Reserve Fund

The budget authority of \$75 million was reduced by 6.6 percent, or \$5 million.

### Investor Protection Fund

The budget authority of \$185.3 million was reduced by 6.6 percent, or \$12.2 million.

## Overview of Financial Position

**Assets.** At September 30, 2018, the SEC's total assets were \$10.4 billion, a decrease of more than \$383 million, or 4 percent, from FY 2017.

Fund Balance with Treasury increased by \$317 million between year end FY 2018 and FY 2017, primarily due to increases in the SEC's Salaries and Expense and Investor Protection Fund balances.

Investments decreased by \$642 million between FY 2018 and FY 2017 year end. The decrease is primarily due to reductions in disgorgement and penalties investments as a result of disbursements to fund administrators for planned distributions.

Accounts Receivable decreased by \$45 million between FY 2018 and FY 2017 year end. The variance is primarily the result of a \$49 million decrease in Section 31 receivables due to a lower fee rate in effect for September of FY 2018 compared to the same period of the previous year.

Chart 1.3 | FY 2018 Assets by Type

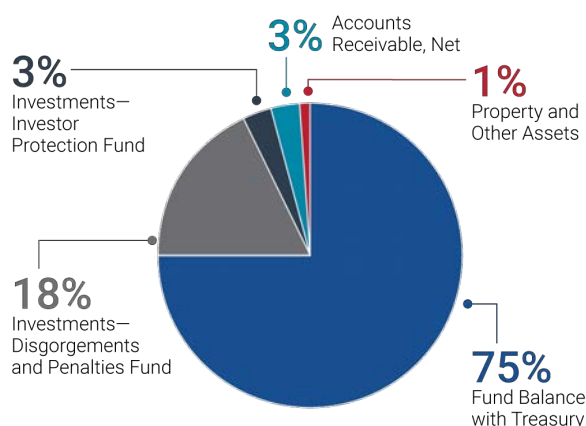


Table 1.2 | Assets as of September 30, 2018 and 2017

(DOLLARS IN MILLIONS)	2018	2017
Fund Balance with Treasury	\$ 7,822	\$ 7,505
Investments – Disgorgement and Penalty Fund	1,811	2,471
Investments – Investor Protection Fund	310	292
Accounts Receivable, Net	320	365
Property and Equipment, Net	121	131
Other Assets	8	11
<b>Total Assets</b>	<b>\$ 10,392</b>	<b>\$ 10,775</b>

**Liabilities.** At September 30, 2018, the SEC’s total liabilities were \$2.7 billion, a decrease of \$708 million, or 21 percent, from FY 2017.

For the assets received resulting from enforcement judgments, the SEC recognizes a corresponding liability, which is either custodial if the collections are transferred to the U.S. Treasury General Fund or the Investor Protection Fund, or governmental if the collections are held pending distribution to harmed investors.

The decrease of \$540 million in the liability for disgorgement and penalties is mostly attributable to disbursements to plan administrators for distribution to harmed investors that occurred between October 1, 2017, and September 30, 2018.

Custodial Liability decreased by \$108 million, reflecting reductions in custodial disgorgement and penalties receivables as a result of collections during FY 2018 for debts established prior to September 30, 2017.

Accounts Payable increased by \$86 million primarily due to an increase in whistleblower awards payable.

Contingent Liabilities decreased by \$157 million as a result of awarding two large potential awards that were included in the \$221 million contingent liability for the year ended September 30, 2017, in FY 2018.

**Ending Net Position.** The SEC’s net position, comprised of both unexpended appropriations and the cumulative results of operations, increased by \$325 million between September 30, 2018 and 2017.

Chart 1.4 | FY 2018 Liabilities by Type

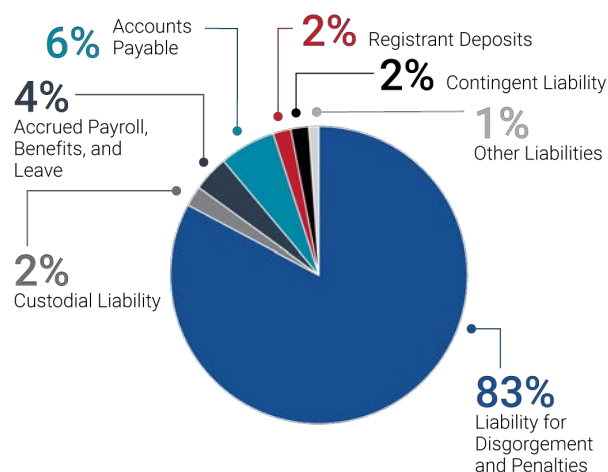


Table 1.3 | Liabilities as of September 30, 2018 and 2017

(DOLLARS IN MILLIONS)	2018	2017
Liability for Disgorgement and Penalties	\$ 2,259	\$ 2,799
Custodial Liability	65	174
Accrued Payroll, Benefits, and Leave	121	118
Accounts Payable	170	84
Registrant Deposits	40	34
Contingent Liability	64	221
Other Liabilities	19	16
<b>Total Liabilities</b>	<b>\$ 2,738</b>	<b>\$ 3,446</b>



## Results of Operations

**Earned Revenues.** Total earned revenues for the year ended September 30, 2018, increased by \$165 million, or 8 percent, from FY 2017.

Filing Fee Revenue increased by 10 percent through September 30, 2018, when compared to the prior year due to the filing fee rate increasing from \$115.90 per million transacted in FY 2017 to \$124.50 per million transacted in FY 2018.

Section 31 fee revenue increased primarily due to a substantially higher dollar amount of covered sales during FY 2018. As a result of this increased transaction volume, the Section 31 fee rate was reduced from \$23.10 to \$13.00 per million transacted, effective May 22, 2018.

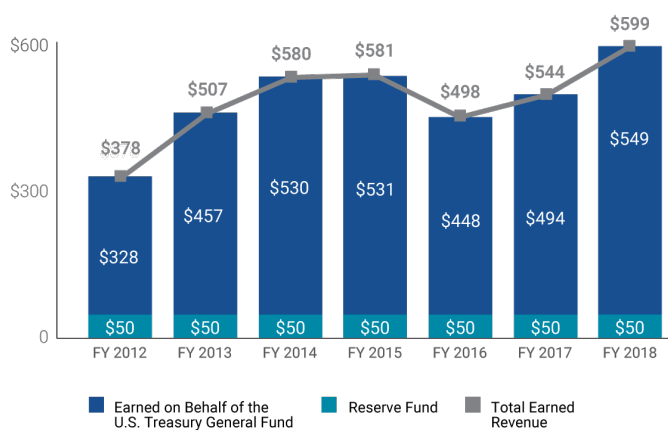
**Reserve Fund.** Section 991(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) authorized the creation of a Reserve Fund. Funded from filing fee collections, the SEC can deposit up to \$50 million per fiscal year, and the fund cannot hold more than \$100 million in total. Excess filing fees are deposited to the U.S. Treasury General Fund.

For the year ended September 30, 2018, filing fee revenues totaled \$599 million. Fifty million dollars was deposited into the Reserve Fund, of which \$5 million was sequestered. The excess of \$549 million was earned on behalf of the U.S. Treasury General Fund.

Table 1.4 | Earned Revenues  
For the years ended September 30, 2018 and 2017

(DOLLARS IN MILLIONS)	2018	2017
Section 31 Securities Transaction Fees	\$ 1,704	\$ 1,594
Securities Registration, Tender Offer, and Merger Fees (Filing Fees)	599	544
<b>Total Earned Revenues</b>	<b>\$ 2,303</b>	<b>\$ 2,138</b>

Chart 1.5 | Reserve Fund Earned Revenue  
(DOLLARS IN MILLIONS)



Filing fees deposited to the Reserve Fund can be used to fund the SEC’s operations, create budgetary authority, and are reported as a component of Appropriations (Discretionary and Mandatory) on the SEC’s Statement of Budgetary Resources. Filing fees deposited to the U.S. Treasury General Fund do not create budget authority and cannot be used to fund the SEC’s operations.

After FY 2018 deposits of \$50 million, prior year sequestration and rescission’s returned totaling \$30 million, and new FY 2018 sequestration totaling \$5 million, Reserve Fund resources totaling \$62 million were obligated for the year ended September 30, 2018, for both capitalized and non-capitalized IT related hardware, software, and contracting, leaving a remaining unobligated balance of \$15 million of available resources.

**Program Costs.** Total Program Costs were \$1.8 billion for the year ended September 30, 2018, a decrease of \$197 million, or 10 percent, compared to FY 2017. Salary and Benefit Expenses increased by \$35 million as the result of a \$15 million increase in payroll expenses, net of attrition, and a \$20 million increase in imputed costs. In accordance with federal accounting standards, the SEC recognizes benefit related imputed costs incurred by the SEC but financed by Office of Personnel Management on behalf of the SEC as an expense. Other Expenses decreased primarily due to a net decrease of \$242 million in Whistleblower Award expense activity in the Investor Protection Fund for FY 2018 when compared to the prior year.

Chart 1.6 | FY 2018 Filing Fee Revenue  
(DOLLARS IN MILLIONS)

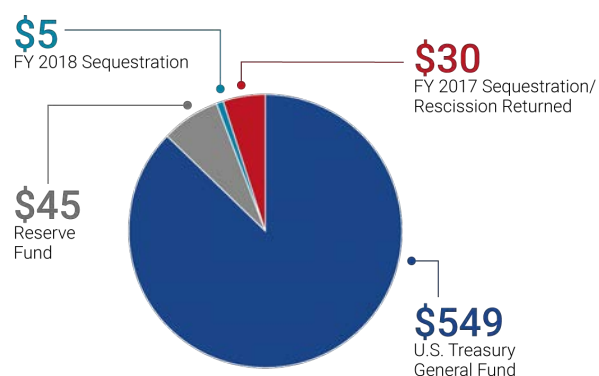
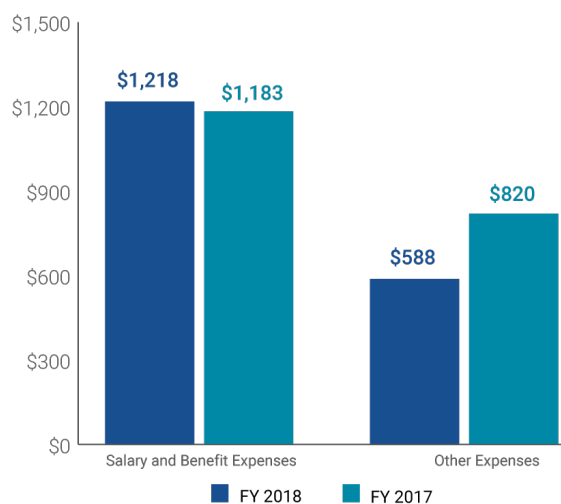


Chart 1.7 | Program Costs  
(DOLLARS IN MILLIONS)



## Budgetary Resources

For the year ended September 30, 2018, the SEC's total budgetary resources equaled \$2.36 billion, a 27 percent increase from FY 2017.

**Unobligated Balance Brought Forward—Unfunded Lease Obligations.** Unfunded lease obligations totaled \$139 million at the beginning of FY 2018. The balance for the year ended September 30, 2018, is \$68 million.

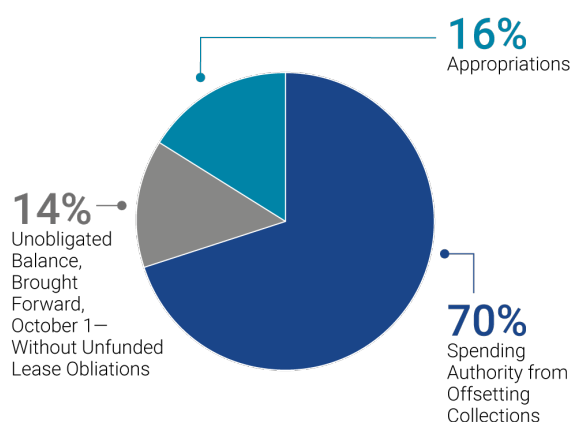
**Appropriations.** The SEC's Appropriations increased by \$320 million, or 433 percent, when compared to FY 2017. The increase is due to a \$125 million increase in salaries and expense appropriation as a result of receiving \$245 million in additional resources in FY 2018 for the potential relocation of the headquarters offices. Of this amount, \$145 million relates to the amount that was left appropriated due to a shortfall in collections used to offset the appropriation. There was a \$169 million increase in appropriated receipts in the Investor Protection Fund for the replenishment of the fund. In addition, the SEC experienced additional Reserve Fund resources in FY 2018 as a result of the FY 2017 temporary rescission becoming available during FY 2018.

Table 1.5 | Total Budgetary Resources  
For the years ended September 30, 2018 and 2017

<i>(DOLLARS IN MILLIONS)</i>	2018	2017
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)		
Salaries and Expenses Fund—Without Unfunded Lease Obligations	\$ 51	\$ 64
Salaries and Expenses Fund—Effect of Change in Legal Interpretation for Lease Obligations	(139)	(213)
Reserve Fund	2	3
Investor Protection Fund	297	340
<b>Total Unobligated Balance, Brought Forward, October 1</b>	<b>211</b>	<b>194</b>
Appropriations (Discretionary and Mandatory)		
Salaries and Expenses Fund	145	20
Reserve Fund	75	50
Investor Protection Fund	174	4
Spending Authority from Offsetting Collections	1,753	1,587
<b>Total Budgetary Resources</b>	<b>\$ 2,358</b>	<b>\$ 1,855</b>

**Spending Authority from Offsetting Collections.** The SEC's Spending Authority from Offsetting Collections increased by \$166 million, or 10 percent, when compared to FY 2017. The increase is primarily due to additional FY 2018 appropriation received in case of potential relocation of the headquarters offices. The additional resources required the SEC to collect an additional amount of Section 31 fees during FY 2018 compared to the previous year to offset the appropriation.

Chart 1.8 | FY 2018 Sources of Funds



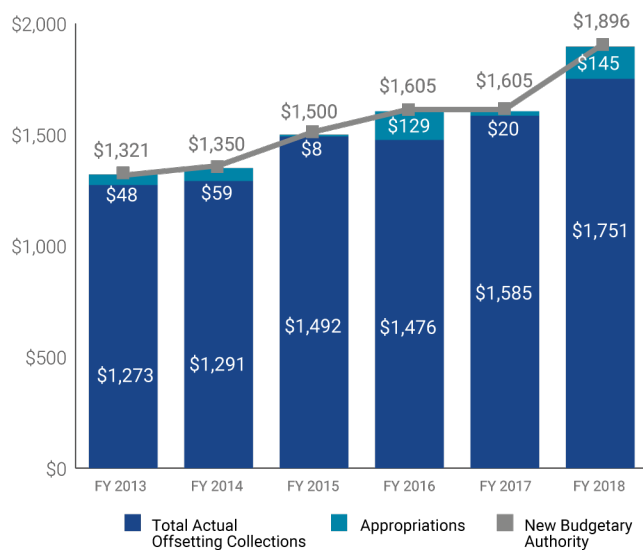
Percentages do not include the Unobligated Balance Brought Forward, October 1—Interpretation for Lease Obligations

## Spending Authority from Offsetting Collections and Appropriations

During the fiscal year, the SEC receives an appropriation to fund its operations. This appropriation establishes the SEC's new budget authority in its Salaries and Expenses Fund for the fiscal year. The SEC received new budget authority of \$1,896 million for FY 2018.

The SEC's Section 31 fee collections are used to offset the appropriation, and as the collections come in, the appropriated authority is returned to the U.S. Treasury General Fund. The SEC collected \$1,751 million in Section 31 transaction fees for the year ended September 30, 2018. In FY 2017, the SEC's appropriation was \$1,605 million, which was offset by \$1,585 million in collections.

Chart 1.9 | Offsetting Collections vs. New Budgetary Authority Section 31 Exchange and Transaction Fees  
(DOLLARS IN MILLIONS)



## Investor Protection Fund

The SEC prepares standalone financial statements for the Investor Protection Fund as required by the Dodd-Frank Act. The Fund was established in FY 2010 to provide funding for a whistleblower award program and to finance the operations of the SEC OIG's Employee Suggestion Program.

For the year ended September 30, 2018, the balance of the Investor Protection Fund increased by \$2 million when compared to the prior fiscal year.

During FY 2018, the SEC deposited available Disgorgement and Penalty collections and interest totaling \$185 million; \$179 million due to Investor Protection Fund replenishments after falling below the \$300 million statutory threshold; and \$6 million due to investment interest in Treasury securities. The definition of balance of the fund was changed in FY 2018 from total assets to unobligated balance effective July 1, 2018.

As of September 30, 2018, the SEC has recognized \$77 million in accounts payable for outstanding whistleblower awards. In addition, the Investor Protection Fund disbursed payments of \$94 million for whistleblower awards and employee related expenses in FY 2018.

## Limitations of the Financial Statements

The principal financial statements are prepared to report the financial position and results of operations of the reporting entity, pursuant to the requirements of 31 U.S.C. § 3515(b). The statements are prepared from the books and records of the entity in accordance with federal generally accepted accounting principles (GAAP) and the formats prescribed by OMB. Reports used to monitor and control budgetary resources are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. Government.

Table 1.6 | Investor Protection Fund Activity  
For the years ended September 30, 2018 and 2017

(DOLLARS IN MILLIONS)	2018	2017
Balance of Fund at beginning of fiscal year, October 1	\$ 297	\$ 340
Amount deposited into or credited to the Fund during the fiscal year	185	4
Amount obligated and unpaid during the fiscal year	(77)	2
Amount paid from the Fund during the fiscal year to whistleblowers	(94)	(49)
Net sequestration and recoveries	(12)	—
<b>Balance of the Fund at the end of the reporting period</b>	<b>\$ 299</b>	<b>\$ 297</b>

# PERFORMANCE HIGHLIGHTS

The SEC's performance data provides a foundation for both programmatic and organizational decision-making, and is critical for gauging the agency's success in meeting its strategic goals. The SEC is committed to using performance management best practices to promote greater accountability. This section provides information on its key performance measures for FY 2018. It outlines the SEC's strategic and performance planning framework and highlights the agency's progress toward reaching key performance targets.

The SEC's FY 2018 Annual Performance Report (APR) will be issued with the agency's FY 2020 Congressional Budget Justification, and will provide a complete discussion of all of the agency's strategic goals, including a description of performance goals and objectives, data sources, performance results and trends, and

information about internal reviews and evaluations. The summary presented below of the SEC's verification and validation of all performance data also will be included in the APR. The SEC's APR is expected to be available in 2019 at [SEC.gov/about/secreports.shtml](https://www.sec.gov/about/secreports.shtml).

## Strategic and Performance Planning Framework

The SEC's FY 2018 strategic and performance planning framework is based on the recently published FY 2018–FY 2022 Strategic Plan, available at [SEC.gov/strategic-plan](https://www.sec.gov/strategic-plan). The Strategic Plan outlines the agency's mission, vision, values, strategic goals, and initiatives. The SEC's work is structured around 3 strategic goals, as well as 14 strategic initiatives the agency plans to achieve in support of those goals.





## SEC INVESTS IN... PROGRESS

Established in 1934, the SEC is no stranger to the ever-changing nature of the U.S. and global markets.

We remain focused on balancing innovative and modern approaches with traditional, tried-and-true methods to ensure we keep pace with this dynamic industry and protect the long-term interests of Main Street investors.



### Verification and Validation of Performance Data

The SEC's programs require accurate data to properly assess program performance and make sound management decisions. To ensure data is correct, a system of data verification and validation is used. Data verification is a systematic process for evaluating a set of data against a set of standards to ascertain its completeness, correctness, and consistency using the methods and criteria defined in the project documentation. Data validation follows the data verification process in an effort to ensure that performance data are free of systematic error or bias, and that what is intended to be measured is actually measured. Together, these processes are used to evaluate whether the information has been generated according to specifications, satisfies acceptance criteria, and is appropriate and consistent with its intended use.

Below is a list of steps taken to ensure the performance data presented in this report is complete, reliable, and accurate.

1. The agency develops performance goals through its strategic planning process.
2. The SEC's divisions and offices provide:
  - The procedures used to obtain assurance as to the accuracy and reliability of the data;
  - The data definitions for reference;
  - Documentation and explanation of the performance goal calculations; and
  - The sources of the underlying data elements.
3. The performance data is approved by the division directors and office heads. This process ensures that the data used in the calculation of performance goals is accurate and reliable, and that internal control is maintained throughout the approval process.

## Strategic Goal 1: Focus on long-term interests of our Main Street Investors.

Table 1.7

Percentage of investment advisers, investment companies, and broker-dealers examined during the year							
Fiscal Year	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018 Plan	FY 2018 Actual
Investment advisers	9%	10%	10%	11%	15%	15%	17%
Investment companies	11%	10%	15%	17%	11%	11%	15%
Broker-Dealers (exams by SEC and SROs)	46%	49%	51%	50%	48%	48%	48%

**Target:** Investment advisers—Exceeded; Investment companies—Exceeded; Broker-Dealers (exams by SEC and SROs)—Met

**Responsible Division/Office:** Office of Compliance Inspections and Examinations

**Data Source:** Tracking and Reporting Exam National Documentation System (TRENDS) (IA, IC, and BD SEC data) and SRO Databases (BD SRO Data)

As part of the SEC’s efforts to focus on the long-term interests of Main Street investors, the agency’s National Examination Program (NEP) conducts inspections of regulated entities, covering as much of the securities industry as resources will allow. The NEP focused particular efforts in the investment adviser/investment company area, and was able to significantly improve coverage over the prior year. In addition to conducting examinations, the staff continued to spend considerable time and attention during the year on other critical activities intended to improve program performance

and protect investors. This included, for example, enhancing risk assessment efforts to ensure that the program is spending its limited resources on activities and firms presenting the highest risk; conducting various industry outreach efforts to promote compliance; and working with rulemaking offices to inform policy. These activities to build and maintain coverage of the industry help the Commission uncover wrongdoing and protect the long-term interests of Main Street investors.

Table 1.8

### Percentage of enforcement actions in which the Commission obtained relief on one or more claims

**Description:** This metric identifies, as to all parties to enforcement actions that were resolved in the fiscal year, the percentage against whom the Commission obtained a judgment or order entered on consent, a default judgment, a judgment of liability on one or more charges, and/or the imposition of monetary or other relief.

Fiscal Year	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018 Plan	FY 2018 Actual
Percentage	93%	94%	95%	97%	94%	92%	92%

**Target:** Met

**Responsible Division/Office:** Division of Enforcement

**Data Source:** HUB case management and tracking system for the Division of Enforcement

Key parts of Main Street investor protection are to quickly and appropriately sanction those who prey on investors and to successfully litigate cases. The Division of Enforcement strives to obtain swift and strong judgment orders consistent with fairness and due process. Successful litigation sanctions wrongdoers, provides relief to victims, and deters wrongdoing. In addition to victories in the specific cases the agency

brings to trial, the SEC's litigation efforts also help the SEC obtain strong settlements in other cases by making it clear that the SEC will go deep into litigation and to trial, if necessary, in order to obtain appropriate relief. The agency seeks to direct its limited resources toward cases that are likely to have the greatest impact in furthering the SEC's mission and goal of protecting the long-term interests of Main Street investors.

Strategic Goal 2: Recognize significant developments and trends in our evolving capital markets and adjust our efforts to ensure we are effectively allocating our resources.

Table 1.9

Time to complete SEC review of SRO rules that are subject to SEC approval							
<b>Description:</b> The SEC reviews SRO rule proposals for consistency with the Exchange Act standards of investor protection, fair and orderly operation of the markets and market structure, as well as other statutory requirements. This metric gauges the timeliness of those reviews.							
Fiscal Year	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018 Plan	FY 2018 Actual
Within 45 days	74%	75%	63%	60%	64%	60%	55%
<b>Target:</b> Not Met							
<b>Responsible Division/Office:</b> Division of Trading and Markets							
<b>Data Source:</b> SRO Rule Tracking System (SRTS)							

During FY 2018, the SEC approved or disapproved 183 SRO rule changes filed pursuant to Section 19(b) (2) of the Exchange Act. Due in part to the increasing complexity of filings, and number of entities filing, the number of filings approved within 45 days has declined over the past two years. Although the SEC did not meet the 45-day standard for reviewing all rule filings, it did meet all of the Dodd-Frank Act statutory timeframes 100 percent of the time.

The adoption of the Dodd-Frank Act in July 2010 required the SEC to approve or disapprove within certain statutory timeframes from the date of publication of a rule change. The SEC must publish a rule

filing for comment within 15 days of receipt. Once a rule filing is published for comment, the SEC must complete a review within 45 days; for complex rule filings, the statute provides for longer periods of time. Of the 183 SRO rule changes subject to standards of the Dodd-Frank Act, 100 percent of the filings were published within 15 days of filing. In addition, 101 filings were subsequently approved or disapproved within 45 days of publication of notice in the Federal Register. The remaining 81 filings were approved or disapproved within the other statutory benchmarks 100 percent of the time (i.e., within 90 days, within 180 days, within 240 days).

Table 1.10

### Length of time to respond to written requests for no-action letters (NAL), exemptive applications, and written interpretive requests

**Description:** The SEC staff responds to requests for guidance from individuals and market participants about specific provisions of the federal securities laws. These queries may seek interpretations of the securities laws or regulations, or assurances that no enforcement action will be taken if the individual or market participant engages in a specified activity. The staff also reviews applications for exemptions from the securities laws. Written responses to such requests for guidance, when provided, generally are publicly available, as are applications and related notices and orders, when issued. This metric gauges the timeliness of initial comments issued by the Divisions of Trading and Markets, Investment Management, and Corporation Finance.

Fiscal Year	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018 Plan	FY 2018 Actual
<b>Division of Trading and Markets</b>							
Percentage within required timeframe	93%	83%	88%	81%	86%	80%	85%
<b>Target:</b> Exceeded							
<b>Data Source:</b> TM Request Tracking Log							
<b>Division of Investment Management</b>							
No-action letters and interpretive requests	100%	100%	100%	97%	97%	80%	100%
Exemptive applications	99%	99%	100%	100%	100%	80%	100%
<b>Target:</b> No-action letters and interpretive requests—Exceeded; Exemptive applications—Exceeded							
<b>Data Source:</b> CCO Tracker							
<b>Division of Corporation Finance</b>							
No-action letters and interpretive requests	98%	97%	94%	93%	98%	90%	98%
Shareholder proposals	100%	100%	100%	100%	100%	100%	100%
<b>Target:</b> No-action letters and interpretive requests—Exceeded; Shareholder proposals—Met							
<b>Data Source:</b> Division No-Action Letter database and Division Shareholder Proposal database							

The process of developing and administering rules and regulations is one of the principal functions of the SEC and involves staff from virtually every division and office. One of the agency's primary objectives is to maintain a regulatory framework that enables market participants to understand their obligations. The SEC devotes resources from the Divisions of Trading and Markets (TM), Investment Management (IM), and Corporation Finance (CF) to respond to no-action letters (NAL), exemptive applications, and interpretive and other requests from regulated entities, public companies, and other outside parties. CF has always met the goal of responding to 90 percent of NALs, exemptive applications, and written interpretive

requests within 30 days. Since FY 2013, the percentage has increased by five percentage points from year to year, and is 98 percent for both FY 2017 and FY 2018. The changes are due to a combination of volume of requests, complexity of requests, and staffing levels. IM did not plan to raise their targets from the prior year because the ability to meet the targets are dependent on factors that could change materially during any fiscal year such as the total number of applications filed, concentration of filings at any particular time period (surges), and the types and complexity of the applications filed. In FY 2018, TM, IM, and CF met or exceeded their response rate targets.

## Strategic Goal 3: Elevate the SEC's performance by enhancing our analytical capabilities and human capital development.

Table 1.11

Survey Rankings							
<b>Description:</b> Annual and other rankings, together with other metrics and indicators of federal government agencies, is one type of metric that will be used to determine the SEC's overall success in improving employee morale and employee engagement.							
Fiscal Year	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018 Plan	FY 2018 Actual
<i>Best Places to Work</i> Ranking	Ranked #15	Ranked # 14	Ranked # 10	Ranked #6	Ranked #5	Ranked #4	N/A
Average of employee engagement and global satisfaction index	61%	66%	68%	75%	77%	80%	80%
<b>Target:</b> <i>Best Places to Work</i> Ranking—TBD; Average of employee engagement and global satisfaction index—Met							
<b>Responsible Division/Office:</b> Office of Human Resources							
<b>Data Source:</b> Annual Partnership for Public Service calculated ranking based on Annual Federal Employee Viewpoint Survey (FEVS) results administered by OPM and Average of Employee Engagement and Global Satisfaction Index from OPM EVS							

The SEC employees are the most important asset of the agency. In FY 2018, the SEC continued to elevate performance by enhancing its human capital development. The SEC must foster a work environment that attracts, engages, and retains a technically proficient and diverse workforce. Specifically, the Federal Employee Viewpoint Survey (FEVS) results demonstrate continued improvement in some of the most important drivers of employee engagement and organizational health. In FY 2017, the SEC ranked

number five among all medium-sized agencies in the federal government. In the Employee Engagement Index, the SEC continued to improve and demonstrate additional gains in some of the most important drivers of employee engagement and organizational health. Based on the 2018 FEVS results for the Global Satisfaction Index, the agency expects to improve on the 5th place ranking from 2017. The *Best Places to Work* rankings will be announced in December of 2018.



# MANAGEMENT ASSURANCES AND COMPLIANCE WITH LAWS

In FY 2018, the SEC demonstrated its continued commitment to maintaining strong internal controls. Internal control is an integral component of effective agency management, providing reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of reporting, and compliance with laws and regulations. The Federal Managers' Financial Integrity Act of 1982 (FMFIA) establishes management's responsibility to assess and report on internal accounting and administrative controls. Such controls include program, operational, and administrative areas, as well as accounting and financial management. The FMFIA requires federal agencies to establish controls that reasonably ensure obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable reports and to maintain accountability over the assets. The FMFIA also requires agencies to annually assess whether financial management systems conform to related requirements (FMFIA § 4). Guidance for implementing the FMFIA

is provided through Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, and the newly revised Appendix A, *Management of Reporting and Data Integrity Risk*.

Section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) describes the responsibility of SEC management to establish and maintain adequate internal controls and procedures for financial reporting. This section requires an annual financial controls audit, a Government Accountability Office (GAO) audit of the SEC's assessment of the effectiveness of financial controls, and attestation by the Chairman and the Chief Financial Officer (CFO). Section 922 of the Dodd-Frank Act requires the SEC to submit audited financial statements of the Investor Protection Fund to the Senate Committee on Banking, Housing, and Urban Affairs, and the House of Representatives Committee on Financial Services. The following Assurance Statement is issued in accordance with the FMFIA, OMB Circular A-123, and Sections 963 and 922 of the Dodd-Frank Act.

## Annual Assurance Statement

SEC management is responsible for establishing and maintaining an effective system of internal control that meets the objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). In accordance with OMB Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, the SEC conducted its annual assessment of its system of internal control. Based on the results of this assessment, the SEC can provide reasonable assurance that its system of internal control over operations, reporting, and compliance was operating effectively as of September 30, 2018, except for a material weakness in internal controls related to cybersecurity risks. This weakness is described later in this section.

SEC management is also responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Based on the results of its annual assessment of internal controls, the SEC can provide reasonable assurance that internal controls and procedures over financial reporting were operating effectively during the year ended September 30, 2018.

The SEC also conducted reviews of its financial management systems in accordance with OMB Circular A-123 Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996*. Based on the results of these reviews, the SEC can provide reasonable assurance that its financial management systems substantially comply with the requirements of the FFMIA as of September 30, 2018.



JAY CLAYTON  
Chairman  
November 9, 2018



CARYN E. KAUFFMAN  
Chief Financial Officer  
November 9, 2018

## Management's Assessment of Internal Control

The Chairman and CFO's FY 2018 annual assurance statement for FMFIA provide reasonable assurance that internal controls over operations, reporting, and compliance were operating effectively as of September 30, 2018. The associated objectives are: effective and efficient operations, compliance with applicable laws and regulations, and reliability of reporting.

The basis for management's assessment of, and assurance about, the SEC's system of internal control is composed of many facets. A central facet is the reports from each division director and office head. These statements were based on each person's knowledge of daily operations, self-assessments, and internal reviews supported by control testing, as well as recommendations for improvement from audits, investigations, and reviews conducted internally by the SEC Office of Inspector General (OIG) and GAO. Management considered the contents of these statements along with other sources of information that included, but were not limited to, the following:

- An entity-level internal control evaluation;
- Internal management reviews, self-assessments, and tests of internal controls;
- Management's personal knowledge gained from daily operations;
- Reports from GAO and the OIG;
- Reviews of financial management systems under OMB Circular A-123 Appendix D, *Compliance with the Federal Financial Management Improvement Act of 1996* (FFMIA);
- Reports pursuant to the Federal Information Security Modernization Act (FISMA) and OMB Circular A-130, *Management of Federal Information Resources*;
- Reviews on improper payments;
- Reviews that support compliance with the Digital Accountability and Transparency Act of 2014 (DATA Act);

- Reports and other information from Congress or agencies such as OMB, the Office of Personnel Management, and/or the General Services Administration reflecting the adequacy of internal controls; and
- Additional reviews relating to a division or office's operations.

With respect to internal controls over reporting of financial information, the SEC performed a comprehensive risk assessment. The agency documented its key controls to address risks, and assessed the design and operating effectiveness of these controls through detailed test procedures. The agency also tested the operating effectiveness of control activities that were found to be deficient in prior years. SEC management analyzed the magnitude of internal control deficiencies, both individually and in the aggregate, to determine whether a material weakness existed in the financial reporting processes.

Taking into account the statements from directors and office heads, the supplemental sources of information as described above, and the results of the assessment of internal controls over operations, reporting, and compliance, the agency's Financial Management Oversight Committee advises the Chairman as to whether the SEC had any internal control deficiencies and, if so, their related significance.

## Material Weakness Related to Cybersecurity Risks

In August 2017, the SEC learned that a cybersecurity incident previously detected in 2016 may have provided the basis for illicit gain through trading. Specifically, a software vulnerability in the test filing component of the agency's EDGAR system was exploited and resulted in access to nonpublic information. The 2016 intrusion resulted in part from a deficiency in the SEC's ability to timely detect and mitigate vulnerabilities within the EDGAR system's

source code. Specifically, the security reviews of EDGAR source code were not consistently implemented. In addition, the agency's incident response protocols did not sufficiently ensure that agency leadership was appropriately apprised of information necessary for addressing cybersecurity risks. Taken together, management determined that these two deficiencies represented a material weakness in the agency's internal control system over operations as of September 30, 2017.

Over the course of the past year, the SEC staff, along with the assistance of outside experts, has worked to understand and remediate the sources of these two deficiencies. The particular source code vulnerability that contributed to the 2016 incident was patched promptly after it was discovered. The agency has also taken a series of substantive steps designed to better detect and prevent code vulnerabilities. The SEC has contracted with multiple private-sector vendors and invested substantial resources in penetration testing and comprehensive source code reviews in an effort to detect and help remediate existing code vulnerabilities. Further, in order to reduce the risk of such issues arising in the first instance, the SEC has implemented a repeatable process by which the source code for each new EDGAR release is reviewed prior to implementation. This has allowed the agency to increase its ability to proactively spot and remediate potential vulnerabilities.

Of course, SEC management remains mindful of the fact that—like many other governmental agencies, financial market participants, and private sector entities—the agency is the subject of frequent attempts by unauthorized actors to disrupt public-facing systems, access data, or otherwise damage technology infrastructure. The SEC has also, therefore, taken other substantive steps designed to improve the agency's detection and response capabilities. For example, in addition to engaging external experts and implementing additional security detection capabilities,

the agency revised and table-top tested its Incident Management Plan in an effort to help ensure that, in the future, information about cyber incidents will be appropriately and timely conveyed to senior management. More generally, the agency has focused closely on its cybersecurity risk governance structure. It has, among other things, established a senior-level cybersecurity working group and created a new position, the Chief Risk Officer (currently filled on an acting basis), to coordinate the SEC's efforts to identify, monitor, and mitigate risks across divisions and offices.

During the coming year, among other projects designed to improve the security of the agency's information systems and overall cybersecurity risk profile, the SEC will focus its efforts on the associated aspects of its system of internal control. The SEC will work to document, test, and—where appropriate—enhance controls relating to information technology. The agency's efforts will incorporate recent recommendations from the SEC's OIG relating to EDGAR governance, security practices, and incident management.<sup>1</sup> Until control measures in furtherance of these efforts are taken, the SEC continues to report, as it did in FY 2017, a material weakness in internal control associated with its operations. SEC management has reasonable assurance that this material weakness in internal control did not extend to its system of internal control over financial reporting during the year ended September 30, 2018.

## Other Reviews

### Fraud Reduction Report

The Fraud Reduction and Data Analytics Act of 2015 (Pub. L. 114-186, 31 U.S.C. 3321 note) requires agencies to implement the GAO's *A Framework to Managing Fraud Risks in Federal Programs*. The GAO framework identifies four steps that agencies should follow: 1) commit to creating an organization that is conducive to manage fraud risk; 2) assess the fraud

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<sup>1</sup> Report entitled "Evaluation of the EDGAR System's Governance and Incident Handling Processes"; Report No. 550, dated September 21, 2018.

risks within the organization; 3) design and implement controls that reduce risk of fraud; and 4) evaluate and adapt assessment outcomes. The SEC's approach to managing fraud risk starts with a strong tone at the top. This includes messaging from senior officials regarding the importance of a culture committed to a high level of integrity, and resources dedicated to ensuring that ethics training is provided annually to all employees. The SEC continues to leverage its Risk Management Oversight Committee, which consists of senior officers from divisions and offices throughout the SEC who facilitate the Commission's efforts to assess, address, and report on identified fraud risks.

The SEC has established a system of internal control to support effective and efficient operations that also helps to mitigate the risk of fraud. Such controls, which overlay formal policies and procedures, typically deal with factors such as approval and authorization processes; access restrictions and transaction controls; account reconciliations; and physical security. These procedures often include the division of responsibilities and checks and balances to reduce risk. To the extent that these controls affect financial reporting, they are reviewed and tested by management on an annual basis. Controls that do not impact financial reporting are reviewed annually and tested on a rotational basis based upon risk as part of the Commission's management assurance evaluation. While strong internal controls help to mitigate the risk of fraud, employees are strongly encouraged to speak with management or the OIG should they suspect instances of fraud.

Analysis of results from testing performed and the overall business environment can lead to additional learning opportunities for which there is a heightened risk of fraud. For example, SEC management requires annual training for all contracting officers and contracting officer representatives around the potential for fraud in the area of procurement. The OIG provides a block of instruction during training.

Management recognizes that the assessment of fraud is an ongoing process and that mitigation strategies need to change as business processes and the overall environment evolve.

#### [The Improper Payments Elimination and Recovery Improvement Act](#)

The Improper Payments Information Act of 2002, as amended by the Improper Payments Elimination and Recovery Act of 2010, the Improper Payments Elimination and Recovery Improvement Act of 2012, and the Federal Improper Payments Coordination Act of 2015, requires agencies to review all programs and activities they administer and identify those which may be susceptible to significant erroneous payments. For all programs and activities in which the risk of erroneous payments is significant, agencies are to estimate the annual amount of erroneous payments made in those programs. The SEC's risk assessments have consistently indicated that none of the SEC's programs are susceptible to significant improper payments. Therefore, per OMB guidelines, the SEC does not need to conduct another risk assessment until FY 2019. The SEC will be required to perform another risk assessment sooner if a program has a significant change in legislation and/or a significant increase in its funding.

#### [Digital Accountability and Transparency Act of 2014](#)

The DATA Act (Pub. L. 113-101) was enacted to establish government-wide financial data standards to increase the availability, accuracy, and usefulness of federal spending information. The DATA Act requires that federal agencies report financial spending data in accordance with data standards established by the U.S. Department of the Treasury (Treasury) and OMB. The DATA Act requires federal agencies to disclose direct federal agency expenditures and link federal contract spending information to programs of federal agencies to enable taxpayers to track federal spending more effectively using [USASpending.gov](http://USASpending.gov).

In accordance with the DATA Act, the SEC formalized financial system and manual controls over the completeness and accuracy of federal spending data reported both internally and externally. The SEC began its successful quarterly reporting transmission to Treasury in the second quarter of FY 2017.

## Financial Management System Conformance

The FFMIA requires that each agency implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the U.S. Standard General Ledger at the transaction level. The purpose of the FFMIA is to advance federal financial management by verifying that financial management systems provide accurate, reliable, and timely financial management information in order to manage daily operations, produce reliable financial statements, maintain effective internal control, and comply with legal and regulatory requirements. Although the SEC is exempt from the requirement to determine substantial compliance with the FFMIA, the agency assesses its financial management systems annually for conformance with the requirements of OMB Circular A-123 Appendix D and other federal financial system requirements.

## Summary of Current Financial System and Future Strategies

The FY 2018 assessment of current financial systems demonstrated that a low risk rating would be appropriate, and that the agency substantially complied with the requirements of Section 803(a) of the FFMIA. The SEC's financial system, Delphi, is supported by an approved Federal Shared Service Provider (FSSP) and meets all of the requirements of the FFMIA.

In FY 2018, the SEC continued to work with its FSSP, the Department of Transportation's Enterprise Services Center, to enhance its existing systems and implement additional financial and mixed systems. The SEC is

also continuing to improve efficiencies with the project to create a new Disgorgements and Penalties System. This project is scheduled for implementation in FY 2020. The SEC believes that continuing to invest in technology-based solutions will help to put its controls on a more sustainable path.

## Federal Information Security Modernization Act (FISMA)

FISMA requires federal agencies to “develop, document, and implement an agency-wide information security program to provide information security for the information and information systems that support the operations and assets of the agency, including those provided or managed by another agency, contractor, or other source.” In addition, FISMA requires federal agencies to conduct annual assessments of their information security and privacy programs, to develop and implement remediation efforts for identified weaknesses and vulnerabilities, and to report compliance to OMB. The SEC's OIG, chief information security officer, and senior agency official for privacy perform a joint review of the Commission's compliance with FISMA requirements each year. The Commission submitted its FY 2018 report to OMB on October 31, 2018.

## Oversight and Compliance

The SEC's Office of Information Technology (OIT), in partnership with business owners, completed assessment and authorization activities for 20 FISMA reportable systems. OIT also conducted two incident response exercises: an exercise involving SEC Executive Management in May, and a Privacy Breach Response Team exercise in September. OIT facilitated the remediation of over 219 self-identified deficiencies that consist of Plans of Action and Milestones (POA&Ms) associated with the SEC's assessments of its network infrastructure and major applications, as well as recommendations issued by the OIG and the GAO that were open at the beginning of FY 2018. OIG closed 18 recommendations during FY 2018, and GAO closed 17. GAO performs the SEC's annual financial



statement audit, which includes an audit of the technology environment supporting financial statement preparation. The SEC's OIG performs an independent evaluation of the SEC's information security program, as required by the E-Government Act of 2002.

OIT conducted 371 privacy reviews for information collections in accordance with the Privacy Act of 1974, the Paperwork Reduction Act, and the E-Government Act of 2002. Because of the privacy reviews, OIT conducted and published seven privacy impact assessments, for systems that collect, maintain, or disseminate personally identifiable information (PII). In addition, OIT published three new and two modified systems of records notices (SORN), and rescinded 33 SORNs because the records either: (1) are not Privacy Act records; (2) will be maintained as part of a new or modified system of records; (3) are duplicative and covered by another SEC system of records; or (4) are obsolete and no longer maintained by the SEC.

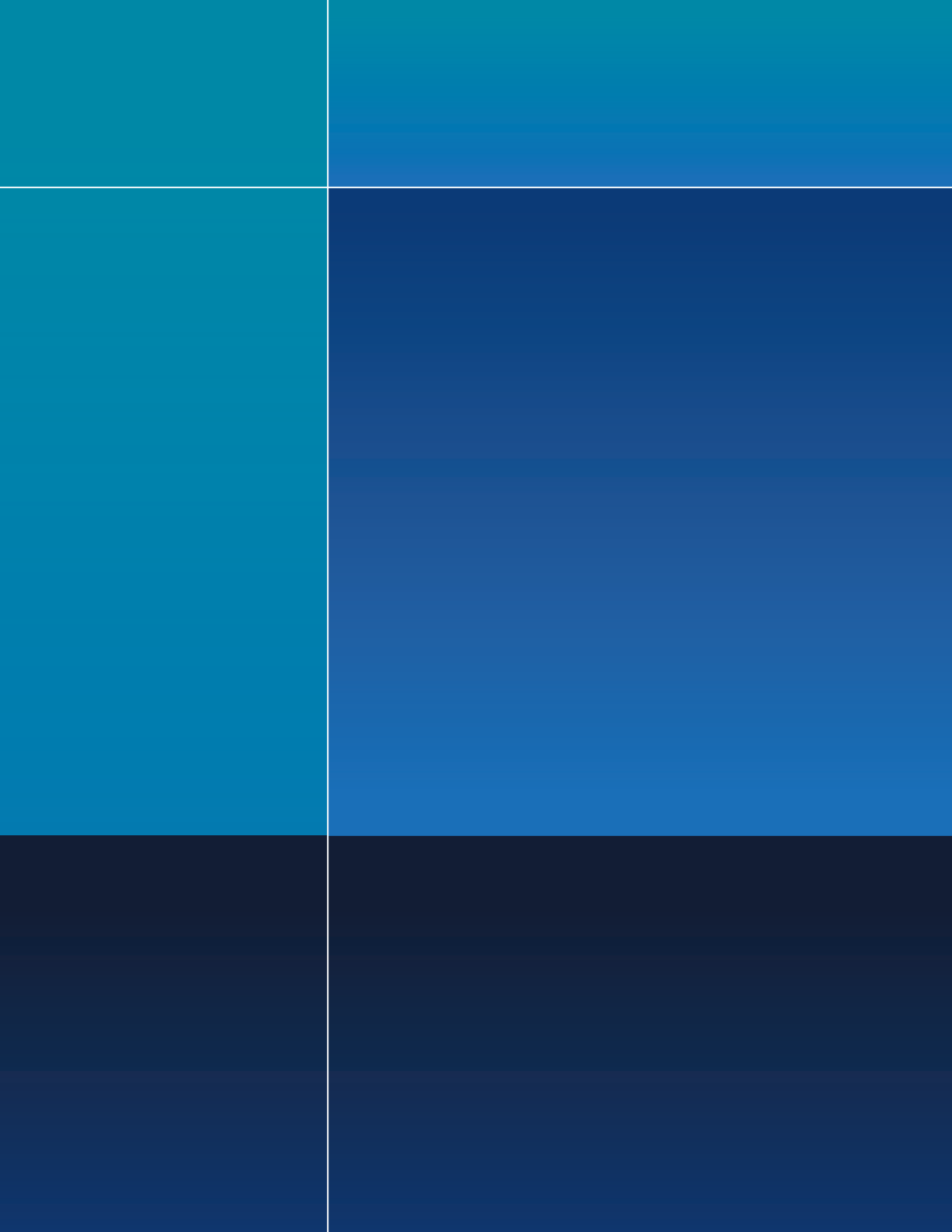
### Training and Communications

OIT developed and delivered Privacy and Information Security Awareness training to all SEC personnel and achieved 99 percent compliance, to include acknowledgement of the agency's acceptable use policy. Network restrictions were placed on personnel who failed to complete training. OIT initiated two key privacy awareness campaigns. In January, the agency observed National Data Privacy Day by issuing an informative article in the agency's internal newsletter, which promoted key topics on protecting PII and the importance of keeping data safe. During the first two weeks of each month, OIT also released PII Tips via agency TV monitors. The PII Tips focused on many practical methods for protecting PII at home and in the office. OIT developed and provided in-person Person-

ally Identifiable Information and Cybersecurity training and distributed awareness material to six SEC regional offices. The training was delivered to approximately 75 percent of users in those regional offices. The training was designed to remind employees about their roles and responsibilities in safeguarding sensitive data, protecting SEC resources, and reporting privacy breaches.

### Governance and Technology

OIT continues updating governance documentation to be consistent with OMB policy and NIST guidance. OIT continues to enhance its operational security capabilities through the continued development of an Information Security Continuous Monitoring (CM) Program, which includes Privacy, and the continued investment and implementation of proactive security capabilities and detection mechanisms, as well as numerous application and database security and vulnerability assessment tools. In support of the CM Program, OIT continues using an integrated information security compliance management capability using a tool recommended by the U.S. Department of Homeland Security (DHS), RSA Archer, to serve as a centralized repository for the management of the Commission's FISMA compliance obligations, information system POA&Ms, and incident tracking and response efforts. The SEC is well positioned to continue the transition to CM and is an active participant in interagency cybersecurity initiatives, many of which are led by DHS. The SEC continues to safely explore cloud computing technologies and solutions based on federal information protection requirements. The SEC leverages five cloud service providers that have been through the Federal Risk and Authorization Management Program, and is exploring opportunities to leverage additional cloud service providers in accordance with emerging agency objectives.



# FINANCIAL SECTION

This section contains the SEC's financial statements and additional information for FYs 2018 and 2017. Information presented here satisfies the financial reporting requirements of the Accountability of Tax Dollars Act of 2002 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The SEC prepares these statements and accompanying notes in compliance with U.S. generally accepted accounting principles for the federal government and OMB Circular A-136, *Financial Reporting Requirements*.

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## SEC Financial Statements

### Balance Sheets

Presents, as of a specific time, the amount of resources that embody economic benefits or services owned or managed by the SEC (assets); amounts owed by the SEC (liabilities); and amounts that comprise the difference (net position).

### Statements of Net Cost

Presents the gross cost incurred by the SEC, less exchange revenue earned from its activities. The SEC presents cost of operations by program to provide cost information at the program level, and recognizes collections as exchange revenue on the Statement of Net Cost, even when the collections are transferred to other entities.

### Statements of Changes in Net Position

Reports the change in net position during the reporting period, including changes to Cumulative Results of Operations and Unexpended Appropriations.

### Statements of Budgetary Resources<sup>1</sup>

Provides information about how budgetary resources were made available, and reports their status at year-end.

### Statements of Custodial Activity

Reports the collection of revenue for the Treasury General Fund. The SEC accounts for sources and

disposition of the collections as custodial activities on this statement. Custodial collections of non-exchange revenue, such as amounts collected from violators of securities laws as a result of enforcement proceedings, are reported only on the Statement of Custodial Activity.

### Accompanying Notes to the Financial Statements

Provides a description of significant accounting policies and detailed information on select statement line items.

### Required Supplementary Information (Unaudited)<sup>2</sup>

Reports the Combining Statements of Budgetary Resources by fund account.

## Investor Protection Fund Financial Statements

### Investor Protection Fund Financial Statements

Provides stand-alone, comparative financial statements (Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and Statements of Budgetary Resources), as required by the Dodd-Frank Act.

### Accompanying Notes to the Investor Protection Fund Financial Statements

Provides a description of significant accounting policies and detailed information on select statement line items, as required by the Dodd-Frank Act.

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<sup>1</sup> Budgetary information aggregated for purposes of the Statement of Budgetary Resources is disaggregated for each of the SEC's major budget accounts and is presented as Required Supplementary Information.

<sup>2</sup> The SEC does not have stewardship over resources or responsibilities for which supplementary stewardship reporting would be required.

# MESSAGE FROM THE CHIEF FINANCIAL OFFICER



I am proud to join Chairman Clayton in presenting the SEC's Agency Financial Report for FY 2018. Our independent auditor, the U.S. Government Accountability Office (GAO), released an unmodified opinion of our financial statements

and internal controls, in which no significant issues were identified. This achievement is reflective of the agency's sustained drive to promote strong internal controls and effective financial management.

In FY 2018, the SEC remained focused on control improvements and high data quality, including through the development of more effective and value added technology solutions. Examples of these efforts include:

- Continued modernization of the EDGAR Financial Management System, which supports the SEC's management of registration fees. These enhancements both improve the security of our data and enable more efficient processing of registrant fees.
- Leveraging the Budget Formulation and Execution Manager, a shared-service offering of the Bureau of the Fiscal Service, to improve the reporting for budget formulation and improve capabilities for tracking the agency's strategic performance metrics.
- Building a comprehensive disgorgement and penalties sub-ledger system to improve both financial and programmatic reporting of enforcement actions. The system is expected to improve the quality of data used to track and manage enforcement actions and is a collaborative effort between the Office of Financial Management and the Division of Enforcement.

- Building upon an Enterprise Risk Management (ERM) function, under the leadership of the new position of Chief Risk Officer.

This section provides citizens with detailed information about the SEC's finances and its internal controls over financial reporting. It contains the results of the FY 2018 audit conducted by GAO and the agency's response. This section also includes the SEC's financial statements and notes, both for the entity as a whole and for the Investor Protection Fund, as required under Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Looking forward, we are committed to sustaining progress in our financial statement audits, strengthening internal controls, reducing manual processes, and improving data quality and reporting. We will continue to build out a robust internal controls program that allows us to identify and mitigate financial, operational, and compliance risks early. We will also continue to mature our ERM program to provide agency leadership with a portfolio view of risk that can inform decision-making and allocation of resources to achieve the SEC's mission.

I deeply appreciate the efforts of the talented SEC professionals who plan, execute, and account for the agency's resources. Their commitment to ensuring sound financial management provides the foundation for our strong stewardship and ensures that reliable financial information is delivered to our stakeholders.

Sincerely,

A handwritten signature in blue ink that reads "Caryn Kauffman".

CARYN E. KAUFFMAN  
Chief Financial Officer  
November 13, 2018

# REPORT OF INDEPENDENT AUDITORS



U.S. GOVERNMENT ACCOUNTABILITY OFFICE

441 G St. N.W.  
Washington, DC 20548

## Independent Auditor's Report

To the Chairman of the United States Securities and Exchange Commission

In our audits of the fiscal years 2018 and 2017 financial statements of the United States Securities and Exchange Commission (SEC)<sup>1</sup> and its Investor Protection Fund (IPF),<sup>2</sup> we found

- the SEC and IPF financial statements as of and for the fiscal years ended September 30, 2018, and 2017, are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles;
- SEC maintained, in all material respects, effective internal control over financial reporting for SEC and for IPF as of September 30, 2018; and
- no reportable noncompliance for fiscal year 2018 with provisions of applicable laws, regulations, contracts, and grant agreements we tested.

The following sections discuss in more detail (1) our report on SEC's and IPF's financial statements and on internal control over financial reporting, which includes the required supplementary information (RSI)<sup>3</sup> and other information included with the financial statements;<sup>4</sup> (2) our report on compliance with laws, regulations, contracts, and grant agreements; and (3) agency comments.

<sup>1</sup>Section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires that (1) SEC annually submit a report to Congress describing management's responsibility for internal control over financial reporting and assessing the effectiveness of such internal control during the fiscal year; (2) the SEC Chairman and Chief Financial Officer attest to SEC's report; and (3) GAO assess the effectiveness of SEC's internal control over financial reporting and evaluate, attest to, and report on SEC's assessment. Pub. L. No. 111-203, § 963(a), (b), 124 Stat. 1376, 1910 (July 21, 2010), *classified at* 15 U.S.C. § 78d-8(a), (b). SEC evaluated its internal control over financial reporting in accordance with the Office of Management and Budget's Circular A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act.

<sup>2</sup>IPF, which was established by section 922 of the Dodd-Frank Act, funds the activities of SEC's whistleblower award program under that section and the SEC Office of Inspector General Employee Suggestion Program established under section 966 of the Dodd-Frank Act. Pub. L. No. 111-203, §§ 922(a), 966, 124 Stat. 1376, 1844, 1912-13 (July 21, 2010), *classified at* 15 U.S.C. §§ 78d-4(e), 78u-6(b), (g). IPF is a separate SEC fund and its financial statements present SEC's financial activity associated with these programs. Accordingly, IPF's financial transactions are also included in SEC's overall financial statements.

<sup>3</sup>The RSI consists of the Management's Discussion and Analysis and the Combined Statement of Budgetary Resources, by Fund, which are included with the financial statements.

<sup>4</sup>Other information consists of information included with the financial statements, other than the RSI and the auditor's report.

## Report on the Financial Statements and on Internal Control over Financial Reporting

The Accountability of Tax Dollars Act of 2002 requires that SEC annually prepare and submit audited financial statements to Congress and the Office of Management and Budget.<sup>5</sup> The Securities Exchange Act of 1934, as amended in 2010 by section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requires SEC to annually submit a complete set of audited financial statements for IPF to Congress.<sup>6</sup> IPF's financial transactions are also included in SEC's overall financial statements. In accordance with the authority conferred by the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994,<sup>7</sup> we have audited the SEC and IPF financial statements. Further, in accordance with the Dodd-Frank Act, we have assessed the effectiveness of SEC's internal control over financial reporting, evaluated SEC's assessment of such effectiveness, and are attesting to and reporting on SEC's assessment of its internal control over financial reporting. SEC's financial statements comprise the balance sheets as of September 30, 2018, and 2017; the related statements of net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended; and the related notes to the financial statements. IPF's financial statements comprise the balance sheets as of September 30, 2018, and 2017; the related statements of net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended; and the related notes to the financial statements. We also have audited SEC's internal control over financial reporting as of September 30, 2018, based on criteria established under 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act (FMFIA).

We conducted our audits in accordance with U.S. generally accepted government auditing standards. We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinions.

### Management's Responsibility

SEC management is responsible for (1) the preparation and fair presentation of SEC's financial statements and those of IPF in accordance with U.S. generally accepted accounting principles; (2) preparing, measuring, and presenting the RSI in accordance with U.S. generally accepted accounting principles; (3) preparing and presenting other information included in documents containing the audited financial statements and auditor's report, and ensuring the consistency of that information with the audited financial statements and the RSI; (4) maintaining effective internal control over financial reporting, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; (5) evaluating the effectiveness of internal control over financial reporting based on the criteria established under FMFIA; and (6) its assessment about the effectiveness of internal control over financial reporting as of September 30, 2018, included in the Management Assurance section of the agency financial report.

<sup>5</sup>Pub. L. No. 107-289, § 2, 116 Stat. 2049-50 (Nov. 7, 2002), amending 31 U.S.C. § 3515.

<sup>6</sup>Dodd-Frank Act, § 922(a), 124 Stat. 1844 (July 21, 2010), adding § 21F(g)(5) of the Securities Exchange Act of 1934, classified at 15 U.S.C. § 78u-6(g)(5).

<sup>7</sup>See the Chief Financial Officers Act of 1990, Pub. L. No. 101-576, 104 Stat. 2838 (Nov. 15, 1990), codified, in relevant part, as amended, at 31 U.S.C. § 3521(g); see also the Government Management Reform Act of 1994, Pub. L. No. 103-356, 108 Stat. 3410 (Oct. 13, 1994), codified, in relevant part, as amended, at 31 U.S.C. § 3515(c).

### Auditor's Responsibility

Our responsibility is to express opinions on SEC's and IPF's financial statements and opinions on internal control over financial reporting for SEC and for IPF, based on our audits. U.S. generally accepted government auditing standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement, and whether effective internal control over financial reporting was maintained in all material respects. We are also responsible for applying certain limited procedures to RSI and other information included with the financial statements.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists.<sup>8</sup> The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also includes obtaining an understanding of internal control over financial reporting, and evaluating and testing the design and operating effectiveness of internal control over financial reporting based on the assessed risk. Our audit of internal control also considered SEC's process for evaluating and reporting on internal control over financial reporting based on criteria established under FMFIA. Our audits also included performing such other procedures as we considered necessary in the circumstances.

We did not evaluate all internal controls relevant to operating objectives as broadly established under FMFIA, such as those controls relevant to preparing performance information and ensuring efficient operations. We limited our internal control testing to testing controls over financial reporting. Our internal control testing was for the purpose of expressing an opinion on whether effective internal control over financial reporting was maintained, in all material respects. Consequently, our audit may not identify all deficiencies in internal control over financial reporting that are less severe than a material weakness.

### Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted

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<sup>8</sup>A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.



accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with provisions of applicable laws, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements due to fraud or error. We also caution that projecting any evaluation of effectiveness 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 the policies or procedures may deteriorate.

#### Opinions on SEC's Financial Statements

In our opinion, SEC's financial statements present fairly, in all material respects, SEC's financial position as of September 30, 2018, and 2017, and its net cost of operations, changes in net position, budgetary resources, and custodial activity for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

#### Opinion on IPF's Financial Statements

In our opinion, IPF's financial statements present fairly, in all material respects, IPF's financial position as of September 30, 2018, and 2017, and its net cost of operations, changes in net position, and budgetary resources for the fiscal years then ended in accordance with U.S. generally accepted accounting principles.

#### Opinion on Internal Control over Financial Reporting

In our opinion, SEC maintained, in all material respects, effective internal control over financial reporting as of September 30, 2018, for SEC and for IPF, based on criteria established under FMFIA. Our opinions on SEC's internal control are consistent with SEC's assessment that its internal control over financial reporting, both for the agency as a whole and for IPF, was operating effectively as of September 30, 2018, and that no material weaknesses were found in the design or operation of the controls.

During our 2018 audit, we identified deficiencies in SEC's internal control over financial reporting that we do not consider to be material weaknesses or significant deficiencies.<sup>9</sup> Nonetheless, these deficiencies warrant SEC management's attention. We have communicated these matters to SEC management and, where appropriate, will report on them separately.

#### Other Matters

##### **Required Supplementary Information**

U.S. generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) require that the RSI be presented to supplement the financial

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<sup>9</sup>A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

statements. Although the RSI is not a part of the financial statements, FASAB considers this information to be an essential part of financial reporting for placing the financial statements in appropriate operational, economic, or historical context. We have applied certain limited procedures to the RSI in accordance with U.S. generally accepted government auditing standards, which consisted of inquiries of management about the methods of preparing the RSI and comparing the information for consistency with management's responses to the auditor's inquiries, the financial statements, and other knowledge we obtained during the audit of the financial statements, in order to report omissions or material departures from FASAB guidelines, if any, identified by these limited procedures. We did not audit and we do not express an opinion or provide any assurance on the RSI because the limited procedures we applied do not provide sufficient evidence to express an opinion or provide any assurance.

#### **Other Information**

SEC's other information contains a wide range of information, some of which is not directly related to the financial statements. This information is presented for purposes of additional analysis and is not a required part of the financial statements or the RSI. We read the other information included with the financial statements in order to identify material inconsistencies, if any, with the audited financial statements. Our audit was conducted for the purpose of forming an opinion on SEC's and IPF's financial statements. We did not audit and do not express an opinion or provide any assurance on the other information.

#### **Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements**

In connection with our audits of SEC's and IPF's financial statements, we tested compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements consistent with our auditor's responsibility discussed below. We caution that noncompliance may occur and not be detected by these tests. We performed our tests of compliance in accordance with U.S. generally accepted government auditing standards.

##### Management's Responsibility

SEC management is responsible for complying with applicable laws, regulations, contracts, and grant agreements applicable to SEC and IPF.

##### Auditor's Responsibility

Our responsibility is to test compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to SEC and IPF that have a direct effect on the determination of material amounts and disclosures in the SEC and IPF financial statements, and to perform certain other limited procedures. Accordingly, we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to SEC and IPF.

##### Results of Our Tests for Compliance with Laws, Regulations, Contracts, and Grant Agreements

Our tests for compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements disclosed no instances of noncompliance for fiscal year 2018 that would be reportable under U.S. generally accepted government auditing standards. However, the objective of our tests was not to provide an opinion on compliance with laws, regulations, contracts, and grant agreements applicable to SEC and IPF. Accordingly, we do not express such an opinion.

Intended Purpose of Report on Compliance with Laws, Regulations, Contracts, and Grant Agreements

The purpose of this report is solely to describe the scope of our testing of compliance with selected provisions of applicable laws, regulations, contracts, and grant agreements, and the results of that testing, and not to provide an opinion on compliance. This report is an integral part of an audit performed in accordance with U.S. generally accepted government auditing standards in considering compliance. Accordingly, this report on compliance with laws, regulations, contracts, and grant agreements is not suitable for any other purpose.

**Agency Comments**

In commenting on a draft of this report, SEC expressed pleasure that GAO found that SEC's financial statements and notes were presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles. SEC stated that its management and staff strive to continually improve its internal control environment and recognize the essential role of a strong internal control program.

SEC also stated that it is continuing to take a number of substantive steps to enhance, as appropriate, the agency's information technology to address continued deficiencies in its controls over operations related to cybersecurity. GAO has monitored SEC's actions related to these deficiencies and will consider reporting on this as a separate matter. The complete text of SEC's response is reproduced in enclosure I.



James R. Dalkin  
Director  
Financial Management and Assurance

November 13, 2018

# ENCLOSURE I: MANAGEMENT'S RESPONSE TO AUDIT OPINION



UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

November 9, 2018

Mr. James R. Dalkin  
Director  
Financial Management and Assurance  
United States Government Accountability Office  
441 G Street, N.W.  
Washington, DC 20548

Dear Mr. Dalkin:

Thank you for the opportunity to review and comment on the audit report of the Government Accountability Office (GAO). I am pleased that the GAO's FY 2018 audit found that the SEC's financial statements and notes were presented fairly, in all material respects, and in conformity with U.S. generally accepted accounting principles. Also, GAO reported that the SEC had effective internal control over financial reporting, and that there was no reportable noncompliance with applicable laws and regulations.

As you know, in the agency's own FY 2017 management assessment of internal control, we identified a material weakness in internal control related to cybersecurity risks. Since then, we have taken a series of substantive steps designed to better detect and prevent vulnerabilities, but more work remains to be done. In the coming year, we will continue to document and test—and, where appropriate, enhance—controls relating to information technology. Until control measures in furtherance of these efforts are taken, we continue to report, as we did in 2017, a material weakness in internal control associated with our operations.

SEC management and staff strive to continually improve the internal control environment and recognize the essential role a strong internal control program plays in helping an agency achieve its mission. We remain committed to further improving our financial management and internal control as a top priority.

I very much appreciate the professional manner in which you and your team conducted the audit for FY 2018. I look forward to continuing our productive dialogue in the coming months on the SEC's efforts to address the areas noted in your report. If you have any questions, please feel free to contact me.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jay Clayton".

Jay Clayton  
Chairman

# SEC FINANCIAL STATEMENTS

U.S. SECURITIES AND EXCHANGE COMMISSION

## Balance Sheets

As of September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018	2017
<b>ASSETS (NOTE 2):</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 3)	\$ 7,822,331	\$ 7,504,874
Investments, Net (Note 5)	2,121,254	2,763,528
Advances and Prepayments	5,814	10,579
Total Intragovernmental	9,949,399	10,278,981
Cash and Other Monetary Assets (Note 4)	2,223	8
Accounts Receivable, Net (Note 6)	319,787	365,265
Property and Equipment, Net (Note 7)	120,469	131,075
Advances and Prepayments	—	2
<b>Total Assets</b>	<b>\$ 10,391,878</b>	<b>\$ 10,775,331</b>
<b>LIABILITIES (NOTE 8):</b>		
Intragovernmental:		
Accounts Payable	\$ 2,751	\$ 2,460
Employee Benefits	7,300	7,279
Unfunded FECA and Unemployment Liability	834	896
Custodial Liability	65,486	173,896
Liability for Non-Entity Assets	2,554	580
Total Intragovernmental	78,925	185,111
Accounts Payable	166,938	81,581
Actuarial FECA Liability	4,511	4,779
Accrued Payroll and Benefits	35,859	35,369
Accrued Leave	77,870	75,752
Registrant Deposits	40,079	34,284
Liability for Disgorgement and Penalties (Note 16)	2,259,278	2,799,436
Contingent Liabilities (Note 10)	63,968	221,044
Other Accrued Liabilities (Note 8)	10,556	9,071
<b>Total Liabilities</b>	<b>2,737,984</b>	<b>3,446,427</b>
Commitments and Contingencies (Note 10)		
<b>NET POSITION:</b>		
Unexpended Appropriations – Funds from Dedicated Collections (Note 11)	145,406	—
Cumulative Results of Operations – Funds from Dedicated Collections (Note 11)	7,508,488	7,328,904
<b>Total Net Position</b>	<b>\$ 7,653,894</b>	<b>\$ 7,328,904</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 10,391,878</b>	<b>\$ 10,775,331</b>

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

## Statements of Net Cost

For the years ended September 30, 2018 and 2017

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>PROGRAM COSTS:</b>		
Enforcement	\$ 578,452	\$ 812,238
Compliance Inspections and Examinations	411,696	389,707
Corporation Finance	164,548	166,451
Trading and Markets	95,366	97,241
Investment Management	66,339	66,199
Economic and Risk Analysis	76,336	76,994
General Counsel	53,192	52,029
Other Program Offices	85,269	90,024
Agency Direction and Administrative Support	256,655	235,533
Inspector General	17,788	16,402
<b>Total Program Costs</b>	<b>1,805,641</b>	<b>2,002,818</b>
Less: Earned Revenue Not Attributed to Programs	2,302,601	2,138,149
<b>Net (Income) Cost from Operations (Note 15)</b>	<b>\$ (496,960)</b>	<b>\$ (135,331)</b>

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

## Statements of Changes in Net Position

For the years ended September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018		
	Funds from Dedicated Collections	All Other Funds	Consolidated Total
<b>UNEXPENDED APPROPRIATIONS:</b>			
<b>Budgetary Financing Sources:</b>			
Appropriations Received	145,406	—	145,406
Appropriations Used	—	—	—
Total Budgetary Financing Sources	145,406	—	145,406
Total Unexpended Appropriations	145,406	—	145,406
<b>CUMULATIVE RESULTS OF OPERATIONS:</b>			
Beginning Balances	7,328,904	—	7,328,904
<b>Budgetary Financing Sources:</b>			
Appropriations Used	—	—	—
Non-Exchange Revenue	183,735	—	183,735
Other	(112)	—	(112)
<b>Other Financing Sources:</b>			
Imputed Financing	47,162	—	47,162
Other (Note 12)	—	(548,161)	(548,161)
Total Financing Sources	230,785	(548,161)	(317,376)
Net Income (Cost) from Operations	(51,201)	548,161	496,960
Net Change	179,584	—	179,584
Cumulative Results of Operations (Note 11)	7,508,488	—	7,508,488
<b>Net Position, End of Period</b>	<b>\$ 7,653,894</b>	<b>\$ —</b>	<b>\$ 7,653,894</b>

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



## Statements of Changes in Net Position *(continued)*

For the years ended September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2017		
	Funds from Dedicated Collections	All Other Funds	Consolidated Total
<b>UNEXPENDED APPROPRIATIONS:</b>			
<b>Budgetary Financing Sources:</b>			
Appropriations Received	19,731	—	19,731
Appropriations Used	(19,731)	—	(19,731)
Total Budgetary Financing Sources	—	—	—
Total Unexpended Appropriations	—	—	—
<b>CUMULATIVE RESULTS OF OPERATIONS:</b>			
Beginning Balances	7,637,242	—	7,637,242
<b>Budgetary Financing Sources:</b>			
Appropriations Used	19,731	—	19,731
Non-Exchange Revenue	2,734	—	2,734
Other	—	—	—
<b>Other Financing Sources:</b>			
Imputed Financing	27,671	—	27,671
Other (Note 12)	—	(493,805)	(493,805)
Total Financing Sources	50,136	(493,805)	(443,669)
Net Income (Cost) from Operations	(358,474)	493,805	135,331
Net Change	(308,338)	—	(308,338)
Cumulative Results of Operations (Note 11)	7,328,904	—	7,328,904
<b>Net Position, End of Period</b>	<b>\$ 7,328,904</b>	<b>\$ —</b>	<b>\$ 7,328,904</b>

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

## Statements of Budgetary Resources

For the years ended September 30, 2018 and 2017

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>BUDGETARY RESOURCES:</b>		
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory) (Note 14)	\$ 211,753	\$ 194,168
Appropriations (Discretionary and Mandatory)	394,079	73,874
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,752,538	1,586,559
<b>Total Budgetary Resources</b>	<b>\$ 2,358,370</b>	<b>\$ 1,854,601</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>		
New Obligations and Upward Adjustments (Total) (Note 14)	\$ 1,855,004	\$ 1,679,431
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	383,575	310,180
Exempt from Apportionment, Unexpired Accounts	15,291	1,212
Unapportioned, Unexpired Accounts	104,500	(136,222)
Unobligated Balance, End of Year (Total)	503,366	175,170
<b>Total Budgetary Resources</b>	<b>\$ 2,358,370</b>	<b>\$ 1,854,601</b>
<b>OUTLAYS, NET:</b>		
Outlays, Net (Total) (Discretionary and Mandatory)	\$ 59,394	\$ 176,115
Distributed Offsetting Receipts	(7,653)	(5,048)
Agency Outlays, Net (Discretionary and Mandatory)	\$ 51,741	\$ 171,067

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

## Statements of Custodial Activity

For the years ended September 30, 2018 and 2017

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>REVENUE ACTIVITY:</b>		
Sources of Cash Collections:		
Disgorgement and Penalties	\$ 845,862	\$ 1,962,021
Other	2,620	1,354
Total Cash Collections	848,482	1,963,375
Accrual Adjustments (Note 13)	(108,409)	(491,612)
<b>Total Custodial Revenue</b>	<b>740,073</b>	<b>1,471,763</b>
<b>DISPOSITION OF COLLECTIONS:</b>		
Amounts Transferred to:		
Department of the Treasury	848,482	1,963,375
Amounts Yet to be Transferred	(108,409)	(491,612)
<b>Total Disposition of Collections</b>	<b>740,073</b>	<b>1,471,763</b>
<b>NET CUSTODIAL ACTIVITY</b>	<b>\$ —</b>	<b>\$ —</b>

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

# NOTES TO THE FINANCIAL STATEMENTS

As of September 30, 2018 and 2017

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

### A. Reporting Entity

The U.S. Securities and Exchange Commission (SEC) is an independent agency of the U.S. Government established pursuant to the Securities Exchange Act of 1934 (Exchange Act), charged with regulating this country's capital markets. The SEC's mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC works with Congress, other executive branch agencies, self-regulatory organizations (SROs) (e.g., stock exchanges and the Financial Industry Regulatory Authority), accounting and auditing standards setters, state securities regulators, law enforcement officials, and many other organizations in support of the agency's mission.

The SEC consists of five presidentially-appointed Commissioners, with staggered five-year terms. The SEC is organized into five divisions and multiple offices. The five divisions are the Division of Enforcement, the Division of Corporation Finance, the Division of Trading and Markets, the Division of Investment Management, and the Division of Economic and Risk Analysis. The offices include the Office of Compliance Inspections and Examinations, the Office of the General Counsel, the Office of Investor Education and Advocacy, the Office of the Chief Accountant, the Office of International Affairs, the Office of Administrative Law Judges, the Office of Credit Ratings, the Office of the Investor Advocate, the Office of Municipal Securities, the Office of Inspector General, 11 regional offices, and various supporting services.

The SEC reporting entity includes the Investor Protection Fund. In addition to being included in the SEC's financial statements, the Investor Protection Fund's financial activities and balances are also presented

separately as stand-alone financial statements, as required by Exchange Act Section 21F(g)5.

As discussed in *Note 1.R, Disgorgement and Penalties*, disgorgement funds collected and held by the SEC on behalf of harmed investors are part of the SEC reporting entity. However, disgorgement funds held by the U.S. Courts and by non-federal receivers on behalf of harmed investors are not part of the SEC reporting entity.

As discussed in *Note 10.A, Commitments: Securities Investor Protection Act*, the SEC reporting entity does not include the Securities Investor Protection Corporation (SIPC).

The SEC reporting entity also does not include the Public Company Accounting Oversight Board (PCAOB), a private-sector, nonprofit corporation created to oversee the audits of public companies, brokers, and dealers registered with the SEC. When the Sarbanes-Oxley Act of 2002 created the PCAOB, it gave the SEC the authority to oversee the PCAOB's operations, to appoint or remove Board members, to approve the PCAOB's budget and rules, and to entertain appeals of PCAOB inspection reports and disciplinary actions.

The PCAOB is not part of the federal government. It is funded by an accounting support fee collected from public companies, brokers, and dealers. The primary duties of the PCAOB include: registering public accounting firms that prepare audit reports for public companies, brokers, and dealers; establishing or adopting auditing and related attestation, quality control, ethics, and independence standards; and inspecting

and disciplining registered accounting firms and their associated persons.

The SEC's financial statements also do not include the Financial Accounting Standards Board (FASB) or its parent organization, the Financial Accounting Foundation (FAF). The FAF is a Delaware nonprofit non-stock corporation, incorporated in 1972, which was created for the purpose of providing a corporate structure for the FASB, the body whose financial accounting and reporting standards for nongovernmental entities have been recognized as authoritative by the American Institute of CPAs and the SEC. The structure of the FAF and the FASB reflects the view that a standard-setter should be independent from preparers of financial statements, from accounting and auditing firms, and from political or governmental influence. This independence is necessary to assure that the interests of the users of financial statements remain paramount, and has been critical to the integrity of our financial and capital markets. Although pursuant to Section 109 of the Sarbanes-Oxley Act of 2002, the SEC is required to determine annually that the FASB accounting support fee is within the parameters prescribed by Congress, the SEC does not have authority, and is not required, to approve the FASB budget.

#### B. Basis of Presentation and Accounting

These footnotes are an integral part of the SEC's financial statements, which present the financial position, net cost of operations, changes in net position, budgetary resources, and custodial activities of the SEC as required by the Accountability of Tax Dollars Act of 2002. The statements 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 the SEC's budgetary resources, due to differences in accounting and reporting principles discussed in the following paragraphs. The SEC's books and records serve as the source of the information presented in the accompanying financial statements.

The agency classifies assets and liabilities in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those due from or to other federal entities.

The SEC's financial statements are prepared in conformity with generally accepted accounting principles (GAAP) for federal reporting entities and presented in conformity with OMB Circular A-136, *Financial Reporting Requirements*. In accordance with OMB Circular A-136, the Statement of Budgetary Resources is presented on a combined basis, and the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Custodial Activities are presented on a consolidated basis.

The Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position are prepared using the accrual basis of accounting. Accordingly, revenues are recognized when services are provided, and expenses are recognized when incurred without regard to the receipt or payment of cash. These principles differ from budgetary accounting and reporting principles on which the Statement of Budgetary Resources is prepared. The differences relate primarily to the capitalization and depreciation of property and equipment, as well as the recognition of other assets and liabilities. The Statement of Custodial Activity is presented on the modified cash basis of accounting. See *Note 13, Custodial Activities*.

The SEC presents cost of operations by program. OMB Circular A-136 defines the term "major program" as describing an agency's mission, strategic goals, functions, activities, services, projects, processes, or any other meaningful grouping. The presentation by program is consistent with the presentation used by the agency in submitting its budget requests.

Certain prior year amounts presented on the Statement of Budgetary Resources have been reclassified, and

the sequence of the two sections of the Statement of Changes in Net Position has been revised, to conform to the changes in presentation required by the FY 2018 issuance of OMB Circular A-136.

### C. Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and costs. These estimates are based on management's best knowledge of current events, historical experience, actions that the SEC may undertake in the future, and various other assumptions believed to be reasonable under the circumstances. The estimates include, but are not limited to, the allowance for uncollectible accounts and the allocation of costs to the SEC programs presented in the Statement of Net Cost. Estimates also include (a) the recognition and disclosure of any contingent liabilities and the disclosure of other potential future payments as of the date of the financial statements, and (b) the reported amounts of revenue and expenses during the reporting period. Actual results may differ from these estimates.

### D. Intra- and Inter-Agency Relationships

The SEC is a single federal agency composed of various Treasury Appropriation Fund Symbols (Funds), and it has only limited intra-entity transactions. The Investor Protection Fund finances the operations of the SEC Office of Inspector General's Employee Suggestion Program on a reimbursable basis. This has given rise to a small amount of intra-entity eliminations of the related revenue and expense transactions between the Investor Protection Fund and the SEC's general Salaries and Expenses Fund. See *Note 1.E, Fund Accounting Structure*, for more information about the SEC's Treasury Appropriation Symbols.

### E. Fund Accounting Structure

The SEC, in common with other federal agencies, utilizes various Funds, to recognize and track appropriation authority provided by Congress, collections from

the public, and other financial activity. These Funds are described below:

1. Funds from Dedicated Collections: Statement of Federal Financial Accounting Standards 27, *Identifying and Reporting Funds from Dedicated Collections*, as amended, states that, "funds from dedicated collections are financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the government's general revenues." The SEC's funds from dedicated collections are deposited into Fund X0100, *Salaries and Expenses*; Fund X5567, *Investor Protection Fund*; and Fund X5566, *Reserve Fund*.

- Salaries and Expenses: Earned revenues from securities transaction fees from SROs are deposited into Fund X0100, *Salaries and Expenses, Securities and Exchange Commission*. These collections are used to offset the SEC's annual appropriation and are remitted to the U.S. Treasury at the end of the year. The Salaries and Expenses Fund is dedicated to carrying out the SEC's mission, functions, and day-to-day operations. Collections in excess of Congressional spending limits are unavailable by law and reported as Non-Budgetary Fund Balance with Treasury. See *Note 3, Fund Balance with Treasury*.
- Investor Protection Fund: The Investor Protection Fund provides funding for the payment of whistleblower awards as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Investor Protection Fund is financed by a portion of monetary sanctions collected by the SEC in

judicial or administrative actions brought by the SEC. Persons may receive award payments from the Investor Protection Fund if they voluntarily provide original information to the SEC that results in a successful enforcement action and other conditions are met. In addition, the Investor Protection Fund is used to finance the operations of the SEC's Office of Inspector General's Employee Suggestion Program for the receipt of suggestions for improvements in work efficiency and effectiveness, and allegations of misconduct or mismanagement within the SEC. This activity is recognized in Fund X5567, *Monetary Sanctions and Interest, Investor Protection Fund, Securities and Exchange Commission (Investor Protection Fund)*.

- Reserve Fund: A portion of SEC registration fee collections up to \$50 million in any one fiscal year may be deposited in the Reserve Fund, the balance of which cannot exceed \$100 million. The Reserve Fund may be used by the SEC to obligate up to \$100 million in one fiscal year as the SEC determines necessary to carry out its functions. Although amounts deposited in the Reserve Fund are not subject to apportionment, the SEC must notify Congress when funds are obligated. Resources available in the Reserve Fund may be rescinded or sequestered through Congressional action. This activity is recognized in Fund X5566, *Securities and Exchange Commission Reserve Fund*.

2. Miscellaneous Receipt Accounts: Miscellaneous Receipt Accounts hold non-entity receipts and accounts receivable from custodial activities that the SEC cannot deposit into funds under its control. These accounts include registration fee collections in excess of amounts deposited into the Reserve Fund, receipts pursuant to certain SEC enforcement actions and other small collections that will be sent to the U.S. Treasury General Fund upon collection. These activities are recognized in Fund 0850.150, *Registration, Filing, and Transaction Fees, Securities and*

*Exchange Commission; Fund 1060, Forfeitures of Unclaimed Money and Property; Fund 1099, Fines, Penalties, and Forfeitures, Not Otherwise Classified; Fund 1435, General Fund Proprietary Interest, Not Otherwise Classified; and Fund 3220, General Fund Proprietary Receipts, Not Otherwise Classified.* Miscellaneous Receipt Accounts are reported as "All Other Funds" on the Statement of Changes in Net Position. The SEC has custodial responsibilities, as disclosed in *Note 1.L, Liabilities*.

3. Deposit Funds: Deposit Funds hold 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. These activities are recognized in Fund X6561, *Unearned Fees, Securities and Exchange Commission* and Fund X6563, *Disgorgement and Penalty Amounts Held for Investors, Securities and Exchange Commission*. Deposit Funds do not impact the SEC's Net Position and are not reported on the Statement of Changes in Net Position.

## F. Entity and Non-Entity Assets

Entity assets are assets that the SEC may use in its operations.

Non-entity assets are assets that the SEC holds on behalf of another federal agency or a third party and are not available for the SEC to use in its operations. See *Note 2, Entity and Non-Entity Assets*.

## G. Fund Balance with Treasury

Fund Balance with Treasury (FBWT) reflects amounts the SEC holds in the U.S. Treasury that have not been invested in federal securities. Additional information regarding the SEC's FBWT is provided in *Note 3, Fund Balance with Treasury*.

The SEC conducts all of its banking activity in accordance with directives issued by the U.S. Department of the Treasury's Bureau of the Fiscal Service.



## H. Investments

The SEC has the authority to invest disgorgement funds in Treasury securities, including civil penalties collected under the “Fair Fund” provision of the Sarbanes-Oxley Act of 2002. As the funds are collected, the SEC holds them in a deposit fund account and may invest them in overnight and short-term market-based Treasury securities through the U.S. Department of the Treasury’s Bureau of the Fiscal Service.

The SEC also has authority to invest amounts in the Investor Protection Fund in overnight and short-term market-based Treasury securities through the Bureau of the Fiscal Service. The interest earned on the investments is a component of the balance of the Fund and available to be used for expenses of the Investor Protection Fund.

Additional information regarding the SEC’s investments is provided in *Note 5, Investments*.

## I. Accounts Receivable and Allowance for Uncollectible Accounts

The SEC’s entity and non-entity accounts receivable consist primarily of amounts due from the public. Entity accounts receivable are amounts that the SEC may retain upon collection. Non-entity accounts receivable are amounts that the SEC will forward to another federal agency or to the public after the funds are collected.

### Entity Accounts Receivable

The bulk of the SEC’s entity accounts receivable arise from securities transaction fees. Securities 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 fees payable to the SEC for one month of securities transaction fee activity (September). In addition, the SEC has small amounts of activity arising from the sale of services provided by the SEC to other federal agencies and employee-related debt.

### Non-Entity Accounts Receivable

Non-entity accounts receivable arise mainly from amounts assessed against violators of securities laws, including disgorgement of illegal gains, civil penalties, and related assessed interest. The SEC is responsible for collection, and recognizes a receivable, when an order of the Commission or a federal court directs payment to the SEC or the U.S. Treasury.

Interest recognized by the SEC on non-entity accounts receivable includes prejudgment interest specified by the court or administrative order as well as post-judgment interest on collectible accounts. The SEC does not recognize interest revenue on accounts considered to be uncollectible.

The SEC’s enforcement investigation and litigation activities often result in court orders directing violators of federal securities laws to pay amounts assessed to a federal court or to a non-federal receiver acting on behalf of harmed investors. These orders are not recognized as accounts receivable by the SEC because the debts are payable to, and collected by, another party.

Securities registration, tender offer, merger, and other fees from registrants (filing fee) collections in excess of those deposited into the SEC’s Reserve Fund are not available for the SEC’s operations and are transferred to the U.S. Treasury General Fund. Accounts receivable amounts arising from filing fees in excess of those deposited into the Reserve Fund are non-entity and are held on behalf of the U.S. Treasury.

### Allowance for Uncollectible Accounts

The SEC uses a three-tiered methodology for calculating the allowance for loss on its disgorgement and penalties accounts receivable. The first tier involves making an individual collection assessment of cases that represent at least 65 percent of the portfolio. The second and third tiers are composed of the remaining cases that are equal to or less than 30 days old and over 30 days old, respectively. For the second and third tiers, the SEC applies an allowance rate based on historical collection data analysis.

The SEC calculates the allowance for uncollectible accounts and the related provision for estimated losses for filing fees and other accounts receivable using an analysis of historical collection data. No allowance for uncollectible accounts or related provision for estimated losses has been established for securities transaction fees payable by SROs, as these amounts are fully collectible based on historical experience.

The SEC writes off receivables that are delinquent for two or more years by removing the debt amounts from the gross accounts receivable and any related allowance for uncollectible accounts.

Additional information about the SEC's accounts receivable and allowance for doubtful accounts is provided in *Note 6, Accounts Receivable, Net*.

#### J. Other Assets

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments and recognized as expenses when the related goods and services are received.

#### K. Property and Equipment, Net

The SEC's property and equipment consists of software, general-purpose equipment used by the agency, capital improvements made to buildings leased by the SEC for office space, and, when applicable, internal-use software development costs for projects in development. The SEC reports property and equipment purchases and additions at historical cost. The agency expenses property and equipment acquisitions that do not meet the capitalization criteria as well as normal repairs and maintenance.

The SEC depreciates property and equipment over the estimated useful lives using the straight-line method of depreciation. The agency removes property and equipment from its asset accounts in the period of disposal, retirement, or removal from service. The SEC

recognizes the difference between the book value and any proceeds as a gain or loss in the period that the asset is removed.

#### L. Liabilities

The SEC recognizes liabilities for probable future outflows or other sacrifices of resources as a result of events that have occurred as of the Balance Sheet date. The SEC's liabilities consist of routine operating accounts payable, accrued payroll and benefits, legal liabilities, liabilities to offset non-entity assets such as registrant monies held temporarily until earned by the SEC, disgorgement and penalties collected and receivable, and amounts collected or receivable on behalf of the U.S. Treasury. See *Note 1.F, Entity and Non-Entity Assets*, for additional information.

##### Enforcement Related Liabilities

A liability for disgorgement and penalties arises when an order is issued for the SEC to collect disgorgement, penalties, and interest from securities law violators. When the Commission or court issues such an order, the SEC establishes an accounts receivable due to the SEC offset by a liability. The presentation of this liability on the Balance Sheet is dependent upon several factors. If the court or Commission order indicates that collections are to be retained by the federal government by transfer to the U.S. Treasury General Fund, the liabilities are classified as custodial (that is, collected on behalf of the government) and intragovernmental. If the order indicates that the funds are eligible for distribution to harmed investors, the SEC will recognize a governmental liability (that is, a liability of the government to make a payment to the public). This liability is not presented as a custodial liability. The SEC does not record liabilities on its financial statements for disgorgement and penalty amounts that another government entity such as a court, or a non-governmental entity, such as a receiver, has collected or will collect.

In accordance with the provisions of the Dodd-Frank Act, collections not distributed to harmed investors may be transferred to either the Investor Protection Fund or the U.S. Treasury General Fund. See *Note 16, Disgorgement and Penalties*, for additional information.

#### Liability Classification

The SEC recognizes liabilities that are covered by budgetary resources, liabilities that are not covered by budgetary resources, and liabilities that do not require the use of budgetary resources. See *Note 8, Liabilities Covered and Not Covered by Budgetary Resources*, for more information.

#### M. Employee Retirement Systems and Benefits

The SEC's employees may participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), depending on when they started working for the federal government. FERS and Social Security automatically cover most employees hired after December 31, 1983.

All employees are eligible to contribute to a Thrift Savings Plan (TSP). For those employees participating in FERS, the TSP is automatically established, and the SEC makes a mandatory 1 percent contribution to this plan. In addition, the SEC matches contributions ranging from 1 to 4 percent for FERS-eligible employees who contribute to their TSP. Employees participating in CSRS do not receive matching contributions to their TSP. The SEC also provides a supplemental retirement contribution program that matches an employee's TSP contribution up to an additional 3 percent of their salary.

The SEC does not report CSRS, FERS, Federal Employees Health Benefits Program, Federal Employees Group Life Insurance Program assets,

or accumulated plan benefits; the U.S. Office of Personnel Management (OPM) reports this information. In accordance with federal accounting standards, the SEC recognizes costs incurred by the SEC but financed by OPM on behalf of the SEC as an expense. The funding for this expense is reflected as imputed financing on the Statement of Changes in Net Position.

#### N. Injury and Post-Employment Compensation

The Federal Employees' Compensation Act (FECA), administered by the U.S. Department of Labor, provides income and medical cost protection to covered federal civilian employees harmed on the job or who have contracted an occupational disease, and dependents of employees whose death is attributable to a job-related injury or occupational disease. See *Note 8, Liabilities Covered and Not Covered by Budgetary Resources*.

#### O. Annual, Sick, and Other Leave

The SEC accrues annual leave and compensatory time as earned and reduces the accrual when leave is taken. The balances in the accrued leave accounts reflect current leave balances and pay rates. See *Note 8, Liabilities Covered and Not Covered by Budgetary Resources*. The SEC expenses sick leave and other types of non-vested leave as used.

#### P. Exchange and Non-Exchange Revenue

The SEC's revenues include exchange revenues, which are generated from transactions in which both parties give and receive value, and non-exchange revenues, which arise from the federal government's ability to demand payment.

The SEC does not recognize amounts collected and held by another government entity, such as a court registry, or a non-government entity, such as a receiver.

The following table summarizes the SEC's sources of exchange and non-exchange revenues.

The SEC's Revenues and Financing Sources	Exchange and Non-Exchange Revenue	Revenue Availability	Financial Statement Presentation
Securities transaction fees <sup>1</sup>	Exchange Revenue	Collection of securities transaction fees are used to offset the SEC's annual appropriation, up to the annual limit set by legislation. Collections of transaction fees beyond the amount needed to offset the SEC's annual appropriation cannot be used to fund the SEC's operations.	Reported on the Statement of Net Cost <sup>4</sup>
Securities registration, tender offer, merger, and other fees from registrants (filing fees) <sup>1,2</sup>	Exchange Revenue	Collections of filing fees up to \$50 million may be transferred to the SEC's Reserve Fund, as directed by legislation. Collections of filing fees that are not transferred to the SEC's Reserve Fund are transferred to the General Fund of the U.S. Treasury.	Reported on the Statement of Net Cost <sup>4</sup>
Collections of monetary sanctions <sup>3</sup>	Non-Exchange Revenue	Certain collections of monetary sanctions are deposited into the SEC's Investor Protection Fund in accordance with legislation.  All other monetary sanctions are not a revenue source for the SEC, and are either: (a) Distributed to harmed investors, or (b) Transferred to the General Fund of the U.S. Treasury.	Reported on the Statement of Changes in Net Position  Reported as follows: (a) Disclosed in <i>Note 16, Disgorgement and Penalties</i> (b) Reported on the Statement of Custodial Activity

1 Transaction fee and filing fee rates are calculated and established by the SEC in accordance with federal law and are applied to volumes of activity reported by SROs or to filings submitted by registrants. Fees are recognized as exchange revenue on the effective date of the transaction or the date of the acceptance of the filing submission. See *Note 1.E, Fund Accounting Structure*. The SEC recognizes amounts remitted by registrants in advance of the transaction or filing date as a liability until earned by the SEC or returned to the registrant.

2 Federal regulation requires the return of registrant advance deposits when an account is dormant for three years, except in certain cases where refunds are not permitted. The Securities Act of 1933 and the Exchange Act do not permit refunds to registrants for securities that remain unsold after the completion, termination, or withdrawal of an offering. However, Code of Federal Regulations (CFR) Title 17 Chapter II, Part 230, Section 457(p) permits filers to offset a fee paid (filing fee offset) for a subsequent registration statement (offering) filed within five years of the initial filing date of the earlier registration statement. The total aggregate dollar amount of the filing fee associated with the unsold securities may be offset against the total filing fee due on the subsequent offering. Unused filing fee offsets are not an accounts payable to the SEC because registrants cannot obtain refunds of fees or additional services in relation to securities that remain unsold.

3 The SEC's non-exchange revenues consist of disgorgement of illegal gains, civil penalties, and related interest.

4 The SEC's exchange revenues are a means to recover all or most of the total cost of all SEC programs and to deposit excess collections from registrants to the U.S. Treasury General Fund. As a result, they offset the total costs of the organization in the Statement of Net Cost, rather than individual SEC programs. This presentation is consistent with the financial accounting concepts described in Statement of Federal Financial Accounting Concepts 2, *Entity and Display*.

## Q. Budgets and Budgetary Accounting

### Salaries and Expenses

The SEC may use funds from the SEC's Salaries and Expenses account only as authorized by Congress and made available by OMB apportionment, upon issuance of a Treasury warrant. Revenue collected in excess of appropriated amounts is restricted from use by the SEC. Collections in excess of Congressional spending limits are unavailable by law and reported as Non-Budgetary Fund Balance with Treasury. (See *Note 3, Fund Balance with Treasury*). Each fiscal year, OMB provides the SEC's Salaries and Expenses account with quarterly apportionments. These apportionments include both new budget authority appropriated by Congress and unused no-year funds (unobligated balances) from prior years. The Salaries and Expenses account also receives a small amount of funds related to reimbursable activity, which are exempt from quarterly apportionment. See *Note 1.E, Fund Accounting Structure*, and *Note 14, Status of Budgetary Resources*.

### Investor Protection Fund

The Dodd-Frank Act provides that the Investor Protection Fund has permanent authority that is available without further appropriation or fiscal year limitation for the purpose of funding awards to whistleblowers and for the operations of the Office of Inspector General's Employee Suggestion Program. However, the SEC is required to request and obtain an annual apportionment from OMB to use these funds. The Investor Protection Fund is financed by transferring a portion of monetary sanctions collected by the SEC under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246). As provided by Section 21F of the Exchange Act, sanctions collected by the Commission payable either to the SEC or the U.S. Treasury General Fund

will be transferred to the Investor Protection Fund if the balance in that fund is less than \$300 million on the day of collection. See *Note 1.E, Fund Accounting Structure*.

### Reserve Fund

The Reserve Fund is a special fund that has the authority to retain certain revenues not used in the current period for future use. The Dodd-Frank Act provides that the Fund is available to the SEC without further appropriation or fiscal year limitation "to carry out the functions of the Commission." Amounts in the Reserve Fund are exempt from apportionment. Collections arising from securities registration, tender offer, and merger fees from registrants, other than those that are deposited in the Reserve Fund, are not available to be used in the operations of the SEC. See *Note 1.E, Fund Accounting Structure*.

### Borrowing Authority

The SEC's borrowing authority is limited to authority to borrow funds from the U.S. Treasury in order to loan funds to the Securities Investor Protection Corporation, as discussed in *Note 10.A, Commitments: Securities Investor Protection Act*.

## R. Disgorgement and Penalties

The SEC maintains non-entity assets related to disgorgement and penalties ordered pursuant to civil injunctive and administrative proceedings. The SEC also recognizes an equal and offsetting liability for these assets, as discussed in *Note 1.I, Accounts Receivable and Allowance for Uncollectible Accounts*, and *Note 1.L, Liabilities*. Additional details regarding disgorgement and penalties are presented in *Note 11, Funds from Dedicated Collections*, and *Note 16, Disgorgement and Penalties*.

## NOTE 2. ENTITY AND NON-ENTITY ASSETS

Entity assets are assets that the SEC may use in its operations.

Non-entity assets are assets that the SEC holds on behalf of another federal agency or a third party and are not available for the SEC's use. The SEC's non-entity assets include the following: (a) disgorgement, penalties, and interest collected and held or invested by the SEC; (b) disgorgement, penalties, and interest

receivable that will be collected by the SEC; (c) securities registration, tender offer, merger, and other fees collected and receivable from registrants, in excess of amounts deposited in the SEC's Reserve Fund; and (d) other miscellaneous receivables and collections such as registrant monies held temporarily until earned by the SEC. Additional details are provided in *Note 16, Disgorgement and Penalties*.

At September 30, 2018, SEC entity and non-entity assets consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Entity	Non-Entity	Total
Intragovernmental:			
Fund Balance with Treasury:			
SEC Funds	\$ 7,497,515	\$ —	\$ 7,497,515
Registrant Deposits	—	40,079	40,079
Disgorgement and Penalties (Note 16)	—	284,710	284,710
Custodial and Other Non-Entity Assets	—	27	27
Investments, Net:			
Disgorgement and Penalties (Note 16)	—	1,811,409	1,811,409
Investor Protection Fund	309,845	—	309,845
Advances and Prepayments	5,814	—	5,814
<b>Total Intragovernmental Assets</b>	<b>7,813,174</b>	<b>2,136,225</b>	<b>9,949,399</b>
Cash and Other Monetary Assets:			
Disgorgement and Penalties (Note 16)	—	2,223	2,223
Accounts Receivable, Net:			
SEC Funds	88,635	—	88,635
Disgorgement and Penalties (Note 16)	—	228,081	228,081
Custodial and Other Non-Entity Assets	—	3,071	3,071
Property and Equipment, Net (Note 7)	120,469	—	120,469
Advances and Prepayments	—	—	—
<b>Total Assets</b>	<b>\$ 8,022,278</b>	<b>\$ 2,369,600</b>	<b>\$ 10,391,878</b>

At September 30, 2017, SEC entity and non-entity assets consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Entity	Non-Entity	Total
Intragovernmental:			
Fund Balance with Treasury:			
SEC Funds	\$ 7,195,397	\$ —	\$ 7,195,397
Registrant Deposits	—	34,284	34,284
Disgorgement and Penalties (Note 16)	—	275,167	275,167
Custodial and Other Non-Entity Assets	—	26	26
Investments, Net:			
Disgorgement and Penalties (Note 16)	—	2,471,245	2,471,245
Investor Protection Fund	292,283	—	292,283
Advances and Prepayments	10,579	—	10,579
<b>Total Intragovernmental Assets</b>	<b>7,498,259</b>	<b>2,780,722</b>	<b>10,278,981</b>
Cash and Other Monetary Assets:			
Disgorgement and Penalties (Note 16)	—	8	8
Accounts Receivable, Net:			
SEC Funds	137,765	—	137,765
Disgorgement and Penalties (Note 16)	—	226,524	226,524
Custodial and Other Non-Entity Assets	—	976	976
Property and Equipment, Net (Note 7)	131,075	—	131,075
Advances and Prepayments	2	—	2
<b>Total Assets</b>	<b>\$ 7,767,101</b>	<b>\$ 3,008,230</b>	<b>\$ 10,775,331</b>



## NOTE 3. FUND BALANCE WITH TREASURY

The status of Fund Balance with Treasury as of September 30, 2018 and 2017 consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
Status of Fund Balance with Treasury:		
Unobligated Balance:		
Available	\$ 260,502	\$ 21,553
Unavailable	83,082	96,664
Obligated Balance not Yet Disbursed	668,445	591,739
Non-Budgetary Fund Balance with Treasury	6,810,302	6,794,918
Total Fund Balance with Treasury	\$ 7,822,331	\$ 7,504,874

Obligated and unobligated balances reported for the status of Fund Balance with Treasury differ from the amounts reported in the Statement of Budgetary Resources due to the fact that budgetary balances are supported by amounts other than Fund Balance with Treasury. These amounts include Investor Protection Fund investments, uncollected payments from federal sources, and the impact of the change in legal interpretation for leases. See *Note 14.C, Other Budgetary Disclosures, Change in Legal Interpretation for Lease Obligations*.

Non-Budgetary Fund Balance with Treasury consists of amounts in deposit funds and offsetting collections temporarily precluded from obligation in the SEC's

general Salaries and Expenses Fund (X0100). Amounts temporarily precluded from obligation represent offsetting collections in excess of appropriated amounts related to securities transactions fees, as well as securities registration, tender offer, merger, and other fees from registrants (filing fees) collected in fiscal years 2011 and prior.

There were no significant differences between the Fund Balance with Treasury reflected in the SEC's financial statements and the corresponding balance in the U.S. Treasury Department accounts.

## NOTE 4. CASH AND OTHER MONETARY ASSETS

The SEC had a cash balance of \$2.2 million as of September 30, 2018. The SEC receives collections throughout the year. Any collections received after the U.S. Treasury Department cut-off for deposit of

checks are treated as deposits in transit and recognized as Cash on the Balance Sheet. The SEC had a cash balance of \$8 thousand as of September 30, 2017.

## NOTE 5. INVESTMENTS

The SEC invests funds in overnight and short-term non-marketable market-based Treasury securities. The SEC records the value of its investments in Treasury securities at cost and amortizes any premium or discount on a straight-line basis (S/L) through the maturity date of these securities. Non-marketable market-based Treasury securities are issued by the U.S. Treasury Department's Bureau of the Fiscal Service to

federal agencies. They are not traded on any securities exchange but mirror the prices of similar Treasury securities trading in the government securities market. The market value of Treasury securities is a composite market bid price, using market data provided by the Federal Reserve Bank of New York, that reflects the average price that brokers were offering to pay on the reporting date.

At September 30, 2018, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 1,805,737	S/L	\$ 5,590	\$ 82	\$ 1,811,409	\$ 1,811,096
Investor Protection Fund – Entity	308,450	S/L	843	552	309,845	309,123
<b>Total</b>	<b>\$ 2,114,187</b>		<b>\$ 6,433</b>	<b>\$ 634</b>	<b>\$ 2,121,254</b>	<b>\$ 2,120,219</b>

At September 30, 2017, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Disgorgement and Penalties	\$ 2,467,217	S/L	\$ 4,009	\$ 19	\$ 2,471,245	\$ 2,162,154
Investor Protection Fund – Entity	294,098	S/L	(3,680)	1,865	292,283	290,274
<b>Total</b>	<b>\$ 2,761,315</b>		<b>\$ 329</b>	<b>\$ 1,884</b>	<b>\$ 2,763,528</b>	<b>\$ 2,452,428</b>

### Intragovernmental Investments in Treasury Securities

The federal government does not set aside assets to pay future benefits or other expenditures associated with the investment by federal agencies in non-marketable federal securities. The funds used to purchase these investments are deposited in the U.S. Treasury, which uses the cash for general government purposes. Treasury securities are issued to the SEC as evidence of these balances. Treasury securities are an asset of the SEC and a liability of the U.S. Treasury. Because the SEC and the U.S. Treasury are both components of the government, these assets and liabilities offset each other from the standpoint of the government as

a whole. For this reason, the investments presented by the SEC do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the SEC with authority to draw upon the U.S. Treasury to make future payments from these accounts. When the SEC requires redemption of these securities to make expenditures, the government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same manner in which the government finances all expenditures.

## NOTE 6. ACCOUNTS RECEIVABLE, NET

At September 30, 2018, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Entity Accounts Receivable:			
Securities Transaction Fees	\$ 88,168	\$ —	\$ 88,168
Other	467	—	467
Non-Entity Accounts Receivable:			
Disgorgement and Penalties <sup>1</sup>	1,461,999	1,233,918	228,081
Filing Fees	2,874	320	2,554
Other	8,671	8,154	517
<b>Total Accounts Receivable</b>	<b>\$ 1,562,179</b>	<b>\$ 1,242,392</b>	<b>\$ 319,787</b>

<sup>1</sup> Disgorgement and Penalties Accounts Receivable by Tiers (Note 1.I)			
<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivable	Allowance	Net Receivable
Tier 1	956,161	815,367	140,794
Tier 2	58,649	29,505	29,144
Tier 3	447,189	389,046	58,143
<b>Total Non-Entity Accounts Receivable: Disgorgement and Penalties</b>	<b>1,461,999</b>	<b>1,233,918</b>	<b>228,081</b>

At September 30, 2017, accounts receivable consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivables	Allowance	Net Receivables
Entity Accounts Receivable:			
Securities Transaction Fees	\$ 137,217	\$ —	\$ 137,217
Other	548	—	548
Non-Entity Accounts Receivable:			
Disgorgement and Penalties <sup>2</sup>	1,938,273	1,711,749	226,524
Filing Fees	620	40	580
Other	7,009	6,613	396
<b>Total Accounts Receivable</b>	<b>\$ 2,083,667</b>	<b>\$ 1,718,402</b>	<b>\$ 365,265</b>

<sup>2</sup> Disgorgement and Penalties Accounts Receivable by Tiers (Note 1.I)			
<i>(DOLLARS IN THOUSANDS)</i>	Gross Receivable	Allowance	Net Receivable
Tier 1	1,196,433	1,074,179	122,254
Tier 2	37,145	24,494	12,651
Tier 3	704,695	613,076	91,619
<b>Total Non-Entity Accounts Receivable: Disgorgement and Penalties</b>	<b>1,938,273</b>	<b>1,711,749</b>	<b>226,524</b>

Refer to *Note 1.I, Accounts Receivable and Allowance for Uncollectible Accounts*, for methods used to estimate allowances. The SEC does not recognize interest revenue on accounts considered to be uncollectible. The SEC estimates that accumulated interest on accounts receivable considered to be uncollectible is \$8.2 million and \$6.6 million, respectively, as of September 30, 2018 and 2017. This estimate does not include interest accumulated on debts written off or officially waived.

Disbursement and penalties net accounts receivable of \$228.1 million and \$226.5 million at September 30, 2018 and 2017, respectively, includes amounts designated as payable to the U.S. Treasury General Fund per court order, as well as amounts held for distribution to harmed investors. As discussed in *Note 1.L, Liabilities*,

the receivables designated as payable to the U.S. Treasury General Fund, their offsetting liabilities, and the associated revenues, are classified as custodial. As of September 30, 2018 and 2017, the custodial disbursement and penalties accounts receivable balance designated as payable to the U.S. Treasury General Fund, net of allowance, was \$65.0 million and \$173.5 million, respectively.

As discussed in *Note 1.I, Accounts Receivable and Allowance for Uncollectible Accounts*, pursuant to Section 991(e) of the Dodd-Frank Act, accounts receivable for securities registration, tender offer, merger, and other fees from registrants in excess of the amounts deposited into the Reserve Fund are held on behalf of the U.S. Treasury and are transferred to the U.S. Treasury General Fund upon collection.

## NOTE 7. PROPERTY AND EQUIPMENT, NET

At September 30, 2018, 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 Cost	Accumulated Depreciation/ Amortization	Net Book Value
Furniture and Equipment	S/L	50	300	3–5	\$ 137,756	\$ 108,268	\$ 29,488
Software	S/L	300	300	3–5	308,312	230,955	77,357
Leasehold Improvements	S/L	300	N/A	10	111,798	98,174	13,624
Total					\$ 557,866	\$ 437,397	\$ 120,469

At September 30, 2017, 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 Cost	Accumulated Depreciation/ Amortization	Net Book Value
Furniture and Equipment	S/L	50	300	3–5	\$ 135,766	\$ 112,967	\$ 22,799
Software	S/L	300	300	3–5	282,138	192,265	89,873
Leasehold Improvements	S/L	300	N/A	10	111,324	92,921	18,403
Total					\$ 529,228	\$ 398,153	\$ 131,075

Bulk purchases are acquisitions of a quantity of similar items that individually cost less than the threshold

for individual purchases but collectively exceed the designated bulk purchase threshold of \$300,000.

## NOTE 8. LIABILITIES COVERED AND NOT COVERED BY BUDGETARY RESOURCES

The SEC recognizes liabilities that are covered by budgetary resources, liabilities that are not covered by budgetary resources, and liabilities that do not require the use of budgetary resources.

Liabilities that are covered by budgetary resources are liabilities incurred for which budgetary resources are available to the SEC during the reporting period without further Congressional action.

The SEC also recognizes liabilities not covered by budgetary resources. Budgetary and financial statement reporting requirements sometimes differ on the timing for the required recognition of an expense. For example, in the financial statements, annual leave expense must be accrued in the reporting period when the annual leave is earned. However, in the budget,

annual leave is required to be recognized and funded in the fiscal year when the annual leave is either used or paid out to a separating employee, not when it is earned. As a result of this timing difference, accrued annual leave liability is classified as a liability “not covered by budgetary resources” as of the financial statement date.

Liabilities that do not require the use of budgetary resources are covered by assets that do not represent budgetary resources to the SEC. Liabilities that do not require the use of budgetary resources include registrant monies held temporarily until earned by the SEC and offsetting liabilities that correspond to non-entity assets that the SEC holds, such as collections and receivables from disgorgement and penalties, as discussed in *Note 1.L, Liabilities*.

At September 30, 2018, liabilities consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Liabilities Not Requiring Budgetary Resources	Total
Intragovernmental:				
Accounts Payable	\$ 2,751	\$ —	\$ —	\$ 2,751
Other Intragovernmental Liabilities				
Accrued Employee Benefits	7,300	—	—	7,300
Unfunded FECA and Unemployment Liability	—	834	—	834
Custodial Liability	—	—	65,486	65,486
Liability for Non-Entity Assets	—	—	2,554	2,554
Subtotal – Other Intragovernmental Liabilities	7,300	834	68,040	76,174
Total Intragovernmental	10,051	834	68,040	78,925
Accounts Payable	166,938	—	—	166,938
Actuarial FECA Liability	—	4,511	—	4,511
Other Liabilities				
Accrued Payroll and Benefits	35,859	—	—	35,859
Accrued Leave	—	77,870	—	77,870
Registrant Deposits	—	—	40,079	40,079
Liability for Disgorgement and Penalties (Note 16)	—	—	2,259,278	2,259,278
Contingent Liabilities (Note 10)	—	63,968	—	63,968
Other Accrued Liabilities				
Recognition of Lease Liability (Note 9)	—	8,283	—	8,283
Other	—	—	2,273	2,273
Subtotal – Other Liabilities	35,859	150,121	2,301,630	2,487,610
Total Liabilities	\$ 212,848	\$ 155,466	\$ 2,369,670	\$ 2,737,984

Other Liabilities (intragovernmental and governmental) totaled \$2.6 billion as of September 30, 2018, of which all but \$151 million is current. The non-current portion of Other Liabilities includes the appropriate portions of Accrued Employee Benefits, Unfunded

FECA and Unemployment Liability, Accrued Leave, Contingent Liabilities, and Lease Liability. Current liabilities not covered by budgetary resources totaled \$380 thousand as of September 30, 2018.

At September 30, 2017, liabilities consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Liabilities Not Requiring Budgetary Resources	Total
Intragovernmental:				
Accounts Payable	\$ 2,460	\$ —	\$ —	\$ 2,460
Other Intragovernmental Liabilities				
Accrued Employee Benefits	7,279	—	—	7,279
Unfunded FECA and Unemployment Liability	—	896	—	896
Custodial Liability	—	—	173,896	173,896
Liability for Non-Entity Assets	—	—	580	580
Subtotal – Other Intragovernmental Liabilities	7,279	896	174,476	182,651
Total Intragovernmental	9,739	896	174,476	185,111
Accounts Payable	81,581	—	—	81,581
Actuarial FECA Liability	—	4,779	—	4,779
Other Liabilities				
Accrued Payroll and Benefits	35,369	—	—	35,369
Accrued Leave	—	75,752	—	75,752
Registrant Deposits	—	—	34,284	34,284
Liability for Disgorgement and Penalties (Note 16)	—	—	2,799,436	2,799,436
Contingent Liabilities (Note 10)	—	221,044	—	221,044
Other Accrued Liabilities				
Recognition of Lease Liability (Note 9)	—	9,013	—	9,013
Other	—	—	58	58
Subtotal – Other Liabilities	35,369	305,809	2,833,778	3,174,956
Total Liabilities	\$ 126,689	\$ 311,484	\$ 3,008,254	\$ 3,446,427

Other Liabilities (intragovernmental and governmental) totaled \$3.4 billion as of September 30, 2017, of which all but \$306 million was current. The non-current portion of Other Liabilities includes the appropriate

portions of the Unfunded FECA and Unemployment Liability, Accrued Leave, and Lease Liability. Current liabilities not covered by budgetary resources totaled \$404 thousand as of September 30, 2017.

## NOTE 9. LEASES

### Operating Leases

At September 30, 2018, the SEC leased office space at 15 locations under operating lease agreements that expire between FY 2019 and FY 2029. The SEC paid \$103 million and \$97 million for rent for the years ended September 30, 2018 and 2017, respectively.

The following table details expected future lease payments for (a) the full term of all non-cancelable

leases with terms of more than one year, and (b) the non-cancelable portion of all cancelable leases with terms of more than one year. “Non-cancelable” leases are leases for which the lease agreements do not provide an option for the lessee to cancel the lease prior to the end of the lease term. The total expected future lease payments reflect an estimate of base rent and contractually required costs.

Under existing commitments, expected future lease payments through FY 2024 and thereafter are as follows:

FISCAL YEAR (DOLLARS IN THOUSANDS)	Federal Non-Cancelable	Non-Federal Non-Cancelable	Non-Cancelable Expected Future Lease Payments
2019	\$ 2,863	\$ 68,484	\$ 71,347
2020	2,970	36,997	39,967
2021	2,970	17,733	20,703
2022	2,970	1,209	4,179
2023	2,980	—	2,980
2024 and thereafter	18,565	—	18,565
Total	\$ 33,318	\$ 124,424	\$ 157,741

As discussed in *Note 14.C, Other Budgetary Disclosures*, \$68 million of the above \$157.7 million are unfunded obligations.

### Expense Recognition of “Rent Holiday”

In the execution of lease agreements, many times lessors offer incentives for the occupation of office space. These include months of free rent at the occupied space or a temporary space while the new office is being prepared for occupancy. When a rent holiday occurs at the beginning of the lease term or at

the beginning of occupancy of the temporary space, a rent expense is accrued, even though no payment is due. This accrued expense is recognized as an unfunded liability because funding will not be provided until the future period in which payment is due. The accrual and amortization of rent holiday discounts allow the rent expense to be allocated equally to each period of the lease term. The accrued lease liability for rent holidays was \$8.3 million and \$9 million as of September 30, 2018 and 2017, respectively.



## NOTE 10. COMMITMENTS AND CONTINGENCIES

### A. Commitments: Securities Investor Protection Act

The Securities Investor Protection Act of 1970 (SIPA), as amended, created the Securities Investor Protection Corporation (SIPC) to restore funds and securities to investors and to protect the securities markets from disruption following the failure of broker-dealers. Generally, if a brokerage firm is not able to meet its obligations to customers, then customers' cash and securities held by the brokerage firm are returned to customers on a pro rata basis. If sufficient funds are not available at the firm to satisfy customer claims, the reserve funds of SIPC are used to supplement the distribution, up to a ceiling of \$500,000 per customer, including a maximum of \$250,000 for cash claims.

SIPA authorizes SIPC to create a fund to maintain all monies received and disbursed by SIPC. SIPA gives SIPC the authority to borrow up to \$2.5 billion from the SEC in the event that the SIPC Fund is or may appear insufficient for purposes of SIPA. To borrow the funds, SIPC must file with the SEC a statement of the uses of such a loan and a repayment plan, and then the SEC must certify to the Secretary of the Treasury that the loan is necessary to protect broker-dealer customers and maintain confidence in the securities markets and that the repayment plan provides as reasonable assurance of prompt repayment as may be feasible under the circumstances. The U.S. Treasury would make these funds available to the SEC through the purchase 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, 2018, the SEC had not loaned any funds to SIPC, and there are no outstanding notes or other obligating instruments issued by the SEC.

Based on the estimated costs to complete ongoing customer protection proceedings, the current size of the SIPC Fund supplemented by SIPC's ongoing assessments on brokers is expected to provide sufficient funds to cover acknowledged customer claims. There are several broker-dealers that are being liquidated under SIPA or that have been referred to SIPC for liquidation that may result in additional customer claims. In the event that the SIPC Fund is or may reasonably appear to be insufficient for the purposes of SIPA, SIPC may seek a loan from the SEC.

### B. Commitments and Contingencies: Investor Protection Fund

As discussed in *Note 1.E, Fund Accounting Structure*, the Investor Protection Fund is used to pay awards to whistleblowers if they voluntarily provide original information to the SEC and meet other conditions. Approved awards are between 10 and 30 percent of the monetary sanctions collected in the covered action or in a related action, with the actual percentage being determined at the discretion of the SEC, using criteria provided in the legislation and the related rules to implement the legislation adopted by the SEC.

A Preliminary Determination is an assessment, made by the Claims Review Staff appointed by the Director of the Division of Enforcement, as to whether the claim should be allowed or denied and, if allowed, what the proposed award percentage amount should be. A contingent liability is recognized when (a) a positive Preliminary Determination has been made by the Claims Review Staff, (b) collection has been made, and (c) the percentage to be paid can be reasonably estimated. A potential liability is disclosed but not recognized when a positive Preliminary Determination is expected and a collection has been received. A liabil-

ity is recognized when a Final Determination has been approved by the Commission and collection has been received. In all cases, the whistleblower award is not paid until amounts have been collected, a final order is issued by the Commission and the appeal rights of all claimants on the matter have been exhausted.

The SEC recognized a contingent liability for potential future whistleblower awards of \$64.0 million and \$221.0 million for the periods ended September 30, 2018 and 2017, respectively.

As of September 30, 2018, potential whistleblower payments for cases where positive Preliminary Determinations have not been made, but are reasonably possible, are estimated to range from \$14.0 million to \$41.9 million given the amount of current collections on those cases. Such claims do not meet the criteria for recognition as contingent liabilities in FY 2018. In the event that whistleblower award payments reduce the Investor Protection Fund total asset balance below \$300 million, the Investor Protection Fund will be

replenished, as described in *Note 1.Q, Budgets and Budgetary Accounting, Investor Protection Fund*. Effective July 1, 2018, the SEC used the unobligated balance in the Investor Protection Fund to trigger replenishment.

As of September 30, 2017, potential whistleblower payments that were reasonably possible, but did not meet the criteria for recognition as contingent liabilities, were estimated to range from \$7.5 million to \$22.6 million.

### C. Other Commitments

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 received. As of September 30, 2018, net obligations for all of the SEC's activities were \$736.3 million, of which \$212.8 million was delivered and unpaid. As of September 30, 2017, net obligations for all of SEC's activities were \$729.8 million, of which \$126.7 million was delivered and unpaid.

## NOTE 11. FUNDS FROM DEDICATED COLLECTIONS

The SEC's funds from dedicated collections consist of transactions and balances recorded in its Salaries and Expenses Fund, Investor Protection Fund, and Reserve Fund. See *Note 1.E.1, Funds from Dedicated*

*Collections*, and *Note 5, Investments*, for additional information about intragovernmental investments in Treasury securities.

For FY 2018, the assets, liabilities, net position, and net income from operations relating to funds from dedicated collections consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Salaries & Expenses	Investor Protection Fund	Reserve Fund	Eliminations	Total Funds From Dedicated Collections
<b>Balance Sheet as of September 30, 2018</b>					
<b>ASSETS</b>					
Fund Balance with Treasury	\$ 7,317,723	\$ 101,084	\$ 78,638	\$ —	\$ 7,497,445
Investments, Net	—	309,845	—	—	309,845
Accounts Receivable, Net	88,635	—	—	—	88,635
Property and Equipment, Net	59,029	—	61,440	—	120,469
Advances and Prepayments	5,814	—	—	—	5,814
<b>Total Assets</b>	<b>\$ 7,471,201</b>	<b>\$ 410,929</b>	<b>\$ 140,078</b>	<b>\$ —</b>	<b>\$ 8,022,208</b>
<b>LIABILITIES</b>					
Accounts Payable	\$ 67,372	\$ 97,965	\$ 4,352	\$ —	\$ 169,689
FECA and Unemployment Liability	5,345	—	—	—	5,345
Accrued Payroll and Benefits	43,159	—	—	—	43,159
Accrued Leave	77,870	—	—	—	77,870
Contingent Liabilities	—	63,968	—	—	63,968
Other Accrued Liabilities	8,283	—	—	—	8,283
<b>Total Liabilities</b>	<b>202,029</b>	<b>161,933</b>	<b>4,352</b>	<b>—</b>	<b>368,314</b>
<b>NET POSITION</b>					
Unexpended Appropriations	145,406	—	—	—	145,406
Cumulative Results of Operations	7,123,766	248,996	135,726	—	7,508,488
<b>Total Net Position</b>	<b>7,269,172</b>	<b>248,996</b>	<b>135,726</b>	<b>—</b>	<b>7,653,894</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 7,471,201</b>	<b>\$ 410,929</b>	<b>\$ 140,078</b>	<b>\$ —</b>	<b>\$ 8,022,208</b>
<b>Statement of Net Cost for the year ended September 30, 2018</b>					
Gross Program Costs	\$ 1,731,943	\$ 14,425	\$ 59,019	\$ (26)	\$ 1,805,361
Less Earned Revenues Not Attributable to Program Costs	1,704,186	—	50,000	(26)	1,754,160
<b>Net (Income) Cost from Operations</b>	<b>\$ 27,757</b>	<b>\$ 14,425</b>	<b>\$ 9,019</b>	<b>\$ —</b>	<b>\$ 51,201</b>

(continued on next page)

<i>(DOLLARS IN THOUSANDS)</i>	Salaries & Expenses	Investor Protection Fund	Reserve Fund	Eliminations	Total Funds From Dedicated Collections
<b>Statement of Changes in Net Position for the year ended September 30, 2018</b>					
Unexpended Appropriations:					
Budgetary Financing Sources:					
Appropriations Received	\$ 145,406	\$ —	\$ —	\$ —	\$ 145,406
Appropriations Used	—	—	—	—	—
Total Unexpended Appropriations	145,406	—	—	—	145,406
Cumulative Results of Operations:					
Net Position, Beginning of Period	7,104,361	79,798	144,745	—	7,328,904
Budgetary Financing Sources:					
Appropriations Used	—	—	—	—	—
Non-Exchange Revenue	—	183,735	—	—	183,735
Other	—	(112)	—	—	(112)
Other Financing Sources:					
Imputed Financing	47,162	—	—	—	47,162
Net Income (Cost) from Operations	(27,757)	(14,425)	(9,019)	—	(51,201)
Net Change	19,405	169,198	(9,019)	—	179,584
Cumulative Results of Operations	7,123,766	248,996	135,726	—	7,508,488
Net Position, End of Period	\$ 7,269,172	\$ 248,996	\$ 135,726	\$ —	\$ 7,653,894

## NOTE 11. FUNDS FROM DEDICATED COLLECTIONS *(CONTINUED)*

For FY 2017, the assets, liabilities, net position, and net income from operations relating to funds from dedicated collections consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Salaries & Expenses	Investor Protection Fund	Reserve Fund	Eliminations	Total Funds From Dedicated Collections
<b>Balance Sheet as of September 30, 2017</b>					
<b>ASSETS</b>					
Fund Balance with Treasury	\$ 7,080,452	\$ 29,397	\$ 85,524	\$ —	\$ 7,195,373
Investments, Net	—	292,283	—	—	292,283
Accounts Receivable, Net	137,765	—	—	—	137,765
Property and Equipment, Net	66,716	—	64,359	—	131,075
Advances and Prepayments	10,581	—	—	—	10,581
<b>Total Assets</b>	<b>\$ 7,295,514</b>	<b>\$ 321,680</b>	<b>\$ 149,883</b>	<b>\$ —</b>	<b>\$ 7,767,077</b>
<b>LIABILITIES</b>					
Accounts Payable	\$ 58,065	\$ 20,838	\$ 5,138	\$ —	\$ 84,041
FECA and Unemployment Liability	5,675	—	—	—	5,675
Accrued Payroll and Benefits	42,648	—	—	—	42,648
Accrued Leave	75,752	—	—	—	75,752
Contingent Liabilities	—	221,044	—	—	221,044
Other Accrued Liabilities	9,013	—	—	—	9,013
<b>Total Liabilities</b>	<b>191,153</b>	<b>241,882</b>	<b>5,138</b>	<b>—</b>	<b>438,173</b>
<b>NET POSITION</b>					
Unexpended Appropriations	—	—	—	—	—
Cumulative Results of Operations	7,104,361	79,798	144,745	—	7,328,904
<b>Total Net Position</b>	<b>7,104,361</b>	<b>79,798</b>	<b>144,745</b>	<b>—</b>	<b>7,328,904</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 7,295,514</b>	<b>\$ 321,680</b>	<b>\$ 149,883</b>	<b>\$ —</b>	<b>\$ 7,767,077</b>
<b>Statement of Net Cost for the year ended September 30, 2017</b>					
Gross Program Costs	\$ 1,702,587	\$ 257,294	\$ 43,051	\$ (129)	\$ 2,002,803
Less Earned Revenues Not Attributable to Program Costs	1,594,458	—	50,000	(129)	1,644,329
<b>Net (Income) Cost from Operations</b>	<b>\$ 108,129</b>	<b>\$ 257,294</b>	<b>\$ (6,949)</b>	<b>\$ —</b>	<b>\$ 358,474</b>

*(continued on next page)*

<i>(DOLLARS IN THOUSANDS)</i>	Salaries & Expenses	Investor Protection Fund	Reserve Fund	Eliminations	Total Funds From Dedicated Collections
<b>Statement of Changes in Net Position for the year ended September 30, 2017</b>					
Unexpended Appropriations:					
Budgetary Financing Sources:					
Appropriations Received	\$ 19,731	\$ —	\$ —	\$ —	\$ 19,731
Appropriations Used	(19,731)	—	—	—	(19,731)
Total Unexpended Appropriations	—	—	—	—	—
Cumulative Results of Operations:					
Net Position, Beginning of Period	7,165,088	334,358	137,796	—	7,637,242
Budgetary Financing Sources:					
Appropriations Used	19,731	—	—	—	19,731
Non-Exchange Revenue	—	2,734	—	—	2,734
Other	—	—	—	—	—
Other Financing Sources:					
Imputed Financing	27,671	—	—	—	27,671
Net Income (Cost) from Operations	(108,129)	(257,294)	6,949	—	(358,474)
Net Change	(60,727)	(254,560)	6,949	—	(308,338)
Cumulative Results of Operations	7,104,361	79,798	144,745	—	7,328,904
Net Position, End of Period	\$ 7,104,361	\$ 79,798	\$ 144,745	\$ —	\$ 7,328,904

## NOTE 12. STATEMENT OF CHANGES IN NET POSITION

In FY 2018, the negative \$548.2 million in “Other Financing Sources” reported in the Statement of Changes in Net Position consists of securities registration, tender offer, merger, and other fees from registrants (“filing fees”) collected for deposit into the U.S. Treasury General Fund. Filing fees are recognized as exchange revenue on the SEC’s Statement of Net Cost, and the transfer-out to the U.S. Treasury General Fund

is recognized as a negative “Other Financing Source” on the SEC’s consolidated Statement of Changes in Net Position. See *Note 1.P, Exchange and Non-Exchange Revenue*.

In FY 2017, the negative \$493.8 million in “Other Financing Sources” consists of the transfer-out of filing fees to the U.S. Treasury General Fund.

## NOTE 13. CUSTODIAL ACTIVITY

The Statement of Custodial Activity reports custodial collections and accounts receivable on a modified cash basis of accounting. Cash collections and amounts transferred to U.S. Treasury General Fund are reported on a cash basis. The change in receivables and related payables are reported on an accrual basis. The SEC’s Miscellaneous Receipt Accounts are used to account for custodial receipts pursuant to SEC enforcement

actions and other small collections that will be sent to the U.S. Treasury. For more information about the SEC’s Miscellaneous Receipt Accounts, see *Note 1.E, Fund Accounting Structure*. For information about the estimated collectability of accounts receivable, see *Note 1.I, Accounts Receivable and Allowance for Uncollectible Accounts*.

## NOTE 14. STATUS OF BUDGETARY RESOURCES

### A. Apportionment Categories of New Obligations and Upward Adjustments

Category A funds are those amounts that are subject to quarterly apportionment by OMB, meaning that a portion of the annual appropriation is not available to the agency until apportioned each quarter. Category B funds represent budgetary resources distributed by a specified time period, activity, project, object, or a

combination of these categories. The SEC’s Category B funds represent amounts apportioned at the beginning of the fiscal year for the SEC’s reimbursable and Investor Protection Fund activities. The SEC’s Reserve Fund is exempt from apportionment. For additional information, see *Note 1.E, Fund Accounting Structure*, and *Note 1.Q, Budgets and Budgetary Accounting*.



For the years ended September 30, 2018 and 2017, the SEC incurred obligations against Category A, Category B, and Exempt funds as follows:

<b>New Obligations and Upward Adjustments</b>		
<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
Direct Obligations		
Category A	\$ 1,619,046	\$ 1,579,913
Category B — Investor Protection Fund	171,502	47,050
Exempt From Apportionment — Reserve Fund	62,322	51,879
Total Direct Obligations	1,852,870	1,678,842
Reimbursable Obligations		
Category B	2,134	589
Total New Obligations and Upward Adjustments	\$ 1,855,004	\$ 1,679,431

### B. Explanation of Differences between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

A comparison between the FY 2018 SBR and the actual FY 2018 data in the President’s budget cannot be presented, as the FY 2020 President’s budget which

will contain FY 2018 actual data is not yet available. The FY 2020 Budget with actual amounts for FY 2018 will be available at a later date at <https://www.whitehouse.gov/omb/budget/>. The comparison will be presented in next year’s financial statements.

The comparison as of September 30, 2017, is presented below:

<i>(DOLLARS IN MILLIONS)</i>	Budgetary Resources	New Obligations and Upward Adjustments	Distributed Offsetting Receipts	Outlays, Net
Combined Statement of Budgetary Resources	\$ 1,854	\$ 1,680	\$ 5	\$ 176
FY 2017 Ending Balance: Comptroller General Decision B 322160, Recording of Obligation for Multiple Year Contract	139	—	—	—
Budget of the U.S. Government	\$ 1,993	\$ 1,680	\$ 5	\$ 176

The differences between the FY 2017 SBR and the prior year column in the FY 2019 Budget of the U.S. Government exist because certain data elements are reported on the SBR differently than those same data elements are reported in the Budget.

The data elements reported differently are those used to report the SEC’s recording of obligations in FY 2011 to reflect the impact of Comptroller General Decision

B 322160, Securities and Exchange Commission—Recording of Obligation for Multiple-Year Contract and the subsequent adjustment and liquidation of those obligations. In consultation with OMB, in FY 2011 the SEC recognized obligations for leases entered into in FY 2010 and prior. The recognition of these lease obligations resulted in an unfunded obligation (deficiency) of \$778 million.

In the Budget, the unfunded obligation is not included in the beginning of the year unobligated balance brought forward, but instead is reported in a separate schedule of the SEC's Budget titled "Unfunded Deficiencies."

Based on an agreement with OMB, the SEC funds the deficiency over time as budgetary resources become available for current year lease operations and as the prior year unfunded lease obligation amounts are recovered. At the end of FY 2017, the SEC's SBR included \$139 million in remaining unfunded obligations after the SEC funded \$74 million for current year lease operations. The SEC SBR for FY 2018 presents this balance as a reduction of the beginning of the year unobligated balance brought forward.

### C. Other Budgetary Disclosures

#### General Provisions of Appropriation

The SEC's annual Appropriations Act provides \$1,652,000,000 in new budget authority for FY 2018, of which funding for information technology initiatives shall be increased over the FY 2017 level by not less than \$45,000,000. The Act contains general provisions that limit the amount that can be obligated for international conferences, International Organization of Securities Commission (IOSCO) dues, and representation expenses. The Act requires the SEC to fund its Office of Inspector General with a minimum of \$14,748,358 and the Division of Economic and Risk Analysis with a minimum of \$68,950,000 in new budget authority. The Act also provides for costs associated with potential relocation under a replacement lease for the Commission's headquarters facilities, not to exceed \$244,507,052, to remain available until expended.

#### Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)

For FY 2018, the Unobligated Balance from Prior Year Budget Authority, Net consisted of available unobligated balance brought forward from the prior year in the amount of \$175.2 million as well as FY 2018 recoveries of prior-year obligations totaling \$36.6 million. For FY 2017, the Unobligated Balance from Prior Year Budget Authority, Net consisted of available unobligated balance brought forward from the prior year in the amount of \$154.0 million as well as FY 2017 recoveries of prior-year obligations totaling \$40.2 million.

#### Undelivered Orders at the End of the Period

Undelivered orders consist of orders of goods and services that the SEC has not received. The SEC's total undelivered orders are \$529.2 million and \$614.4 million for the years ended September 30, 2018 and 2017, respectively. Of the \$529.2 million total undelivered orders at September 30, 2018, \$52.4 million were with federal trading partners and \$476.9 million were with non-federal trading partners. The total undelivered orders contain unpaid and paid undelivered orders, with unpaid orders making up the majority of the total. The SEC's total unpaid undelivered orders are \$523.4 million and \$603.8 million for the years ended September 30, 2018 and 2017, respectively. Of the \$523.4 million unpaid undelivered orders at September 30, 2018, \$46.5 million were with federal trading partners and \$476.9 million were with non-federal trading partners.

#### Change in Legal Interpretation for Lease Obligations

The SEC was granted independent leasing authority in 1990. Based on a legal review of its statutory authority at the time, the SEC adopted a policy of obligating only the annual portion of lease payments due each year.

On October 3, 2011, the Government Accountability Office (GAO) issued a decision that this longstanding practice of recording lease obligations only on an annual basis violated the recording statute, 31 U.S.C. sect. 1501(a)(1). Specifically, the GAO's decision was that the SEC lacks statutory authority to obligate an amount less than the government's total obligation. If the SEC lacks sufficient budget authority to cover this obligation, the SEC should report a violation of the Antideficiency Act.

The SEC recorded obligations in the same manner for all its leasing actions between the time the agency was granted independent leasing authority in 1990 and 2010. Further, the agency did not have sufficient

remaining unobligated funds in the years in which the various leases were entered to cover the full obligations associated with those leases. As a result, the agency recorded unfunded obligations totaling \$778 million for leases executed between 1990 and 2010 in FY 2011.

Unfunded lease obligations totaled \$68 million and \$139 million as of September 30, 2018 and 2017, respectively. Accrual accounting requires expenses to be recognized in the period in which the expenses are incurred. Because future lease expenses are not an expense of the current fiscal year, they are not reported as expenses or liabilities in the current fiscal year. See *Note 9, Leases*, for additional information.

#### Borrowing Authority

See *Note 10.A, Commitments: Securities Investor Protection Act*, for information on the SEC's borrowing authority.

## NOTE 15. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

For the years ended September 30, 2018 and 2017:

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>RESOURCES USED TO FINANCE ACTIVITIES:</b>		
Budgetary Resources Obligated:		
New Obligations and Upward Adjustments (Note 14)	\$ 1,855,004	\$ 1,679,431
Less: Spending Authority from Offsetting Collections, Recoveries, and Downward Adjustments of Prior Year Unfunded Lease Obligations	(1,789,121)	(1,625,967)
Less: Reserve Fund Appropriations	(50,000)	(50,000)
Net Obligations	15,883	3,464
Other Resources:		
Imputed Financing from Cost Absorbed by Others	47,162	27,671
Total Resources Used to Finance Activities	63,045	31,135
<b>RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF OPERATIONS:</b>		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered But Not Yet Provided	84,438	126,817
Resources That Finance the Acquisition of Assets Capitalized on the Balance Sheet	(52,285)	(58,226)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	32,153	68,591
Total Resources Used to Finance the Net Cost of Operations	95,198	99,726
<b>COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD:</b>		
Components Requiring or Generating Resources in Future Periods:		
Change in Accrued Leave Liability	2,118	2,916
Change in Revenue Receivables Not Generating Resources Until Collected	49,130	(9,346)
Change in Lease Liability	(730)	2,706
Change in Unfunded Liability	(157,406)	209,412
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	(106,888)	205,688
Components Not Requiring or Generating Resources:		
Depreciation and Amortization	61,407	52,716
Revaluation of Assets or Liabilities	1,484	344
Non-Entity Filing Fee Revenue, Net	(548,122)	(493,761)
Other Costs that will not Require or Generate Resources	(39)	(44)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Future Period	(485,270)	(440,745)
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	(592,158)	(235,057)
Net (Income) Cost from Operations	\$ (496,960)	\$ (135,331)

Components of net cost of operations that will not require or generate budgetary resources represent required timing differences in the Statement of Net Cost and the Statement of Budgetary Resources.

For example, as noted in *Note 1.L, Liabilities*, annual leave that is earned but not either taken or paid out to separating employees by the end of the fiscal year is required to be reported as an expense in the financial statements in the year when it is earned, but it is required to be funded by budgetary resources in the future fiscal year when it is either used or paid out to separating employees. In the reconciliation, it is reported as a component of net cost that will not require resources in the current period.

Another example is depreciation expense. In budgetary reporting, the entire cost of a depreciable asset is recognized in the period when the asset is purchased. However, in financial statement reporting, accrual accounting requires the cost of such assets to be allocated among the reporting periods that represent the estimated useful life of the asset. In the reconciliation, depreciation is recognized as a “component not requiring or generating resources.”

An example of a revenue that does not generate budgetary resources is Non-Entity Filing Fee Revenue, Net. “Non-entity” filing fee revenue is not available to the SEC for use in its operations; accordingly, this revenue does not generate budgetary resources for the SEC.

## NOTE 16. DISGORGEMENT AND PENALTIES

The SEC’s non-entity assets include disgorgement, penalties, and interest assessed against securities law violators by the Commission or a federal court. The SEC also recognizes an equal and offsetting liability for these non-entity assets, as discussed in *Note 1.L, Liabilities*.

When the Commission or court issues an order for the SEC to collect disgorgement, penalties, and interest from securities law violators, the SEC establishes an account receivable due to the SEC. Upon collection, the SEC may (a) hold receipts in the Disgorgement and Penalty Deposit Fund as FBWT or Treasury investments pending distribution to harmed investors, (b) deposit receipts in the U.S. Treasury General Fund or, (c) transfer amounts to the Investor Protection Fund. The situations where funds would not be held for distribution to harmed investors arise when the SEC either determines it is not practical to return funds to investors or when court orders expressly state

that funds are to be remitted to the U.S. Treasury. The determination as to whether funds not held for distribution to harmed investors will be deposited in the U.S. Treasury or transferred to the Investor Protection Fund is made in accordance with the provisions of the Dodd-Frank Act, and is dependent on the balance in the Investor Protection Fund on the day the amounts are collected.

Disbursements related to disgorgement and penalties include distributions to harmed investors, payments to tax authorities, and fees paid to plan administrators and the Bureau of the Fiscal Service. The SEC does not record activity in its financial statements related to Enforcement actions that result in amounts ordered to another government entity such as a court, or a non-governmental entity such as a receiver. See *Note 1.R, Disgorgement and Penalties*, and *Note 2, Entity and Non-Entity Assets*.

In FY 2018, total Disgorgement and Penalties assets of \$2.3 billion include \$2.2 billion held for distribution to harmed investors and \$67 million to be transferred to the U.S. Treasury General Fund. In FY 2017, total

Disgorgement and Penalties assets of \$3.0 billion included \$2.8 billion held for distribution to harmed investors and \$174 million to be transferred to the U.S. Treasury General Fund.

At September 30, the net inflows and outflows for FBWT, Investments, and Accounts Receivable related to disgorgement and penalties consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
Fund Balance with Treasury:		
Beginning Balance	\$ 275,167	\$ 351,735
Collections	1,028,554	2,078,713
Purchases and Redemptions of Treasury Securities	694,451	52,532
Disbursements	(687,974)	(245,792)
Transfers and Deposits to the Investor Protection Fund	(179,626)	—
Transfers and Deposits to the U.S. Treasury General Fund	(845,862)	(1,962,021)
Total Fund Balance with Treasury (Note 2)	284,710	275,167
Cash and Other Monetary Assets:		
Beginning Balance	8	27
Net Activity	2,215	(19)
Total Cash and Other Monetary Assets (Notes 2 and 4)	2,223	8
Investments, Net:		
Beginning Balance	2,471,245	2,506,317
Net Activity	(659,836)	(35,072)
Total Investments, Net (Notes 2 and 5)	1,811,409	2,471,245
Accounts Receivable, Net:		
Beginning Balance	226,524	896,328
Net Activity	1,557	(669,804)
Total Accounts Receivable, Net (Notes 2 and 6)	228,081	226,524
Total Disgorgement and Penalties	\$ 2,326,423	\$ 2,972,944

## REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

This section provides the Required Supplementary Information as prescribed by OMB Circular A-136, *Financial Reporting Requirements*.

U.S. SECURITIES AND EXCHANGE COMMISSION

### Combining Statements of Budgetary Resources by Fund

For the year ended September 30, 2018

<i>(DOLLARS IN THOUSANDS)</i>	Salaries and Expenses and Other Funds	Investor Protection Fund	Reserve Fund	Total
	X0100, 1435, 3220, 3875	5567	5566	
<b>BUDGETARY RESOURCES:</b>				
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory) (Note 14)	\$ (88,022)	\$ 297,387	\$ 2,388	\$ 211,753
Appropriations (Discretionary and Mandatory)	145,405	173,449	75,225	394,079
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,752,538	—	—	1,752,538
<b>Total Budgetary Resources</b>	<b>\$ 1,809,921</b>	<b>\$ 470,836</b>	<b>\$ 77,613</b>	<b>\$ 2,358,370</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>				
New Obligations and Upward Adjustments (Total) (Note 14)	\$ 1,621,180	\$ 171,502	\$ 62,322	\$ 1,855,004
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	254,328	129,247	—	383,575
Exempt from Apportionment, Unexpired Accounts	—	—	15,291	15,291
Unapportioned, Unexpired Accounts	(65,587)	170,087	—	104,500
Unobligated Balance, End of Year (Total)	188,741	299,334	15,291	503,366
<b>Total Budgetary Resources</b>	<b>\$ 1,809,921</b>	<b>\$ 470,836</b>	<b>\$ 77,613</b>	<b>\$ 2,358,370</b>
<b>OUTLAYS, NET:</b>				
Outlays, Net (Discretionary and Mandatory)	\$ (91,867)	\$ 94,375	\$ 56,886	\$ 59,394
Distributed Offsetting Receipts	(1,907)	(5,746)	—	(7,653)
Agency Outlays, Net (Discretionary and Mandatory)	\$ (93,774)	\$ 88,629	\$ 56,886	\$ 51,741

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



## Combining Statements of Budgetary Resources by Fund

For the year ended September 30, 2017

<i>(DOLLARS IN THOUSANDS)</i>	Salaries and Expenses and Other Funds	Investor Protection Fund	Reserve Fund	Total
	X0100, 1435, 3220, 3875	5567	5566	
<b>BUDGETARY RESOURCES:</b>				
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory) (Note 14)	\$ (149,217)	\$ 340,219	\$ 3,166	\$ 194,168
Appropriations (Discretionary and Mandatory)	19,731	4,218	49,925	73,874
Spending Authority from Offsetting Collections (Discretionary and Mandatory)	1,586,559	—	—	1,586,559
<b>Total Budgetary Resources</b>	<b>\$ 1,457,073</b>	<b>\$ 344,437</b>	<b>\$ 53,091</b>	<b>\$ 1,854,601</b>
<b>STATUS OF BUDGETARY RESOURCES:</b>				
New Obligations and Upward Adjustments (Total) (Note 14)	\$ 1,580,502	\$ 47,050	\$ 51,879	\$ 1,679,431
Unobligated Balance, End of Year:				
Apportioned, Unexpired Accounts	12,793	297,387	—	310,180
Exempt from Apportionment, Unexpired Accounts	—	—	1,212	1,212
Unapportioned, Unexpired Accounts	(136,222)	—	—	(136,222)
Unobligated Balance, End of Year (Total)	(123,429)	297,387	1,212	175,170
<b>Total Budgetary Resources</b>	<b>\$ 1,457,073</b>	<b>\$ 344,437</b>	<b>\$ 53,091</b>	<b>\$ 1,854,601</b>
<b>OUTLAYS, NET:</b>				
Outlays, Net (Discretionary and Mandatory)	\$ 79,151	\$ 49,170	\$ 47,794	\$ 176,115
Distributed Offsetting Receipts	(570)	(4,478)	—	(5,048)
Agency Outlays, Net (Discretionary and Mandatory)	\$ 78,581	\$ 44,692	\$ 47,794	\$ 171,067

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

# INVESTOR PROTECTION FUND FINANCIAL STATEMENTS

U.S. SECURITIES AND EXCHANGE COMMISSION  
INVESTOR PROTECTION FUND

## Balance Sheets

As of September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018	2017
<b>ASSETS:</b>		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	\$ 101,084	\$ 29,397
Investments, Net (Note 3)	309,845	292,283
<b>Total Assets</b>	<b>\$ 410,929</b>	<b>\$ 321,680</b>
<b>LIABILITIES (NOTE 4):</b>		
Accounts Payable	97,965	20,838
Contingent Liabilities (Note 5)	63,968	221,044
<b>Total Liabilities</b>	<b>161,933</b>	<b>241,882</b>
Commitments and Contingencies (Note 5)		
<b>NET POSITION:</b>		
Cumulative Results of Operations – Funds from Dedicated Collections	248,996	79,798
Total Net Position – Funds from Dedicated Collections	248,996	79,798
Total Net Position	248,996	79,798
<b>Total Liabilities and Net Position</b>	<b>\$ 410,929</b>	<b>\$ 321,680</b>

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

U.S. SECURITIES AND EXCHANGE COMMISSION  
INVESTOR PROTECTION FUND

## Statements of Net Cost

For the years ended September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018	2017
<b>PROGRAM COSTS:</b>		
Awards to Whistleblowers	\$ 14,398	\$ 257,165
Employee Suggestion Program	27	129
<b>Total Program Costs</b>	<b>14,425</b>	<b>257,294</b>
<b>Net (Income) Cost from Operations (Note 7)</b>	<b>\$ 14,425</b>	<b>\$ 257,294</b>

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

## Statements of Changes in Net Position

For the years ended September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018	2017
<b>CUMULATIVE RESULTS OF OPERATIONS:</b>		
Beginning Balances	\$ 79,798	\$ 334,358
<b>Budgetary Financing Sources:</b>		
Non-Exchange Revenue	183,735	2,734
Other	(112)	—
Total Financing Sources	183,623	2,734
Net Income (Cost) from Operations	(14,425)	(257,294)
Net Change	169,198	(254,560)
Cumulative Results of Operations	248,996	79,798
<b>Net Position, End of Period</b>	<b>\$ 248,996</b>	<b>\$ 79,798</b>

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

## Statements of Budgetary Resources

For the years ended September 30, 2018 and 2017

(DOLLARS IN THOUSANDS)	2018	2017
<b>BUDGETARY RESOURCES:</b>		
Unobligated Balance from Prior Year Budget Authority, Net (Discretionary and Mandatory)	\$ 297,387	\$ 340,219
Appropriations (Discretionary and Mandatory)	173,449	4,218
<b>Total Budgetary Resources</b>	<b>\$ 470,836</b>	<b>\$ 344,437</b>
<b>STATUS OF BUDGETARY RESOURCES (NOTE 6):</b>		
New Obligations and Upward Adjustments (Total)	\$ 171,502	\$ 47,050
Unobligated Balance, End of Year:		
Apportioned, Unexpired Accounts	129,247	297,387
Unapportioned, Unexpired Accounts	170,087	—
Unobligated Balance, End of Year (Total)	299,334	297,387
<b>Total Budgetary Resources</b>	<b>\$ 470,836</b>	<b>\$ 344,437</b>
<b>OUTLAYS, NET:</b>		
Outlays, Net (Total) (Discretionary and Mandatory)	94,375	49,170
Distributed Offsetting Receipts	(5,746)	(4,478)
Agency Outlays, Net (Discretionary and Mandatory)	\$ 88,629	\$ 44,692

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

# NOTES TO THE INVESTOR PROTECTION FUND FINANCIAL STATEMENTS

U.S. SECURITIES AND EXCHANGE COMMISSION

As of September 30, 2018 and 2017

## NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

### A. Reporting Structure

The U.S. Securities and Exchange Commission (SEC) is an independent agency of the U.S. Government established pursuant to the Securities Exchange Act of 1934 (Exchange Act), charged with regulating this country's capital markets. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) established the Securities and Exchange Commission Investor Protection Fund. The Investor Protection Fund provides funding for the Dodd-Frank Whistleblower Program and finances the operations of the SEC Office of Inspector General's Employee Suggestion Program. The Investor Protection Fund is a fund within the SEC, and these financial statements present a segment of the SEC's financial activity.

### B. Basis of Presentation and Accounting

These footnotes are an integral part of the Investor Protection Fund's financial statements, which present the financial position, net cost of operations, changes in net position, and budgetary resources of the Investor Protection Fund as required by Exchange Act Section 21F(g)(5). The Act requires a complete set of financial statements that includes a balance sheet, income statement, and cash flow analysis. The legislative requirements to prepare an income statement and cash flow analysis are addressed by the Statement of Net Cost and *Note 2, Fund Balance with Treasury*, respectively.

The SEC's books and records serve as the source of the information presented in the accompanying financial statements. The SEC is a federal reporting entity, in accordance with the provisions of the Accountability of

Tax Dollars Act of 2002. The SEC's financial statements are prepared in conformity with generally accepted accounting principles (GAAP) for the federal government, and are presented in conformity with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. Audited financial statements are a special-purpose report required by legislation. As a stand-alone entity, the Investor Protection Fund does not meet the criteria provided in the CFO Act and the Accountability of Tax Dollars Act to constitute a "federal reporting entity." In addition, federal GAAP and OMB Circular A-136 do not provide for either an Income Statement or a cash flow analysis. However, the Investor Protection Fund financial statements are consistent with the SEC financial statements, except for additional elements, such as cash flow analysis, that are required by legislation.

The agency classifies assets, liabilities, revenues, and costs in these financial statements according to the type of entity associated with the transactions. Intragovernmental assets and liabilities are those due from or to other federal entities, including other funds within the SEC. Intragovernmental revenues and costs result from transactions with other federal entities, including other funds within the SEC.

In accordance with OMB Circular A-136, the Statement of Budgetary Resources is presented on a combined basis, and the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Custodial Activities are presented on a consolidated basis.

The Balance Sheet, Statement of Net Cost, and Statement of Changes in Net Position are prepared using the accrual basis of accounting. Accordingly, revenues are recognized when services are provided, and expenses are recognized when incurred without regard to the receipt or payment of cash. These principles differ from the budgetary accounting and reporting principles on which the Statement of Budgetary Resources is prepared. A reconciliation of differences, if any, between the accrual-based Statement of Net Cost and the budgetary-based Statement of Budgetary Resources is presented in *Note 7, Reconciliation of Net Cost of Operations to Budget*.

Certain prior year amounts presented on the Statement of Budgetary Resources have been reclassified, and the sequence of the two sections of the Statement of Changes in Net Position has been revised, to conform to the changes in presentation required by the FY 2018 issuance of OMB Circular A-136.

### C. Use of Estimates

The preparation of financial statements on the accrual basis of accounting requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and costs. These estimates are based on management's best knowledge of current events, historical experience, actions that the SEC may undertake in the future, and various other assumptions. The estimates include, but are not limited to, the recognition and disclosure of potential future whistleblower award payments as of the date of the financial statements. Actual results may differ from these estimates.

### D. Intra- and Inter-Agency Relationships

#### Transactions with Other SEC Funds

The Investor Protection Fund is comprised of a single Treasury Appropriation Fund Symbol. The Investor Protection Fund is the recipient of non-exchange revenues collected by the SEC. Amounts transferred to

the Investor Protection Fund are classified as "retained by the SEC" because the Investor Protection Fund is a fund within the SEC. These intra-agency transfers are required because the Investor Protection Fund finances the operations of the SEC Office of Inspector General's Employee Suggestion Program.

#### Transactions with Other Federal Agencies

Whistleblower payments may be made from the Investor Protection Fund as a result of monetary sanctions paid to other federal agencies in related actions, but only if there has been a Commission enforcement action resulting in sanctions of a million dollars or greater and the Commission has determined that the whistleblower is eligible for an award and recommended the percentage. In those instances, the SEC remains liable for paying the whistleblower. However, in instances where a whistleblower has already received an award from the Commodity Futures Trading Commission, the whistleblower is not entitled to an award from the SEC.

### E. Funds from Dedicated Collections

A fund from dedicated collections is financed by specifically identified revenues, provided to the government by non-federal sources, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the government's general revenues. Investor Protection Fund resources are funds from dedicated collections and may only be used for the purposes specified by the Dodd-Frank Act.

### F. Entity Assets

Assets that an agency is authorized to use in its operations are entity assets. The SEC is authorized to use all funds in the Investor Protection Fund for the purposes specified by the Dodd-Frank Act. Accordingly, all assets are recognized as entity assets.

### G. Fund Balance with Treasury

Fund Balance with Treasury reflects amounts the Investor Protection Fund holds in the U.S. Treasury that have not been invested in federal securities. The SEC conducts all of its banking activity in accordance with directives issued by the U.S. Department of the Treasury's Bureau of the Fiscal Service.

### H. Investments

The SEC has authority to invest amounts in the Investor Protection Fund in overnight and short-term, market-based Treasury securities. The interest earned on the investments is a component of the Fund and is available to be used for expenses of the Investor Protection Fund. Additional details regarding Investor Protection Fund investments are provided in *Note 3, Investments*.

### I. Liabilities

The SEC records liabilities for probable future outflows or other sacrifices of resources as a result of events that have occurred as of the Balance Sheet date. The Investor Protection Fund's liabilities consist of amounts payable to whistleblowers and amounts recognized as contingent liabilities for whistleblower awards.

The SEC recognizes liabilities that are covered by budgetary resources and liabilities that are not covered by budgetary resources. Budgetary and financial statement reporting requirements sometimes differ on the timing for the required recognition of an expense. Liabilities that are covered by budgetary resources are liabilities incurred for which budgetary resources are available to the SEC without further Congressional action. Refer to *Note 4, Liabilities Covered and Not Covered by Budgetary Resources*, for detailed information regarding liabilities covered and not covered by budgetary resources.

The Dodd-Frank Act and the SEC implementing regulations establish the eligibility criteria for whistleblower awards. Refer to *Note 5, Commitments and Contingencies*, for additional information regarding the disclosure and recognition of actual and contingent liabilities for whistleblower awards.

### J. Program Costs

The Investor Protection Fund reimburses the SEC's Salaries and Expenses account (X0100) for expenses incurred by the Office of Inspector General to administer the Employee Suggestion Program. The Investor Protection Fund also finances payments to whistleblowers under Section 21F of the Exchange Act.

### K. Non-Exchange Revenue

#### Disgorgement and Penalty Transfers

Non-exchange revenue arises from the government's ability to demand payment. The Investor Protection Fund is financed through the receipt of monetary sanctions collected by the SEC in judicial or administrative actions brought by the SEC under the securities laws that are not either: (1) added to the disgorgement fund or other fund under Section 308 of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246) or (2) otherwise distributed to victims of a violation of the securities laws. Section 21F of the Exchange Act provides that monetary sanctions collected by the SEC are deposited into the Investor Protection Fund if the balance in the Fund is below \$300 million on the day of collection. The Investor Protection Fund recognizes non-exchange revenue for monetary sanctions that are transferred into the Fund. Additional details regarding Investor Protection Fund funding are provided in *Note 5, Commitments and Contingencies*.

#### Interest Earnings on Investments with Treasury

Interest earned from investments in U.S. Treasury securities is classified in the same way as the predominant source of revenue to the fund. The Investor Protection Fund is financed through the receipt of non-exchange revenues and thus interest earnings are also recognized as non-exchange revenues.

### L. Budgets and Budgetary Accounting

The Investor Protection Fund (X5567) is a special fund established with permanent authority to retain revenues and other financing sources not used in the current period for future use. The Dodd-Frank Act provides

that the Fund is available to the SEC without further appropriation or fiscal year limitation for the purpose of paying awards to whistleblowers and funding the activities of the Office of Inspector General’s Employee Suggestion Program. However, the SEC is required to request and obtain an annual apportionment from OMB to use these funds.

The resources of the Investor Protection Fund are apportioned under Category B authority, which means that the funds represent budgetary resources distributed by a specified project and are not subject to quarterly apportionment. Thus, all obligations incurred as presented on the Statement of Budgetary Resources are derived from Category B funds.

## NOTE 2. FUND BALANCE WITH TREASURY

The status of Fund Balance with Treasury as of September 30, 2018 and 2017 consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>Status of Fund Balance with Treasury:</b>		
Unobligated Balance		
Available	(9,116)	8,249
Unavailable	12,235	310
Obligated Balance not Yet Disbursed	97,965	20,838
<b>Total Status of Fund Balance with Treasury</b>	<b>\$ 101,084</b>	<b>\$ 29,397</b>

Unobligated balances reported for the status of Fund Balance with Treasury do not agree with the amounts reported in the Statement of Budgetary Resources due to the fact that funds for unobligated balances are held in investments as well as in Fund Balance with Treasury. There were no differences between the Fund Balance reflected in the Investor Protection Fund financial statements and the balance in the Treasury accounts.

### Cash Flow

The Investor Protection Fund cash flows during FY 2018 consisted of:

- Net cash outflows from investment redemptions of \$20.8 million;
- Net cash inflows from investment interest of \$7.3 million (which include \$5.4 million of interest collections and \$1.9 million in discounts received);
- Net cash inflows from fund replenishment required under the Dodd-Frank Act of \$179.6 million; and

- Net cash outflows for payment of whistleblower awards totaling \$2 thousand for amounts that were awarded during FY 2017 and \$94.3 million for amounts that were awarded during FY 2018, and payment of expenses of operating the Office of Inspector General’s Employee Suggestion Program of \$27 thousand.

Cash flows during FY 2017 consisted of:

- Net cash inflows from investment redemptions of \$56.2 million;
- Net cash inflows for investment interest of \$4.5 million (which includes \$9.3 million of interest collections, less \$5 million of premiums paid, and \$128 thousand in discounts received); and
- Net cash outflows for payment of whistleblower awards totaling \$23 million for amounts that were awarded during FY 2016 and \$26.1 million for amounts that were awarded during FY 2017, and the cost of operating the Office of Inspector General’s Employee Suggestion Program of \$129 thousand.



## NOTE 3. INVESTMENTS

The SEC invests funds in overnight and short-term non-marketable market-based Treasury bills. The SEC records the value of its investments in Treasury bills at cost and amortizes any premium or discount on a straight-line basis (S/L) through the maturity date of these securities. Non-marketable market-based

Treasury securities are issued by the Bureau of the Fiscal Service to federal agencies. They are not traded on any securities exchange but mirror the prices of similar Treasury securities trading in the government securities market.

At September 30, 2018, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Investor Protection Fund – Entity	\$ 308,450	S/L	\$ 843	\$ 552	\$ 309,845	\$ 309,123

At September 30, 2017, investments consisted of the following:

<i>(DOLLARS IN THOUSANDS)</i>	Cost	Amortization Method	Amortized (Premium) Discount	Interest Receivable	Investment, Net	Market Value Disclosure
Non-Marketable Market-Based Securities						
Investor Protection Fund – Entity	\$ 294,098	S/L	\$ (3,680)	\$ 1,865	\$ 292,283	\$ 290,274

### Intragovernmental Investments in Treasury Securities

Market-based Treasury securities are debt securities that the U.S. Treasury issues to federal entities without statutorily determined interest rates. Although the securities are not marketable, the terms (prices and interest rates) mirror the terms of marketable Treasury securities.

The federal government does not set aside assets to pay future benefits or other expenditures associated with the investment by federal agencies in non-marketable federal securities. The balances underlying these investments are deposited in the U.S. Treasury, which uses the cash for general government purposes. Treasury securities are issued to the SEC as evidence of these balances. Treasury securities are an asset of the SEC and a liability of the U.S. Treasury. Because

the SEC and the U.S. Treasury are both components of the government, these assets and liabilities offset each other from the standpoint of the government as a whole. For this reason, the investments presented by the SEC do not represent an asset or a liability in the U.S. government-wide financial statements.

Treasury securities provide the SEC with authority to draw upon the U.S. Treasury to make future payments from these accounts. When the SEC requires redemption of these securities to make expenditures, the government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same manner in which the government finances all expenditures.

## NOTE 4. LIABILITIES COVERED AND NOT COVERED BY BUDGETARY RESOURCES

The SEC recognizes liabilities that are covered by budgetary resources and liabilities that are not covered by budgetary resources. Budgetary and financial

statement reporting requirements sometimes differ on the timing for the required recognition of an expense.

At September 30, 2018, liabilities consisted of the following:

(DOLLARS IN THOUSANDS)	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Total
Accounts Payable	\$ 97,965	\$ —	\$ 97,965
Contingent Liabilities	—	63,968	63,968
Total Liabilities	\$ 97,965	\$ 63,968	\$ 161,933

At September 30, 2017, liabilities consisted of the following:

(DOLLARS IN THOUSANDS)	Liabilities Covered by Budgetary Resources	Liabilities Not Covered by Budgetary Resources	Total
Accounts Payable	\$ 20,838	\$ —	\$ 20,838
Contingent Liabilities	—	221,044	221,044
Total Liabilities	\$ 20,838	\$ 221,044	\$ 241,882

## NOTE 5. COMMITMENTS AND CONTINGENCIES

### Commitments: Dodd-Frank Whistleblower Program

As discussed in *Note 1.1, Liabilities*, the Investor Protection Fund is used to pay awards to whistleblowers if they voluntarily provide original information to the SEC and meet other conditions. Approved awards are between 10 and 30 percent of the monetary sanctions collected in the covered action or in a related action, with the actual percentage being determined at the discretion of the SEC using criteria provided in the legislation and the related rules to implement the legislation adopted by the SEC.

A Preliminary Determination is a first assessment, made by the Claims Review Staff appointed by the Director of the Division of Enforcement, as to whether

the claim should be allowed or denied, and if allowed, what the proposed award percentage amount should be. A contingent liability is recognized when (a) a positive Preliminary Determination has been made by the Claims Review Staff, (b) collection has been made, and (c) the percentage to be paid can be reasonably estimated. A potential liability is disclosed but not recognized when a positive Preliminary Determination is expected and a collection has been received. A liability is recognized when a positive Proposed Final Determination has been issued by the Claims Review Staff and collection has been received. In all cases the whistleblower award is not paid until amounts have been collected, a final order is issued by the Commission and the appeal rights of all claimants on the matter have been exhausted.

The SEC recognized a contingent liability for potential future whistleblower awards of \$64.0 million and \$221.0 million for the periods ended September 30, 2018 and 2017, respectively.

As of September 30, 2018, potential whistleblower payments for cases where positive Preliminary Determinations have not been made, but are reasonably possible, are estimated to range from \$14.0 million to \$41.9 million given the amount of current collections on those cases. Such claims do not meet the criteria for recognition as contingent liabilities in FY 2018. In the event that whistleblower awards payments reduce

the Investor Protection Fund total asset balance below \$300 million, the Investor Protection Fund will be replenished as described in the “Disgorgement and Penalty Transfers” section of *Note 1.K, Non-Exchange Revenue*. Effective July 1, 2018, the SEC used the unobligated balance in the Investor Protection Fund to trigger replenishment.

As of September 30, 2017, potential whistleblower payments that were reasonably possible, but did not meet the criteria for recognition as contingent liabilities, were estimated to range from \$7.5 million to \$22.6 million.

## NOTE 6. STATUS OF BUDGETARY RESOURCES, OTHER BUDGETARY DISCLOSURES

### A. Explanation of Differences between the Statement of Budgetary Resources (SBR) and the Budget of the U.S. Government

A comparison between the FY 2018 Statement of Budgetary Resources and the actual FY 2018 data in the President’s budget cannot be presented, as the FY 2020 President’s budget, which will contain FY 2018 actual data is not yet available; the comparison will be presented in next year’s financial statements. The FY 2020 Budget with actual amounts for FY 2018 will be available at a later date at <https://www.whitehouse.gov/omb/budget/>.

There are no differences between the FY 2017 Statement of Budgetary Resources and the FY 2017 data in the President’s budget.

### B. Other Budgetary Disclosures

There were no budgetary resources obligated for undelivered orders as of September 30, 2018 and 2017.

There are no legal arrangements affecting the use of unobligated balances of budget authority, such as time limits, purpose, and obligation limitations.

## NOTE 7. RECONCILIATION OF NET COST OF OPERATIONS TO BUDGET

For the years ended September 30, 2018 and 2017:

<i>(DOLLARS IN THOUSANDS)</i>	2018	2017
<b>RESOURCES USED TO FINANCE ACTIVITIES:</b>		
Budgetary Resources Obligated:		
New Obligations and Upward Adjustments (Total)	\$ 171,502	\$ 47,050
<b>Total Resources Used to Finance the Net Cost of Operations</b>	171,502	47,050
<b>COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN CURRENT PERIOD:</b>		
Components Requiring or Generating Resources in Future Periods:		
Change in Unfunded Liability	(157,077)	210,244
<b>Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>	(157,077)	210,244
<b>Net (Income) Cost from Operations</b>	\$ 14,425	\$ 257,294

Components of net cost of operations that will not require or generate budgetary resources represent required timing differences in the Statement of Net Cost and the Statement of Budgetary Resources. For the year ended September 30, 2018, the SEC awarded \$171.5 million in new whistleblower awards, of which \$98.0 million was payable at September 30, 2018, and recognized \$64.0 million in contingent liabilities for whistleblower awards. Refer to *Note 4, Liabilities Covered and Not Covered by Budgetary Resources,*

and *Note 5, Commitments and Contingencies,* for more information about contingent liabilities.

For the year ended September 30, 2017, the SEC awarded \$47 million in new whistleblower awards, of which \$20.8 million was payable at September 30, 2017. The SEC also recognized \$221 million in contingent liabilities for potential future whistleblower awards.

# OTHER INFORMATION

This section provides additional information related to the SEC's financial and performance management.

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## Inspector General's Statement on Management and Performance Challenges

Summarizes the most significant management and performance challenges facing the SEC, as identified by management and the Office of Inspector General in accordance with the Reports Consolidation Act of 2000. Also included is a response from the SEC Chairman outlining the agency's progress toward addressing these challenges.

## Summary of Financial Statement Audit and Management Assurances

Reveals each material weakness and non-conformance found and/or resolved during the U.S. Government Accountability Office's audit, as well as those found by management during the evaluation of internal control and financial systems, as required by the Federal Managers' Financial Integrity Act.

## Payment Integrity Reporting Details

Provides information about the SEC's commitment to, and progress with, reducing improper payments, and outlines the efforts taken to recapture improperly-made payments.

## Civil Monetary Penalty Adjustment for Inflation

Provides inflationary adjustments to civil monetary penalties, as required by the Federal Civil Penalties Inflation Adjustment Act of 1990, as amended.

# INSPECTOR GENERAL'S STATEMENT ON MANAGEMENT AND PERFORMANCE CHALLENGES




OFFICE OF  
INSPECTOR GENERAL

UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

## MEMORANDUM

October 5, 2018

**TO:** Jay Clayton, Chairman

**FROM:** Carl W. Hoecker, Inspector General 

**SUBJECT:** *The Inspector General's Statement on the SEC's Management and Performance Challenges, October 2018*

The Reports Consolidation Act of 2000 requires the U.S. Securities and Exchange Commission's (SEC or agency) Office of Inspector General to identify and report annually on the most serious management and performance challenges facing the SEC.<sup>1</sup> In deciding whether to identify an issue as a challenge, we consider its significance in relation to the SEC's mission; its susceptibility to fraud, waste, and abuse; and the SEC's progress in addressing the challenge. We compiled this statement on the basis of our past and ongoing audit, evaluation, investigation, and review work; our knowledge of the SEC's programs and operations; and information from the U.S. Government Accountability Office and SEC management and staff. We reviewed the agency's response to the prior year's statement and efforts to address prior recommendations for improvement in areas of concern. We also provided a draft of this statement to SEC officials and considered all comments received when finalizing the statement. As we begin fiscal year 2019, we have again identified the following as areas where the SEC faces management and performance challenges to varying degrees:

- Meeting Regulatory Oversight Responsibilities
- Ensuring an Effective Information Security Program
- Improving Contract Management
- Ensuring Effective Human Capital Management

The challenges and corresponding audit, evaluation, investigation, or review work are discussed in the attachment. If you have any questions, please contact Rebecca L. Sharek, Deputy Inspector General for Audits, Evaluations, and Special Projects.

### Attachment

cc: Lucas Moskowitz, Chief of Staff, Office of Chairman Clayton  
Sean Memon, Deputy Chief of Staff, Office of Chairman Clayton  
Peter Uhlmann, Managing Executive, Office of Chairman Clayton

<sup>1</sup> Pub. L. No. 106-531, § 3a, 114 Stat. 2537-38 (2000).

Kara M. Stein, Commissioner  
Robert Peak, Advisor to the Commissioner, Office of Commissioner Stein  
Robert J. Jackson Jr, Commissioner  
Caroline Crenshaw, Counsel, Office of Commissioner Jackson  
Prashant Yerramalli, Counsel, Office of Commissioner Jackson  
Hester M. Peirce, Commissioner  
Jonathan Carr, Counsel, Office of Commissioner Peirce  
Elad Roisman, Commissioner  
Christina Thomas, Counsel, Office of Commissioner Roisman  
Robert B. Stebbins, General Counsel  
Rick Fleming, Investor Advocate  
John J. Nester, Director, Office of Public Affairs  
Bryan Wood, Director, Office of Legislative and Intergovernmental Affairs  
Stephanie Avakian, Co-Director, Division of Enforcement  
Steven Peikin, Co-Director, Division of Enforcement  
Peter Driscoll, Director, Office of Compliance Inspections and Examinations  
Kenneth Johnson, Chief Operating Officer  
Vance Cathell, Director, Office of Acquisitions  
Charles Riddle, Acting Chief Information Officer, Office of Information Technology  
Jamey McNamara, Acting Chief Human Capital Officer, Office of Human Resources  
Julie Erhardt, Acting Chief Risk Officer, Office of the Chief Operating Officer



## **Attachment. THE INSPECTOR GENERAL'S STATEMENT ON THE SEC'S MANAGEMENT AND PERFORMANCE CHALLENGES, OCTOBER 2018**

### ***CHALLENGE: Meeting Regulatory Oversight Responsibilities***

#### ***Impacts of Changing Markets, Increasing Responsibilities, and Other Developments.***

The U.S. Securities and Exchange Commission (SEC, agency, or Commission) is charged with overseeing more than 26,000 registered market participants, including investment advisers, mutual funds, exchange-traded funds, broker-dealers, municipal advisors, and transfer agents. The agency also oversees 21 national securities exchanges, 10 credit rating agencies, and 7 active registered clearing agencies, as well as the Public Company Accounting Oversight Board, Financial Industry Regulatory Authority, Municipal Securities Rulemaking Board, the Securities Investor Protection Corporation, and the Financial Accounting Standards Board. In addition, the SEC is responsible for selectively reviewing the disclosures and financial statements of more than 8,000 reporting companies.

As in previous years, agency management and the Office of Inspector General (OIG) recognize that, as markets evolve, so must the SEC. According to the agency's Fiscal Year (FY) 2019 Congressional Budget Justification and Annual Performance Plan,<sup>2</sup> in the last 5 years, the number of registered advisers has grown by more than 15 percent and the assets under management of these firms has increased by more than 40 percent. In addition, both the scope and number of clearing agencies required to be examined by the SEC have grown, and the registration of municipal advisors has added responsibility for hundreds of additional registrants with increasingly complex business lines. At the same time, there has been rapid growth in distributed ledger (i.e., blockchain) technologies and in the cryptocurrency markets, and the SEC has reported that cyber threats in securities markets have continued to increase in both frequency and sophistication. The FY 2019 Congressional Budget Justification and Annual Performance Plan states that, "These types of industry developments and financial innovation will continue to present challenges to the staff, requiring additional staff expertise, resources, and a program that is agile, responsive, and continuously improving."

As further noted in the document, the agency's annual appropriation to maintain effective oversight in this changing environment has remained essentially flat since FY 2016 at about \$1.6 billion. To stay within the agency's annual appropriated amounts, in January 2017 the SEC implemented a hiring freeze that continued throughout FY 2018. With only few exceptions to the hiring freeze permitted, according to the SEC's Office of Human Resources (OHR), the agency's overall staffing level declined from 4,689 positions at the beginning of the hiring freeze to 4,459 positions at the end of FY 2018 (or about 5 percent).<sup>3</sup> In FY 2019, the SEC seeks to restore 100 positions to address critical priorities and enhance the agency's expertise in key areas.

*Office of Compliance Inspections and Examinations (OCIE).* Changes in the securities markets and financial industry, as well as difficult fiscal realities, have agency-wide impacts; however, since 2014, we have reported as a challenge the immediate and pressing need for

<sup>2</sup> U.S. Securities and Exchange Commission, *Fiscal Year 2019 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2017 Annual Performance Report*; February 12, 2018.

<sup>3</sup> We further discuss the challenge of ensuring effective human capital management on page 12.

ensuring sufficient examination coverage of registered investment advisers by OCIE. OCIE directs the SEC's National Examination Program, which protects the interests of retail investors by determining whether money managers handling retail customer funds are complying with SEC rules. According to the agency's FY 2019 Congressional Budget Justification and Annual Performance Plan, in FY 2017, staff examined about 15 percent of registered investment advisers (an increase over prior years), yet nearly 35 percent of all registered investment advisers have never been examined. The document further states:

Significant additional resources are critical to the examination program in order to improve the examination coverage of these entities. . . . As stated above, the number of registered investment advisers and their assets under management has grown steadily over the years, while staff resources have not kept pace with the growing responsibilities. OCIE expects this growth to continue through FY 2018 and FY 2019 and estimates there will be approximately 20 investment advisers per staff member. In addition, it is anticipated that the population of investment advisers will be larger and more complex than ever.

In light of these challenges, in FY 2019 the SEC requested 24 positions for OCIE—the largest increase for any division or office—to partially restore critical staffing losses from the last 2 years, enhance examination coverage of investment advisers, focus on critical risks impacting market participants, address new responsibilities, and implement other program improvements. It is imperative that agency management effectively use risk-based processes and leverage technology and analytics to address regulatory responsibilities, including those of the examination program, given limited resources.

To assess aspects of the SEC's investment adviser examinations, in FY 2017, we initiated an audit to determine whether OCIE established effective controls over its investment adviser examination completion process. In part, we sought to determine whether OCIE effectively used findings from examinations and Corrective Action Reviews as part of its risk-based, data-driven examination selection process. In our report titled *Audit of the Office of Compliance Inspections and Examinations' Investment Adviser Examination Completion Process* (Report No. 541, issued July 21, 2017), we made three recommendations for corrective action, including that OCIE develop and disseminate to staff guidance for assigning final examination risk ratings before closing examinations. As of the date of this memorandum, this recommendation remains open.<sup>4</sup>

In FY 2018, we completed an evaluation of OCIE's Technology Controls Program (TCP), which manages a relatively new area of responsibility for the SEC. In November 2014, the SEC adopted Regulation Systems Compliance and Integrity (SCI), under which the agency monitors the security and capabilities of U.S. securities markets' technological infrastructure.<sup>5</sup>

<sup>4</sup> We closed the other two recommendations in August 2018. According to OCIE management, in response to the remaining open recommendation, management has developed and disseminated general guidance for assigning risk ratings and is undertaking technological updates to implement the guidance. Formal guidance will be issued program-wide once the technological updates are finalized.

<sup>5</sup> Regulation SCI applies primarily to the systems of SCI entities—self-regulatory organizations, certain alternative trading systems, disseminators of consolidated market data (known as plan processors), and certain exempt clearing agencies—that directly support any one of the following six key securities market functions: (1) trading, (2) clearance and settlement, (3) order routing, (4) market data, (5) market regulation, and (6) market surveillance.

OCIE's TCP is responsible for ensuring SCI entity compliance and for evaluating whether entities have established, maintained, and enforced written policies and procedures reasonably designed to ensure the capacity, integrity, resiliency, availability, and security of their Regulation SCI systems.<sup>6</sup> Our evaluation assessed OCIE's TCP to determine, among other things, whether the program provided effective oversight of entities' compliance with Regulation SCI.

In our report titled *TCP Established Method to Effectively Oversee Entity Compliance With Regulation SCI But Could Improve Aspects of Program Management* (Report No. 551, issued September 24, 2018), we reported that TCP has an established method to effectively oversee entity compliance with Regulation SCI through its CyberWatch program and through TCP examinations. However, we identified opportunities to improve aspects of TCP program management, including its development and use of information technology systems (further discussed on page 6). We made three recommendations for corrective action. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

*Division of Enforcement (Enforcement).* Enforcement plays an essential role in carrying out the SEC's mission by investigating and bringing actions against those who violate Federal securities laws. The Commission's enforcement actions cover a broad range of subject areas, including investment management, securities offerings, issuer reporting and accounting, market manipulation, insider trading, broker-dealer activities, cyber-related conduct, and the Foreign Corrupt Practices Act, among others.

Despite Enforcement's successes in returning funds to harmed investors, agency management has acknowledged a recent development that threatens Enforcement's ability to continue doing so for long-running frauds. Specifically, in their May 16, 2018, congressional testimony, and in the Office of the Investor Advocate's Report on Objectives for FY 2019, Enforcement's co-directors and the agency's Investor Advocate, respectively, cited as a concern the Supreme Court's June 2017 decision in *Kokesh v. SEC*.<sup>7</sup> The Court held that Commission claims for disgorgement are subject to a 5-year statute of limitations—a decision that agency officials have stated may have a far-reaching impact on SEC enforcement actions and the Commission's ability to recover funds stolen from investors. Enforcement's co-directors stated in their congressional testimony that the *Kokesh* decision has already had a significant impact on the Division, and they estimated that, in the year since the decision, Enforcement has had to forego more than \$800 million of disgorgement in both litigated and settled actions.<sup>8</sup>

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<sup>6</sup> Regulation SCI established rules for SCI entities designed to reduce the occurrence of systems issues, improve resiliency when systems problems occur, and enhance the SEC's oversight and enforcement of securities market technology infrastructure.

<sup>7</sup> Co-Directors, Division of Enforcement, Stephanie Avakian and Steven Peikin, *Oversight of the SEC's Division of Enforcement*, before the Committee on Financial Services, Subcommittee on Capital Markets, Securities, and Investment, U.S. House of Representatives; May 16, 2018.

U.S. Securities and Exchange Commission, Office of the Investor Advocate, *Report on Objectives for Fiscal Year 2019*; June 29, 2018.

<sup>8</sup> Webcast of verbal testimony available at: <https://financialservices.house.gov/calendar/eventsingle> (40:50 mark).

Although the ultimate impact of *Kokesh* remains to be seen, it is imperative that Enforcement uncover, investigate, and bring cases as quickly as possible. We note that, in FY 2017, the percentage of first enforcement actions filed within 2 years of the opening of the matter under inquiry or investigation was 52 percent. This did not meet the FY 2017 target of 65 percent and was a decrease from FYs 2012 through 2016, when the percentage ranged from 64 percent to 53 percent. In addition, in FY 2017, the average number of months between opening a matter under inquiry or investigation and commencing an enforcement action was 24 months, which was the same in the 2 previous years. This also did not meet the FY 2017 target of 20 months and was an increase from FYs 2012 through 2014 when the average number of months was 21. To address the issue of timeliness in investigations, Enforcement has reported measures that include emphasizing expediency in quarterly case reviews, promoting best practices regarding efficiencies in various phases of the investigative process, leveraging data analytics capabilities, and conducting training on tools that expedite investigations.<sup>9</sup>

**Obstruction of SEC Programs.** The SEC depends on the provision of accurate, truthful information from the people and entities it regulates. To this end, as we reported in 2017, the OIG conducts investigations of individuals who provide false or misleading information to the SEC during its examinations and enforcement actions. In one such case, and as a result of a joint Federal Bureau of Investigation and OIG investigation, the former Vice President of Investor Relations at a Massachusetts-based company pleaded guilty to charges of securities fraud in connection with a scheme to manipulate trading in the company's shares and obstruction of proceedings before the SEC. At his plea, the individual admitted that, beginning in or about November 2016, he engaged in manipulative trades in company stock that simulated market interest in the stock and artificially pushed up the trading price. These trades included orders to buy at a price much higher than the price of the preceding market transaction. The individual also admitted that during a 2017 SEC investigation into manipulative trading in the company's stock, he testified falsely before the SEC. Two associates of the former Vice President of Investor Relations were also arrested and charged.

In another case, two former senior officials of a company were arrested and charged for their role in an alleged conspiracy and fraud scheme. From at least 2013 to 2017, individuals conspired in a scheme to defraud by making misrepresentations to raise money for an outdoor media company, and then by misappropriating that money from the company through another entity. They then both concealed their misstatements and misappropriation in various ways, and obstructed an SEC investigation into their conduct.

**Importance of Leveraging Technology and Analytics.** As in previous years, agency management and the OIG recognize that technology and analytics are critical to the mission of the SEC and its ability to deliver information to the public, identify risks, uncover frauds, sift through large volumes of data, inform policy-making, and streamline operations. The SEC's FY 2019 Congressional Budget Justification and Annual Performance Plan states:

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<sup>9</sup> The SEC's FY 2017 Annual Performance Report (February 12, 2018) (1) includes Performance Goal 2.3.2, *Percentage of first enforcement actions filed within two years of the opening of an investigation*, and Performance Goal 2.3.3, *Average months between opening a matter under inquiry or an investigation and commencing an enforcement action*; (2) compares the agency's results from FY 2012 through FY 2017; and (3) describes plans for improving program performance, where necessary.

Long-term investment and development in technology and analytical tools will be critical to the future success of the Commission's oversight responsibilities. Particularly important in FY 2019 will be a continued focus on enhancing quantitative and data analytic efforts. These tools will provide staff with a greater ability to monitor for trends and emerging risks, ultimately enabling the staff to allocate SEC resources more effectively.

In support of these efforts, the SEC requested an additional \$45 million in FY 2019 to fund critical requirements. This request relies on continued access to the Reserve Fund, created by the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>10</sup> We note that the President's Budget for FY 2019 again proposes to eliminate the Reserve Fund beginning in 2020.<sup>11</sup> Critical requirements the SEC seeks to fund include:

- continuing the development of advanced analytics solutions for detecting suspicious behavior in high frequency trading and other complex trading areas;
- improving storage, processing, security, and management of large volumes of data;
- modernizing the SEC's infrastructure and computing environment to enhance security, improve performance, and streamline delivery; and
- improving the SEC's ability to analyze fixed income market data.

Other key information technology initiatives include improving examinations through risk assessment and surveillance tools; enhancing systems that support the enforcement program; increasing investments in cybersecurity (further discussed on page 7); and improving access and usefulness of information available to the public through the Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

The EDGAR system is at the heart of the SEC's mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation. The system supports 18 of the agency's 23 major business functions (or about 78 percent), including the agency's corporation finance, examination, and enforcement functions. In FY 2017, we completed an audit of the SEC's progress in enhancing and redesigning the EDGAR system. In our report titled *Audit of the SEC's Progress in Enhancing and Redesigning the Electronic Data Gathering, Analysis, and Retrieval System* (Report No. 544, issued September 28, 2017), we made nine recommendations for corrective action. Management took corrective action sufficient to close all nine recommendations.

On September 20, 2017, the SEC Chairman publicly disclosed that a software vulnerability in a component of the EDGAR system previously detected in 2016 resulted in unauthorized access to non-public information, which may have provided a basis for illicit trading. After the Chairman's disclosure, the agency learned that an EDGAR test filing accessed by third parties contained personally identifiable information (PII)—names, dates of birth, and social security numbers—of two individuals. The Chairman, who began his service in May 2017 and was

<sup>10</sup> Pub. L. No. 111-203, § 991e, 124 Stat. 1376, 1954-55 (2010).

<sup>11</sup> Office of Management and Budget, *Budget of the U.S. Government, Efficient, Effective, Accountable American Budget, Fiscal Year 2019*.

notified of the incident in August 2017, initiated several work streams, including requesting that the OIG review the agency's handling of, and response to, the 2016 incident. As we further discuss on page 8, during FY 2018, we completed our evaluation and provided our results and recommendations to agency management.

We also investigated allegations that a false filing announcing a bid to take over a company was submitted in the EDGAR system and that the filing had the effect of manipulating the price of the company's stock. The investigation determined that an individual submitted the false information to the SEC. On May 5, 2017, a criminal complaint was filed, charging the individual with violations of 15 United States Code (USC) §§ 78j(b) and 78ff, Securities Fraud, Manipulative and Deceptive Devices; 17 Code of Federal Regulations §240.10b-5, Securities and Exchange Act, Employment of Manipulative and Deceptive Devices; and 18 USC § 1343, Wire Fraud. The individual pleaded guilty to criminal charges relating to the false EDGAR filing. As a result of the individual's guilty plea, the individual was sentenced to 24 months imprisonment and 24 months supervised release; the individual was also ordered to forfeit \$3,914.08 and pay a \$100.00 special assessment.

Finally, in FY 2018 we assessed OCIE's continued development of the SEC's Technology Risk Assurance, Compliance, and Examination Report (TRACER) system in support of the TCP. Between September 2015 and January 2018, TCP continued development of the system at a cost of nearly \$780,000. TRACER was originally intended to intake filings and monitor SCI entity system outages and changes; but the system evolved into the system of record for TCP examinations. In our report titled *TCP Established Method to Effectively Oversee Entity Compliance With Regulation SCI But Could Improve Aspects of Program Management* (Report No. 551, issued September 24, 2018), we reported that certain planned system capabilities were not realized and, based on a lack of documentation, it was unclear how TCP assessed or managed system requirements. On May 4, 2018, TCP management decided to discontinue developing the TRACER system and transition the TCP examination program to OCIE's Tracking and Reporting Examinations National Documentation System, which is expected to yield operational and cost savings benefits.

In FY 2019, we will continue assessing how well the SEC achieves its regulatory oversight responsibilities and leverages technology and analytics. We will follow-up on previous recommendations related to OCIE's examination programs and to enhancing and redesigning the EDGAR system. As needed, we will leverage our resources to investigate obstruction of SEC programs. We are also planning work to (1) determine whether Enforcement's case tracking system facilitates efficient and effective information sharing; (2) determine whether the Division of Trading and Markets has provided adequate oversight of broker-dealers; (3) follow up on a prior OIG assessment of the Office of Investor Education and Advocacy's efficiency in addressing investor inquiries and processing investor complaints; (4) assess agency processes and controls for suspending trading in stocks; and (5) assess whether the SEC is adequately managing certain information technology investments to ensure investments meet budget and schedule goals and contribute to mission-related outcomes. Moreover, we will complete an ongoing evaluation of the Division of Economic and Risk Analysis' use of analytics and data in support of agency risk assessment and enforcement activities.

## **CHALLENGE: Ensuring an Effective Information Security Program**

**Strengthening the SEC's Cybersecurity Posture.** As stated in the SEC's FY 2017 Agency Financial Report, "Cybersecurity is vitally important to [the SEC], especially given the increased use of and dependence on data and electronic communications, greater complexity of technologies present in the financial marketplace, and continually evolving threats from a variety of sources."<sup>12</sup> The SEC's information systems process and store significant amounts of sensitive, non-public information, including information that is personally identifiable, commercially valuable, and market sensitive. The agency reported that its e-Discovery program alone is approaching one petabyte of data,<sup>13</sup> and management has worked to implement technological enhancements and additional data protection technologies.<sup>14</sup> However, in the FY 2017 Agency Financial Report, the SEC recognized a material weakness in its internal control over agency operations as a result of cybersecurity risks. Moreover, in his June 21, 2018, congressional testimony, the SEC Chairman acknowledged that more needs to be done to strengthen the SEC's cybersecurity posture.<sup>15</sup>

In recognition of these risks and organizational deficiencies identified by reviewing the 2016 intrusion into the EDGAR system, the SEC requested additional funds for FY 2019 to advance its cybersecurity program. Among other things, the agency is working to strengthen its data management capabilities and migrate select applications and workloads to secure cloud environments. As noted in the Chairman's congressional testimony, principal efforts to date include improving the SEC's:

- information technology governance and oversight,
- preventive and detective cybersecurity controls,
- awareness across the agency of the sensitivity and risks related to data collection and storage, and
- efforts to modernize key legacy information systems, especially EDGAR.

As previously stated, the EDGAR system is central to the agency's mission and critical to the functioning of the capital markets. On a typical day, investors and other market participants access more than 50 million pages of disclosure documents through the system, making the availability of accurate, complete, and timely information essential. Without adequate controls to ensure the SEC identifies, handles, and responds to EDGAR system incidents in a timely manner, threat actors could gain unauthorized access to the system, which could lead to illicit

<sup>12</sup> U.S. Securities and Exchange Commission, *Agency Financial Report, Fiscal Year 2017*; November 14, 2017.

<sup>13</sup> A petabyte is a unit of information equal to about 1 quadrillion bytes, 1 million gigabytes, or 1 thousand terabytes. One petabyte of data is roughly equivalent to the amount of information that can be stored in about 20 million four-drawer filing cabinets (See U.S. Government Accountability Office, *Military Base Realignments and Closures: The National Geospatial-Intelligence Agency's Technology Center Construction Project*; GAO-12-770R; June 29, 2012).

<sup>14</sup> U.S. Securities and Exchange Commission, *Fiscal Year 2019 Congressional Budget Justification and Annual Performance Plan; Fiscal Year 2017 Annual Performance Report*; February 12, 2018.

<sup>15</sup> SEC Chairman Jay Clayton, *Testimony on Oversight of the U.S. Securities and Exchange Commission*, before the Committee on Financial Services, U.S. House of Representatives; June 21, 2018.



trading, negative impacts to the economy and public access to filings, and loss of public confidence in the SEC.

In response to the 2016 intrusion into the EDGAR system, the SEC Chairman initiated several work streams to assess the nature, cause, and scope of the intrusion; the potential factors that may have led to the intrusion; the agency's response at the time; and the extent to which cybersecurity enhancements are needed at the SEC. One work stream was a request that the OIG review the agency's handling of, and response to, the 2016 incident. In November 2017, we initiated an evaluation. In July 2018, we presented the Chairman and other SEC Commissioners with the non-public results of our evaluation relative to the 2016 EDGAR intrusion. In addition, on September 21, 2018, we issued a report titled *Evaluation of the EDGAR System's Governance and Incident Handling Processes* (Report No. 550), which presented the OIG's findings and recommendations from our broader assessment of the information security practices applicable to the EDGAR system between FYs 2015 and 2017.

In our report, we noted that, during the period we reviewed, the EDGAR system lacked adequate governance commensurate with the system's importance to the SEC's mission. In addition, certain preventive controls either did not exist or operate as designed, and the SEC lacked an effective incident handling process. Among other things, these weaknesses potentially increased the risk of EDGAR security incidents and impeded the SEC's efforts to respond to incidents. An internal review conducted by the agency's Office of General Counsel reached similar conclusions.

The SEC has strengthened EDGAR's system security posture, including the handling of and response to vulnerabilities. Among other actions, the agency established a Cyber Initiative Working Group to oversee and lead a number of priority cyber initiatives such as an EDGAR security uplift. In addition, the Commission has acted to eliminate the collection of social security numbers and dates of birth on a number of EDGAR forms where it was determined that the information was not necessary to the SEC's mission. As this and other work continues, opportunities for further improvement exist. Our report made 14 recommendations to improve the SEC's EDGAR system governance, security practices, and incident handling processes. We also noted that open recommendations from prior OIG work should address some of our observations, and we encouraged management to implement all agreed-to corrective actions.

***Maturing the SEC's Information Security Program.*** Federal guidance makes clear that, from senior management down to individual users, many individuals in an organization have a stake in information security and should work collaboratively to ensure information security.<sup>16</sup> The SEC's own privacy and information security awareness training acknowledges the collective responsibility for maintaining data security. To comply with the Federal Information Security Modernization Act of 2014 (FISMA),<sup>17</sup> annually, we assess the SEC's implementation of FISMA information security requirements and the effectiveness of the agency's information security program on a maturity model scale. In addition, as further described below, we

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<sup>16</sup> National Institute of Standards and Technology Special Publication 800-100, *Information Security Handbook: A Guide for Managers*; October 2006 (Updated March 7, 2007).

<sup>17</sup> Pub. L. No. 113-283, which amended the Federal Information Security Management Act of 2002, Title III of the E-Government Act of 2002 (Pub. L. No. 107-347).



continue to identify opportunities to mature the SEC's information security program outside the scope of our FISMA-related work, often where responsibility for information security crosses organizational boundaries.

Since our audit of the SEC's compliance with FISMA for FY 2016,<sup>18</sup> the agency's Office of Information Technology improved aspects of the SEC's information security program. Among other actions taken, the Office of Information Technology implemented improved identification and authentication processes, finalized the SEC's information security continuous monitoring strategy, developed and delivered privacy and information security awareness training to SEC employees and contractors (achieving a 99-percent compliance rate), and conducted two incident response exercises and an annual test of the agency's enterprise disaster recovery plan. Although the agency took steps to strengthen its information security program, we determined in FY 2017 that the program had not significantly matured and, as in FY 2016, did not meet annual Inspector General FISMA reporting metrics' definition of "effective."<sup>19</sup>

In our report titled *Audit of the SEC's Compliance With the Federal Information Security Modernization Act for Fiscal Year 2017* (Report No. 546, issued March 30, 2018), we noted that the SEC's maturity level for the five Cybersecurity Framework security functions ("identify," "protect," "detect," "respond," and "recover") was either Level 2 ("Defined") or Level 3 ("Consistently Implemented"). None of the functions reached Level 4 ("Managed and Measurable"). These results were similar to the previous year's results. We reported opportunities for improvement in each of the assessment domains identified by the Department of Homeland Security, stating that the SEC can mature its programs for risk management, configuration management, identity and access management, information security training, information security continuous monitoring, incident response, and contingency planning. Acting on these opportunities will help minimize the risk of unauthorized disclosure, modification, use, and disruption of the SEC's sensitive, non-public information, and assist the agency's information security program reach the next maturity level.

Our FY 2017 FISMA report made 20 recommendations for corrective action. Management concurred with each recommendation and is working to implement corrective actions.<sup>20</sup> In addition, our FY 2018 evaluation of the SEC's compliance with FISMA, which began in May 2018, is ongoing.

Lastly, in June 2018, we completed our *Audit of the SEC's Internal Controls for Retaining External Experts and Foreign Counsel for the Division of Enforcement* (Report No. 547, issued June 15, 2018). Although not related to our FISMA work, we identified certain information security risks that crossed organizational boundaries.

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<sup>18</sup> U.S. Securities and Exchange Commission, Office of Inspector General, *Audit of the SEC's Compliance With the Federal Information Security Modernization Act for Fiscal Year 2016*, Report No. 539; March 7, 2017.

<sup>19</sup> *FY 2017 Inspector General Federal Information Security Modernization Act of 2014 Reporting Metrics*, Version 1.0; April 17, 2017.

*FY 2016 Inspector General Federal Information Security Modernization Act of 2014 Reporting Metrics*, Version 1.1.3; September 26, 2016.

<sup>20</sup> As of the date of this memorandum, we have closed 19 of the 21 recommendations from our FY 2016 FISMA report, and 1 of the 20 recommendations from our FY 2017 FISMA report.

Enforcement routinely retains outside experts—attorneys, accountants, economists, and other professionals—and foreign counsel (collectively referred to hereafter as “experts”) to fulfill a variety of roles during investigations and litigation. So that experts can fulfill contract requirements, Enforcement may provide experts sensitive, non-public information, including information that is personally identifiable, commercially valuable, and market-sensitive.

We judgmentally selected and reviewed 21 of Enforcement’s 197 contracts for expert services awarded between April 1, 2015, and March 31, 2017. Although the SEC established some requirements in recognition of certain information security risks, agency personnel did not always enforce those requirements. For example, more than half of the 113 individuals reported as having worked on the contracts we reviewed either had not signed the required non-disclosure agreement or had signed one after beginning work. For one contract we reviewed, 11 of 12 non-disclosure agreements on file were signed, on average, 305 days after individuals began work. The remaining six individuals who performed work under the contract had not signed a non-disclosure agreement. In addition, in at least five instances, agency personnel had not enforced contract requirements related to safeguarding PII even though experts had access to PII, including investors’ names, addresses, dates of birth, and customer account information. We also found that contracts lacked controls regarding the inadvertent release or disclosure of information after the SEC transmits information to experts. As a result, the agency lacked assurance that experts and their information systems achieved basic levels of security to protect the SEC’s sensitive, non-public information, including PII. We did not identify instances in which unauthorized individuals accessed such information after it was provided to experts. However, the agency should take steps to minimize the risk of unauthorized disclosure, modification, and use of its sensitive, non-public information provided to experts.

We made seven recommendations for corrective action, including that Enforcement and Office of Acquisitions personnel work together to assess protection of PII under expert services contracts, develop a process that ensures contracting officers enforce contract requirements related to PII when necessary, and implement a standardized process to verify receipt of non-disclosure agreements from individuals who will perform work under contracts for expert services. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action. We further discuss this audit on the following page.

In FY 2019, we will continue to assess the SEC’s information security program, including its cybersecurity program. In particular, we will (1) determine whether the agency has an effective process to acquire, implement, and manage its cloud computing environment; (2) evaluate the SEC’s mobile device program and controls for protecting information stored and/or processed on such devices; and (3) assess the agency’s implementation of its data loss prevention program. As necessary, we will also continue making recommendations for improvement where processes and responsibilities for information security cross organizational lines.

### ***CHALLENGE: Improving Contract Management***

In 2017, we identified contract management, including systemic issues regarding the performance and oversight of SEC CORs, as an agency management and performance challenge. In response, SEC management reported that the agency’s Office of Acquisitions

worked on a variety of fronts to further promote effective contract management. Such actions included improving communications between contracting officers and CORs, ensuring CORs received proper training and enforced their use of the Electronic Contract File system, conducting annual reviews of contract files to make sure files contain all appropriate documentation, and improving reporting. In addition, over the last year, SEC management developed and provided training to contracting officers and CORs around the potential for fraud in the area of procurement, and the OIG provided a block of instruction during training. The agency is also working to address prior OIG recommendations related to agency management of contracts we reviewed.

According to the agency's FY 2019 Congressional Budget Justification and Annual Performance Plan, in FY 2019, the Office of Acquisitions plans to continue the COR Improvement Initiative "to create a more comprehensive COR Program that will provide efficient and functional control, transparency, and management of the COR Program across the SEC."

As previously stated, in June 2018, we completed our *Audit of the SEC's Internal Controls for Retaining External Experts and Foreign Counsel for the Division of Enforcement* (Report No. 547, issued June 15, 2018), which again raised concerns about the performance of SEC CORs. For example, to help CORs monitor the agency's contracts for expert services, the SEC required experts to submit monthly status reports. Experts generally did not submit these reports, and agency personnel did not enforce the requirement to do so. In addition, some experts submitted invoices with little to no detail about the work performed and the personnel who performed it. Because CORs for the contracts we reviewed had limited first-hand knowledge of the sufficiency of contract deliverables and work performed, the CORs were unable to determine whether invoices accurately reflected work performed. Instead, CORs relied on Enforcement attorneys for that determination. As a result, CORs' ability to conduct surveillance of contractors' performance was limited.

We also completed an audit to determine whether the SEC's Information Services Branch (Library)—directly or through SEC divisions, offices, and/or working groups—developed and implemented effective controls for acquiring, maintaining, and tracking electronic information sources (EIS) and data source subscriptions, including proper assessment of agency needs and associated costs. In our report titled *The SEC Should Take Action to Strengthen Its Management of Electronic Information Sources, Data Sources, and Print Materials* (Report No. 548, issued September 11, 2018), we identified improvements needed in the acquisition and management of the SEC's EIS, data source, and print material resources. Specifically, we found that:

- contracting staff did not detect in 2 vendors' price quotes \$157,650 in calculation errors;
- 3 of the 22 contract files we reviewed were missing adequate support to justify a fair and reasonable price determination;
- in multiple instances, the responsible COR approved vendor invoices without validating receipt of deliverables; and
- Library personnel were unable to support certain print material acquisitions because personnel did not retain the justification of need.

Moreover, although the Library assesses usage of the SEC's EIS, data source, and print material resources before renewing subscriptions, no policies or procedures existed to guide this process. Also, the final decision whether an assigned Bloomberg resource (used by staff to access real-time market data) should be cancelled or transferred to another user remains with divisions and offices, which limits the Library's ability to ensure these resources are fully used. In fact, we found 128 instances of potentially underused Bloomberg resources, with an estimated cost of \$231,745. We made nine recommendations for corrective action. Management concurred with the recommendations, which will be closed upon completion and verification of corrective action.

In FY 2019, we will further assess the SEC's contract management and acquisition processes. Specifically, we will complete an ongoing audit of the agency's infrastructure support services contract. To better determine the nature and extent of progress and/or deficiencies in the area of contract management, we will also continue to leverage standardized steps we created to obtain an understanding of the agency's contract management when contracting is central to answering an audit's or evaluation's objectives. Lastly, we will continue to support the SEC's efforts to train contracting officers and CORs about the potential for procurement-related fraud.

### ***CHALLENGE: Ensuring Effective Human Capital Management***

The SEC's new, multi-year strategic plan establishes that strengthening the agency's human capital management program is key to achieving agency goals.<sup>21</sup> Likewise, according to the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*, effective management of an entity's workforce, its human capital, is essential to achieving results and an important part of internal control.<sup>22</sup> In the February 2017 update to its High-Risk Series, GAO again recognized Strategic Human Capital Management as a high-risk area needing attention by Congress and the executive branch.<sup>23</sup> Moreover, in 2016, we and the GAO reported needed improvements in the SEC's management of human capital.<sup>24</sup> As in previous years, in 2017 we recognized human capital management as an agency management and performance challenge.

To determine the SEC's progress toward addressing human capital management challenges, in March 2018, we initiated an evaluation that assessed the SEC's implementation of applicable Federal internal control standards and plans for aligning the agency's human capital management strategy with key elements of the Office of Personnel Management's (OPM)

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<sup>21</sup> U.S. Securities and Exchange Commission, *Strategic Plan Fiscal Years 2018-2022*, draft for comment.

<sup>22</sup> U.S. Government Accountability Office, *Standards for Internal Control in the Federal Government*; GAO-14-704G, September 2014.

<sup>23</sup> U.S. Government Accountability Office, *HIGH-RISK SERIES Progress on Many High-Risk Areas, While Substantial Efforts Needed on Others*; GAO-17-317, February 2017.

<sup>24</sup> U.S. Securities and Exchange Commission, Office of Inspector General, *Final Closeout Memorandum: Audit of the SEC's Hiring Practices*; August 19, 2016.

U.S. Government Accountability Office, Securities and Exchange Commission, *Actions Needed to Address Limited Progress in Resolving Long-Standing Personnel Management Challenges*; GAO-17-65, December 2016.

Human Capital Framework (HCF).<sup>25</sup> In our report titled *The SEC Made Progress But Work Remains To Address Human Capital Management Challenges and Align With the Human Capital Framework* (Report No. 549, issued September 11, 2018), we reported that the SEC's OHR has taken steps to address the human capital management challenges the agency faces. Among other things, OHR worked to identify competency gaps and address succession planning, conducted quality of new hire surveys and annual human capital reviews, began developing a workforce dashboard, and implemented various quality assurance reviews. However, we identified limitations and delays in OHR's efforts and additional challenges and opportunities for improvement. Specifically, the SEC:

- has faced delays in identifying competency gaps, and limitations in efforts to develop a plan to fill supervisory positions;
- lacks a formal succession plan; and
- lacks periodic validations of the agency's current performance management system and related standard operating procedures.

Many of these issues resulted from delays in reaching agreements with the National Treasury Employees Union.

Also, although it appears that additional controls implemented since 2016 have helped to improve the accuracy of the SEC's Workforce Transformation and Tracking System data, OHR could maintain more detailed hiring action information in the system to explain inconsistencies in the data when they occur. In addition, OHR may have opportunities to improve hiring processes to better meet its hiring timeframes.

Although OHR has also taken steps to align with OPM's HCF, work remains. Specifically, in addition to the work that remains related to competency assessments, succession planning, and performance management, OHR's internal evaluation system needs improvement, as described in our report. Moreover, we surveyed OHR and SEC divisions, offices, and regional offices on areas of the HCF that correlate to the agency's previously identified human capital management challenges. We encouraged OHR to explore significant differences in survey responses and to address the four areas in which OHR acknowledged that additional work is needed to fully align with corresponding aspects of the HCF.

In our most recent evaluation report, we made nine recommendations for corrective action. Management concurred with the recommendations and has already made progress in some areas. For example, in August 2018, the SEC signed a Memorandum of Understanding with the National Treasury Employees Union. As of the date of this memorandum, agency-wide competency surveys were underway and were targeted for completion by the end of calendar year 2018. Additionally, the SEC engaged OPM to assist with assessing and implementing the current performance management program. OPM is expected to complete its assessment in March 2019. Our recommendations will be closed upon completion and verification of these and other corrective actions.

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<sup>25</sup> Although implementing Federal regulations for OPM's HCF (5 CFR Part 250, Subpart B, Strategic Human Capital Management) apply only to Chief Financial Officers Act agencies (which do not include the SEC), the SEC is transitioning aspects of the agency's human capital management strategy to align with OPM's HCF guidance.

Chairman Clayton  
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Section 962 of the Dodd-Frank Wall Street Reform and Consumer Protection Act mandates GAO to report triennially on the SEC's personnel management, including the competence of professional staff; the effectiveness of supervisors; and issues related to employee performance assessments, promotion, and intra-agency communication.<sup>26</sup> GAO issued its first and second reports in 2013 and 2016, respectively. In FY 2019, we will continue to (1) monitor the SEC's progress toward addressing previously identified human capital management challenges, and (2) coordinate with GAO on its next personnel management review.

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<sup>26</sup> Pub. L. No. 111-203, § 962, 124 Stat. 1376, 1908-09 (2010).

# MANAGEMENT'S RESPONSE TO INSPECTOR GENERAL'S STATEMENT



OFFICE OF  
THE CHAIRMAN

UNITED STATES  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

October 31, 2018

Mr. Carl W. Hoecker  
Inspector General  
U.S. Securities and Exchange Commission  
Washington, D.C. 20549

Dear Mr. Hoecker:

Thank you for your “Statement on the SEC’s Management and Performance Challenges,” issued on October 5, 2018 (Statement). We remain committed to enhancing the financial and operational effectiveness of the SEC and recognize the Office of the Inspector General’s important role in this effort. We also appreciate your assessment of the agency’s progress in addressing the challenges.

The SEC has taken or is taking actions to better prepare the agency to address key management and performance challenges. Of particular note, during this past fiscal year we established the new Chief Risk Officer role to lead an expansion of the agency’s enterprise risk capabilities. We anticipate a number of enhancements over the course of the new fiscal year as we work to further establish the Chief Risk Officer function to better assess, coordinate, and lead the agency’s various risk management efforts. In addition, below are comments concerning the action the agency has taken, is taking, or intends to take to address the specific challenges identified in your Statement.

## **Meeting Regulatory Oversight Responsibilities**

Your Statement rightly points out that rapidly evolving markets require the SEC to regularly assess and update its programs. For this same reason, the SEC’s new Strategic Plan identifies the need to adjust agency efforts in response to significant developments and trends in our evolving capital markets as one of our three primary strategic goals for the next four years. Your Statement highlights the need for continued focus within the Office of Compliance Inspections and Examinations (OCIE), the Division of Enforcement (Enforcement), and on leveraging technology and analytics across the agency.

As you note, OCIE faces the continuing challenge of ensuring sufficient examination coverage of registered investment advisers, which offer products to retail investors, including seniors and those saving for retirement. OCIE leadership works hard to manage this challenge every day. Moreover, we agree with your observation that, given limited resources, agency management must effectively use risk-based processes and leverage technology and analytics. To both of these ends, OCIE is completing work on the one remaining open recommendation

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from your report entitled “Audit of the Compliance Inspections and Examinations’ Investment Adviser Examination Completion Process” (Report No. 541, issued July 21, 2017). As recommended, OCIE management developed and disseminated general guidance for assigning risk ratings, and plans to issue further guidance to staff once necessary technology updates are made. Further, OCIE management is taking action to address the three recommendations contained in your more recent report entitled “TCP [Technology Controls Program] Established Method To Effectively Oversee Entity Compliance With Regulation SCI But Could Improve Aspects of Program Management” (Report No. 551, issued on September 24, 2018). These efforts will help improve the technology tools, policies, and documentation of the risks and controls related to the program.

Enforcement also continues to evolve its approaches to meet a changing landscape. Your Statement references the impact of the U.S. Supreme Court’s June 2017 decision in *Kokesh v. SEC* on the agency’s collection of disgorgement, particularly for matters where the improper conduct occurred over five years ago. The Division continues to focus on matters with the potential for greatest impact for investors and the market, while evaluating how it can efficiently and timely investigate and bring cases. The Division has implemented, and will continue to promote, measures to improve case planning and scheduling. In addition, the Division continues to leverage data analytics to help detect and investigate securities law violations, including by using analytical experts within the Division’s Center for Risk and Quantitative Analytics and the Market Abuse Unit’s Analysis and Detection Center and within the Division of Economic and Risk Analysis and OCIE’s Office of Risk and Strategy.

Finally, the SEC also continues to develop and enhance the tools supporting quantitative and data analytics. Such tools provide our staff with a greater ability to monitor for trends and emerging risks, ultimately enabling the staff to allocate SEC resources more effectively. In May 2018 the SEC launched the cloud-based Data Science Workstations (DSW), which allows staff access to powerful virtual computing resources. The DSW program has reduced the time needed for some analysis from one week to less than one day. Additionally, the SEC also during the past year established an executive-level Data Management Board to provide strategic oversight of the SEC’s effort to establish new capabilities for data analytics and ensure data-related technology projects are delivering value and advancing the mission of the agency.

### **Ensuring an Effective Information Security Program**

Information security is an area of vital importance to the SEC and our markets. Our Office of Information Technology works diligently to build and enhance the agency’s information security capabilities. The challenge of doing so is complex and evolving each day with changes in the global cybersecurity landscape, emerging threats, new compliance requirements, and finite resources.

In FY 2018, the SEC made important strides in bolstering our information security. While more work remains to be done, we appreciate your Statement’s acknowledgement of the efforts that we have undertaken during the past year to strengthen EDGAR’s system security posture. For example, the agency made several significant enhancements to reduce EDGAR’s risk profile and strengthen its security, including implementing enhancements to EDGAR’s data



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protection capabilities, eliminating the ability of filers to retrieve return copies, eliminating the storage of return copies in EDGAR, and removing sensitive personally identifiable information (PII) from certain forms submitted to EDGAR. I also very much appreciate your report entitled “Evaluation of the EDGAR System’s Governance and Incident Handling Processes” (Report No. 550, issued September 21, 2018). In FY 2019, the agency will continue its efforts to address the recommendations and opportunities for improvement identified in the report.

Our vigilance on information security is not limited to EDGAR alone, and we are focused on ensuring the security of our network, other applications, and sensitive data. I set out in June 2018 Congressional testimony our principal efforts to date to improve security. These include improving the SEC’s information technology governance and oversight, implementing new preventive and detective cybersecurity controls, raising awareness across the agency of the sensitivity and risks related to data collection and storage, and modernizing key legacy information systems.

These areas remain information security priorities for FY 2019. In addition, the SEC plans to deploy enhanced security capabilities, engage with third-parties to assist with assessments of our enterprise security controls and practices, and implement additional security capabilities provided through the Department of Homeland Security Continuous Diagnostics and Mitigation Program.

### **Improving Contract Management**

I appreciate that your Statement acknowledges the improvements the SEC has made in ensuring effective contract management, and we intend to continue to build upon those efforts. More specifically, your Statement discusses the findings and recommendations from two reports released in fiscal 2018, namely “Audit of the SEC’s Internal Controls for Retaining External Experts and Foreign Counsel for the Division of Enforcement” (Report No. 547, issued June 15, 2018) and “The SEC Should Take Action to Strengthen Its Management of Electronic Information Sources, Data Sources, and Print Materials” (Report No. 548, issued September 11, 2018). Our Office of Acquisitions is working to improve communications between Contracting Officers and Contracting Officer Representatives, conduct more regular reviews of contract files to make sure they contain all the appropriate documentation, and improve the quality of contract file documents. Further, Enforcement continues to work to ensure proper control of PII and non-public information as well as continue to improve the management of litigation support contracts.

### **Ensuring Effective Human Capital Management**

Given the criticality of the SEC’s workforce to our agency’s ongoing success, the SEC takes very seriously our obligation to continually improve our human capital programs. We appreciate your acknowledgement of the progress that our Office of Human Resources (OHR) has made, including recognition that the SEC has voluntarily undertaken numerous improvements in its human capital management that go beyond the requirements to which the agency must adhere, including, for example, implementation of internal quality reviews for staffing case files and personnel actions. At the same time, we support and will continue our

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work to address the recommendations in your recent report entitled “The SEC Made Progress But Work Remains To Address Human Capital Management Challenges and Align With the [Office of Personnel Management’s] Human Capital Framework” (Report No. 549, issued September 11, 2018). Most notably, the agency recently launched projects to assess skill gaps in its workforce and improve succession planning to help inform the agency’s human capital strategy. These efforts will remain a high priority in FY 2019.

\* \* \* \*

I trust that the actions outlined in this letter demonstrate our responsiveness to your report and commitment to strengthening internal control and improving the agency’s performance. I want to thank you for your continued insights and commitment to improving the SEC, and we look forward to working with you in the coming year.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jay Clayton", with a horizontal line extending to the right.

Jay Clayton  
Chairman

# SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

Table 1.12 | Summary of Financial Statement Audit

Audit Opinion: Unmodified

Restatement: No

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Internal Control over Financial Reporting	—	—	—	—	—
Total Material Weaknesses	—	—	—	—	—

Table 1.13 | Summary of Management Assurances

## Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)

Statement of Assurance: Unmodified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Internal Control over Financial Reporting	—	—	—	—	—	—
Total Material Weaknesses	—	—	—	—	—	—

## Effectiveness of Internal Control over Operations (FMFIA § 2)

Statement of Assurance: Modified

Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Cybersecurity Risks	1	—	—	—	—	1
Total Material Weaknesses	1	—	—	—	—	1

## Conformance with Financial Management System Requirements (FMFIA § 4)

Statement of Assurance: Systems Conform

Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Federal Financial Management System Requirements	—	—	—	—	—	—
Total Non-Conformances	—	—	—	—	—	—

# PAYMENT INTEGRITY REPORTING DETAILS

The Improper Payments Information Act of 2002 (IPIA), as amended by the Improper Payments Elimination and Recovery Act of 2010 (IPERA), the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA), and the Federal Improper Payments Coordination Act of 2015, requires agencies to review all programs and activities they administer to identify those that may be susceptible to significant erroneous payments. For all programs and activities in which the risk of erroneous payments is significant, agencies are to estimate the annual amount of erroneous payments made in those programs. Guidance provided by the Office of Management and Budget (OMB) in Circular A-136, *Financial Reporting Requirements*, and Appendix C of Circular A-123, *Requirements for Effective Estimation and Remediation of Improper Payments*, requires agencies to report specific details about the SEC's Improper Payments Elimination Program, which are below. Additionally, the following link further explains improper payments and the information reported in previous AFRs that is not included in the FY 2018 AFR: <https://paymentaccuracy.gov/>.

## Risk Assessment

In FY 2017 and FY 2018, the SEC did not conduct a new risk assessment. IPERIA guidelines state that if an agency deems a program to be low risk for improper payments, the agency will re-assess that program's risk at least every three years. An agency is only required to conduct a formal risk assessment earlier than three years if the program experiences a significant change in legislation and/or a significant increase in funding level. Based on this, the SEC did not perform a risk assessment for FY 2018 and will not perform another risk assessment until FY 2019.

The SEC made this determination based upon the results of FYs 2016 and 2015 risk assessments, in which none of its programs and activities were deemed susceptible to significant improper payments at or above the threshold levels set by OMB given the historically low volume of improper payments and the low risk of improper payments given the controls and processes in place.

To perform its risk assessment, the SEC instituted a systematic method of reviewing each program and activity by considering risk factors likely to contribute to significant improper payments. The risk assessment encompassed a review of existing data that included the Government Accountability Office (GAO) and the SEC Office of Inspector General audit reports, prior internal controls over financial reporting assessments, and the results of improper payments testing performed in prior years. These risk assessments were performed for the following programs:

- Vendor payments (includes travel and credit card payments);
- Disbursement and penalty distributions (made by the SEC to fund and tax administrators and directly to harmed investors);
- Returned deposits of registration filing fees under Section 6b of the Securities Act of 1933 and Sections 13 and 14 of the Securities Exchange Act of 1934;
- Payroll and benefit payments (includes base pay, overtime pay, and agency contributions to retirement plans, health plans, thrift savings plans, and supplemental retirement); and
- Whistleblower payments.

## Recapture of Improper Payments

In FY 2018, implementation of recapture auditing—if determined to be cost-effective—would apply to vendor payments, disgorgement and penalty distributions, refunds of registration filing fee deposits, payroll, and whistleblower payments. Because the definition of payment in the IPERIA legislation is any payment or transfer of federal funds to any non-federal person or entity, the SEC is not required to review—and has not reviewed—intragovernmental transactions.

The SEC determined that implementing a payment recapture audit program for vendor payments, disgorgement and penalty distributions, refunds of registration filing fee deposits, payroll, and whistleblower payments is not cost-effective and notified OMB in September 2015. The benefits or recaptured amounts associated with implementing and overseeing the program do not exceed the costs, including staff time and payments to contractors, of a payment recapture audit program. In making this determination, the SEC considered its low improper payment rate based on testing conducted over the past eight years. The SEC also considered whether sophisticated software and other cost-efficient techniques could be used to identify significant overpayments at a low cost per overpayment, or if labor intensive manual reviews of paper documentation would be required. In

addition, the SEC considered the availability of tools to efficiently perform the payment recapture audit and minimize payment recapture audit costs.

The SEC will continue to monitor its improper payments across all programs and activities it administers and assess whether implementing payment recapture audits for each program is cost-effective. If the SEC determines, through future risk assessments, that a program is susceptible to significant improper payments and implementing a payment recapture program may be cost-beneficial, the SEC will implement a pilot payment recapture audit to gauge whether such audits would be cost-effective on a larger scale.

## Do Not Pay (DNP)

The DNP Solution is a government-wide initiative mandated by the IPERIA to screen payment recipients before a contract award or payment is made to minimize payment errors. The SEC, in coordination with its Federal Shared Service Provider (FSSP) and the Do Not Pay Business Center, follows established pre-award, pre-payment, and post-payment reviews as part of its existing business processes and programs. The dollar amounts and the number of payments reviewed for improper payments utilizing the DNP system are shown in Table 1.14 below.

Table 1.14 | Results of the Do Not Pay Initiative in Preventing Improper Payments (Dollars In Millions)

	Number (#) of Payments Reviewed for Possible Improper Payments	Dollars (\$) of Payments Reviewed for Possible Improper Payments	Number (#) of Payments Stopped	Dollars (\$) of Payments Stopped	Number (#) of Potential Improper Payments Reviewed and Determined Accurate	Dollars (\$) of Potential Improper Payments Reviewed and Determined Accurate
Reviews with the Do Not Pay databases	19,785	\$ 794.84	0	\$ —	0	\$ —
Reviews with databases not listed in IPERIA as Do Not Pay databases	0	\$ —	0	\$ —	0	\$ —

Note 1: Databases used in row 1 above are SAM, LEIE, DMF, CAIVRS, Debt Check, EPLS, OFAC

# CIVIL MONETARY PENALTY ADJUSTMENT FOR INFLATION

The Federal Civil Penalties Inflation Adjustment Act of 1990 (FCPIA), 28 U.S.C. 2461 note, as amended by the Debt Collection Improvement Act of 1996, and the Federal Civil Penalties Inflation Adjustment Act Improvements Act of 2015 (2015 Act), requires agencies to annually adjust for inflation any civil monetary penalties that are assessed or enforced by that agency. This adjustment must be performed for any penalty where either the amount of the penalty or the maximum penalty is set by law. The 2015 Act replaces the inflation adjustment mechanism previously contained in the FCPIA and all previous inflation adjustments made pursuant to the FCPIA with a new mechanism for calculating the inflation-adjusted amount of civil monetary penalties. The 2015 Act implemented this change by first requiring that each agency perform a “catch-up adjustment” to be published by July 1, 2016. Thereafter, agencies are to adjust their penalty amounts every January, starting in January 2017.

The FCPIA also directs the Commission to include in its Agency Financial Report information about the civil monetary penalties within the jurisdiction of the agency, including the adjustment of civil monetary penalties for inflation under the FCPIA. Further, the FCPIA directs the Comptroller General of the United States to annually submit to Congress a report assessing agencies’ compliance with the inflation adjustments required by the FCPIA.

The SEC administers four statutes that provide for civil monetary penalties:

- The Securities Act of 1933;
- The Securities Exchange Act of 1934;
- The Investment Company Act of 1940; and
- The Investment Advisers Act of 1940.

In addition, the Sarbanes-Oxley Act of 2002 provides the Public Company Accounting Oversight Board (PCAOB) authority to levy civil monetary penalties in its disciplinary proceedings. These penalties are established by federal law and are enforced by the Commission for purposes of the FCPIA because the Commission may by order affirm, modify, remand, or set aside civil monetary penalties imposed by the PCAOB and may enforce the PCAOB’s civil monetary penalty orders in federal district court.

The Commission will adjust for inflation the maximum penalty amounts provided in these statutes as required by the FCPIA and will publish these adjustments in the Federal Register. The catch-up adjustment in July 2016 was published in the Federal Register, Volume 81, No. 127, on July 1, 2016 (81 FR 43042). The first annual adjustment in January 2017 was published in the Federal Register, Volume 82, No. 11, on January 18, 2017 (82 FR 5367). The Commission performed its second annual adjustment in January 2018, which was published in the Federal Register, Volume 83, No. 8, on January 11, 2018 (83 FR 1396).



# APPENDICES

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Appendix A: Chairman and Commissioner Biographies

Appendix B: Divisions and Offices

Appendix C: Glossary of Selected Terms

Appendix D: Acronyms and Abbreviations



# APPENDIX A: CHAIRMAN AND COMMISSIONER BIOGRAPHIES



Jay Clayton was nominated to chair the U.S. Securities and Exchange Commission on January 20, 2017 by President Donald Trump and sworn in on May 4, 2017.

Since joining the Commission, Chairman Clayton has focused on the long-term interests of America's retail investors,

a perspective he shares with the SEC staff. Chairman Clayton has made it a priority to increase the access of retail investors to a diverse range of investment opportunities and see that they continue to benefit from the protections of our securities laws.

Key areas of focus for Chairman Clayton include:

- making our capital markets more accessible to businesses and investors alike, while ensuring the United States continues to be the world's leader in terms of effective disclosure and other investor protections; and
- examining and addressing equity and fixed income market structure issues with an emphasis on fairness, efficiency and resiliency, recognizing that our markets are ever-changing.

Chairman Clayton also has been outspoken on securities law issues related to distributed ledger technology, cryptocurrencies and initial coin offerings.

Prior to joining the Commission, Chairman Clayton was a partner at Sullivan & Cromwell LLP, where he was a member of the firm's Management Committee and co-head of the firm's corporate practice.

Chairman Clayton has authored publications on securities law, cybersecurity, and other regulatory issues, and from 2009 to 2017 he was a Lecturer in Law and Adjunct Professor at the University of Pennsylvania Law School. Prior to joining Sullivan & Cromwell, Chairman Clayton served as a law clerk for the Honorable Marvin Katz of the U.S. District Court for the Eastern District of Pennsylvania. A member of the New York and Washington, D.C. bars, Chairman Clayton earned a B.S. in Engineering from the University of Pennsylvania (summa cum laude), a B.A. and M.A. in Economics from the University of Cambridge (Thouron Scholar), and a J.D. from the University of Pennsylvania Law School (cum laude, Order of the Coif).

Chairman Clayton was born at Fort Eustis in Newport News, Virginia and was raised primarily in central and southeastern Pennsylvania. In his professional career, he has lived in Philadelphia, New York, London, and Washington, D.C.



**Kara M. Stein**  
COMMISSIONER

Kara M. Stein was appointed by President Barack Obama to the U.S. Securities and Exchange Commission (SEC) and was sworn in on August 9, 2013.

While at the Commission, Commissioner Stein has advocated for strong investor protections and for initiatives to further increase competition and

facilitate capital formation. Commissioner Stein has focused on identifying ways to enhance our securities market structure to promote efficiency and resiliency. She also has advocated for updating the Commission's rules and practices for the Digital Age, including calling for the formation of a Digital Disclosure Task Force to aid in the Commission's assessment of the nature, timing, and delivery of information to a variety of investors and other market participants. In addition, Commissioner Stein has advocated for the formation of an Office of Data Strategy and a Chief Data Officer to concentrate on the governance and utilization of information in a data-driven environment. She is also a strong advocate for the timely completion of the consolidated audit trail (CAT); the shortening of the settlement cycle for equities and fixed income; enhanced clearing agency standards; and the further development of tools that facilitate the use of machine readable disclosures.

Commissioner Stein serves as the Commission's liaison to the North American Securities Administrators Association (NASAA), represents the Commission at meetings of the International Organization of Securities Commissions (IOSCO), and is an ardent supporter of furthering diversity and inclusion initiatives at the SEC. Currently, Commissioner Stein sponsors the SEC's LGBT and the Disability Interests Advisory Committees, and she serves as the Chair of the SEC's Diversity Council.

Commissioner Stein joined the Commission after serving as Senior Policy Advisor for securities and banking matters to U.S. Sen. Jack Reed. From 2009 to 2013, she was Staff Director of the Securities, Insurance, and Investment Subcommittee of the U.S. Senate Committee on Banking, Housing, and Urban Affairs. During that time, Commissioner Stein played an integral role in drafting and negotiating significant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

During her tenure in the U.S. Senate, Commissioner Stein also served as Staff Director of the Banking Committee's Subcommittee on Housing and Transportation, as Legal Counsel to Sen. Jack Reed, and a Legislative Assistant to Sen. Chris Dodd.

Before working in the U.S. Senate, Commissioner Stein was an associate at the law firm of Wilmer, Cutler & Pickering, an assistant professor with the University of Dayton School of Law, an Advocacy Fellow with the Georgetown University Law Center, and a Skadden Public Interest Fellow.

Commissioner Stein received her B.A. from Yale College and J.D. from Yale Law School.



Robert J. Jackson Jr. was appointed by President Donald Trump to the U.S. Securities and Exchange Commission (SEC) and was sworn in on January 11, 2018.

Commissioner Jackson has extensive experience as a legal scholar, policy professional, and corporate lawyer. He comes to the SEC from NYU School

of Law, where he is a Professor of Law. Previously, he was Professor of Law at Columbia Law School and Director of its Program on Corporate Law and Policy. Commissioner Jackson's academic work has focused on corporate governance and the use of advanced data science techniques to improve transparency in securities markets. He was the founding director of Columbia Law School's Data Lab, which used cutting-edge technology to study the reliability of corporate disclosures. Commissioner Jackson has written more than 20 articles in the nation's most prestigious legal and economics journals. His published work includes a study shining light on trading activity before the announcement of major corporate events, the first study of the effect of mandatory disclosure required by the JOBS Act on trading by individual investors,

and the first comprehensive study of CEO pay in firms owned by private equity. In 2012, Columbia Law School students honored Commissioner Jackson with the Willis L.M. Reese Prize for Excellence in Teaching. He has testified on his scholarship before the U.S. Senate, and his work was previously the subject of rulemaking commentary before federal agencies, including the Federal Reserve and the SEC.

Before joining the Columbia Law School faculty in 2010, Commissioner Jackson served as a senior policy advisor at the U.S. Department of Treasury, working with Kenneth Feinberg, the Special Master for TARP Executive Compensation. In this role, he oversaw the development of policies designed to give shareholders a say on pay, improve the disclosure of executive bonuses, and encourage TARP recipients to more closely tie pay to performance. Earlier in his career, Commissioner Jackson practiced law in the executive compensation department of Wachtell, Lipton, Rosen & Katz.

Commissioner Jackson holds two bachelor's degrees from the University of Pennsylvania, an MBA in Finance from the Wharton School of Business, a master's degree from Harvard's Kennedy School of Government, and a law degree from Harvard Law School. He was born in the Bronx, New York, and is a lifelong Yankees fan.



**Hester M. Peirce**  
COMMISSIONER

Hester M. Peirce was appointed by President Donald Trump to the U.S. Securities and Exchange Commission (SEC) and was sworn in on January 11, 2018.

Prior to joining the Commission, Commissioner Peirce served as Senior Research Fellow and Director of the Financial Markets Working

Group (now Program on Financial Regulation) at the Mercatus Center at George Mason University. While at the Mercatus Center, Commissioner Peirce's research explored how financial markets foster economic growth and prosperity and the role well-designed regulation plays in protecting investors and consumers while promoting financial stability and innovation. Commissioner Peirce co-edited two books, authored publications, testified before Congress, and served on the SEC's Investor Advisory Committee.

Before joining the Mercatus Center, Commissioner Peirce worked on Senator Richard Shelby's Committee on Banking, Housing, and Urban Affairs staff as Senior Counsel. In that position, she oversaw financial regulatory reform efforts following the 2008 financial crisis and conducted oversight of the regulatory implementation of the Dodd-Frank Act.

From 2004 to 2008, Commissioner Peirce worked as counsel to SEC Commissioner Paul S. Atkins. Prior to serving Commissioner Atkins, Commissioner Peirce worked as a Staff Attorney in the Division of Investment Management.

Before working at the SEC, Commissioner Peirce was an associate at Wilmer, Cutler & Pickering (now WilmerHale) and clerked for Judge Roger Andewelt on the Court of Federal Claims.

Commissioner Peirce earned her B.A. in Economics from Case Western Reserve University and her J.D. from Yale Law School.



Elad L. Roisman was appointed by President Donald Trump to the U.S. Securities and Exchange Commission (SEC) and was sworn into office on September 11, 2018.

Commissioner Roisman joined the SEC from the U.S. Senate Committee on Banking, Housing, and Urban Affairs, where he served as Chief Counsel.

In that role, and as Securities Counsel on the Committee, he counseled Chairmen Mike Crapo (R-ID) and Richard Shelby (R-AL), as well as members of the Committee, on securities, financial regulation, and international financial matters. Commissioner Roisman

worked on drafting several pieces of legislation that became law and played an integral role in the drafting and negotiation of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

Before working in the Senate, he served as Counsel to SEC Commissioner Daniel M. Gallagher, focusing on enforcement and policy relating to the U.S. equity and fixed income markets, the asset management industry, and international regulation of capital markets. Prior to joining the SEC, he held positions as a Chief Counsel at NYSE Euronext and an associate at the law firm of Milbank, Tweed, Hadley & McCloy LLP in New York.

Commissioner Roisman earned his bachelor's degree in History at Cornell University and his J.D. at the Boston University School of Law.

# APPENDIX B: DIVISIONS AND OFFICES

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DIVISION OF ENFORCEMENT

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Richard Best, Regional Director  
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email: atlanta@sec.gov

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email: boston@sec.gov

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Chicago, IL 60604  
email: chicago@sec.gov

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Denver, CO 80294  
email: denver@sec.gov

### FORT WORTH REGIONAL OFFICE

Shamoil Shipchandler, Regional Director  
Burnett Plaza  
801 Cherry Street  
Suite 1900, Unit 18  
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email: dfw@sec.gov

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Michele Wein Layne, Regional Director  
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Los Angeles, CA 90071  
email: losangeles@sec.gov

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email: miami@sec.gov

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email: newyork@sec.gov

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Philadelphia, PA 19103  
email: philadelphia@sec.gov

### SALT LAKE REGIONAL OFFICE

Daniel J. Wadley, Regional Director  
351 S. West Temple Street, Suite 6.100  
Salt Lake City, UT 84101  
email: saltlake@sec.gov

### SAN FRANCISCO REGIONAL OFFICE

Jina L. Choi, Regional Director  
44 Montgomery Street, Suite 2800  
San Francisco, CA 94104  
email: sanfrancisco@sec.gov



# APPENDIX C: GLOSSARY OF SELECTED TERMS

## 401(k)

An employer-sponsored retirement savings plan that gives the employee a choice of investment options.

## Accountability of Tax Dollars Act of 2002

A federal law requiring most federal agencies that are not subject to the Chief Financial Officers Act of 1990 to prepare annual audited financial statements.

## Annual Performance Report (APR)

Outlines the goals and intended outcomes of an agency's programs and initiatives.

## Asset

A resource that embodies economic benefits or services that the reporting entity controls.

## Blockchain

A digital database containing information (such as records of financial transactions) that can be simultaneously used and shared within a large decentralized, publicly accessible network.

## Broker-Dealers

A **broker** is any person engaged in the business of effecting transactions in securities for the account of others. A **dealer** is any person engaged in the business of buying and selling securities for his or her own account, through a broker or otherwise.

## Chief Financial Officers Act of 1990

Legislation focused on improving the government's financial management, performance, and disclosure.

## Clearing Agencies

Self-regulatory organizations that come in two types: clearing corporations and depositories. **Clearing corporations** compare member transactions (or report to members the results of exchange comparison operations), clear those trades and prepare instructions for automated settlement of those trades, and often act as intermediaries in making those settlements. **Depositories** hold securities certificates in bulk form for their participants and maintain ownership records of the securities on their own books.

## Consolidated Audit Trail (CAT)

A single, comprehensive database of orders to trade in National Market System securities and over-the-counter equities that enables regulators to more efficiently and thoroughly track all trading activity in the U.S. equity and options markets.

## Custodial Activity

Revenue that is collected, and its disposition, by a federal agency on behalf of other entities is accounted for as a custodial activity of the collecting entity. SEC custodial collections include amounts collected from violators of securities laws as a result of enforcement proceedings.

## Cryptocurrency

Currency that only exists digitally and usually has no central issuing or regulating authority but instead uses a decentralized system to record transactions and manage the issuance of new units.



## Cybersecurity

The steps taken to prevent illegal or unauthorized access to a computer system or network.

## Deposit Fund

Consists of funds that do not belong to the federal government such as 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.

## Derivative

A contract between two parties that specifies conditions (dates, resulting values of the underlying variables, and notional amounts) under which payments are to be made between the parties.

## Digital Accountability and Transparency Act of 2014 (DATA Act)

Aims to make information on federal expenditures more easily accessible and transparent.

## Disclosure

Information about a company's financial condition, results of operations and business that it makes public. Investors can use this information to make informed investment decisions about the company's securities.

## Disgorgement

The act of returning or repaying ill-gotten gains obtained from fraudulent activities. Disgorgement is ordered, the judge or the Commission may also order that any money collected, including fines paid, be placed in a Fair Fund for distribution to investors who were the victims of the violation.

## Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act)

Legislation that enforces transparency and accountability while implementing rules for consumer protection.

## Electronic Data Gathering, Analysis, and Retrieval System (EDGAR)

The system that all public companies use to transmit required filings to the SEC.

## Entity Assets

Assets that an agency is authorized to use in its operations.

## Entity Accounts Receivable

Monies owed to the SEC generated from securities transaction fees and filing fees paid by registrants.

## Exchange Revenue

Inflows of earned resources to an entity. Exchange revenues arise from exchange transactions, which occur when each party to the transaction sacrifices value and receives value in return. Examples include the sale of goods and services, entrance fees, and most interest revenue.

## Exchanges

A place (physical or virtual) where stock traders come together to decide on the price of securities.

## Exchange-Traded Fund (ETF)

SEC-registered investment companies that offer investors a way to pool their money in a fund that invests in stocks, bonds, or other assets.

## Fair Fund

A fund created by the SEC to return money to harmed investors.

## Federal Accounting Standards Advisory Board (FASAB)

Develops the generally accepted accounting principles for the federal government.

## Federal Civil Penalties Inflation Adjustment Act (FCPIA)

Requires agencies to adjust its civil monetary penalties for inflation and requires them to make adjustments at least once every four years thereafter.

### Federal Information Security Modernization Act of 2014 (FISMA)

Requires federal agencies to conduct annual assessments of their information security and privacy programs; develop and implement remediation efforts for identified weaknesses and vulnerabilities; and report on compliance to the Office of Management and Budget.

### Federal Register

The official journal of the federal government of the United States that contains government agency rules, proposed rules, and public notices.

### Financial Industry Regulatory Authority (FINRA)

A private corporation that acts as a self-regulatory organization.

### Foreign Corrupt Practices Act

Addresses transparency requirements under the Securities Exchange Act of 1934, and improper payments to foreign officials.

### Fund Balance with Treasury (FBWT)

The amount of funds in the entity's accounts with the U.S. Treasury for which the entity is authorized to make expenditures and pay liabilities, and that have not been invested in federal securities.

### Funds from Dedicated Collections

Accounts containing specifically identified revenues—often supplemented by other financing sources—that are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the government's general revenues.

### Gatekeepers

Professionals—such as attorneys, accountants, and other consultants—who are enlisted to help protect investors through the detection and prevention of compliance breakdowns and fraudulent schemes that cause investor harm.

### General Funds—Salaries and Expenses

Appropriations by Congress that are used to carry out the agency's mission and day-to-day operations that may be used in accordance with spending limits established by Congress.

### Generally Accepted Accounting Principles (GAAP)

A framework of accounting standards, rules, and procedures defined by the professional accounting industry.

### Imputed Financing

Financing provided to the reporting entity by another federal entity covering certain costs incurred by the reporting entity.

### Initial Coin Offering (ICO)

The first sale of a cryptocurrency to the public; typically conducted for the purpose of raising funds (as to support a start-up).

### Initial Public Offering (IPO)

The first time a company offers its shares of capital stock to the general public. Under the federal securities laws, a company may not lawfully offer or sell shares unless the transaction has been registered with the SEC or an exemption applies.

### Insider Trading

The purchase or sale of a security by someone who has access to material, nonpublic information about the security.

### Intragovernmental Costs

Costs that arise from the purchase of goods and services from other components of the federal government.

### Investment Advisers Act of 1940

The federal law that was created to regulate the actions of investment advisers. Advisers must register with the SEC in an effort to protect investors.

### Investor Protection Fund (IPF)

A fund established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 to pay awards to eligible whistleblowers who voluntarily provide the Commission with original information about a violation of federal securities laws.

### Jumpstart Our Business Startups Act of 2012 (JOBS Act)

A federal law enacted on April 5, 2012, intended to encourage small businesses within the United States by easing securities regulations for those businesses.

### Liability

A present obligation of the reporting entity to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.

### Main Street Investor

A colloquial term that refers to individual investors and employees rather than large corporations and investment firms.

### Market Based Treasury Securities

Debt securities that the U.S. Treasury issues to federal entities without statutorily determined interest rates.

### Miscellaneous Receipt Account

A fund used to collect non-entity receipts from custodial activities that the SEC cannot deposit into funds under its control or use in its operations. These amounts are forwarded to the U.S. Treasury General Fund and are considered to be non-entity assets of the SEC.

### Municipal Advisor

A person (not a municipal entity or an employee of a municipal entity) who: (1) provides advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities, including advice with respect to the structure, timing, terms, and other similar

matters concerning such financial products or issues; or (2) undertakes a solicitation of a municipal entity. This definition includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and swap advisors who provide municipal advisory services, unless they are statutorily excluded.

### Municipal Securities Rulemaking Board (MSRB)

Writes investor protection rules and other rules regulating broker-dealers and banks in the U.S. municipal securities market, including tax-exempt and taxable municipal bonds, municipal notes, and other securities issued by states, cities, and counties or their agencies to help finance public projects or for other public policy.

### Nationally Recognized Statistical Rating Organization (NRSRO)

Credit rating agencies that have registered with the Commission and meet certain disclosure, governance, internal controls, conflict of interest, and recordkeeping requirements.

### Non-Entity Assets

Assets that are held by an entity but are not available to the entity. Examples of non-entity assets are disgorgement, penalties, and interest collected and held on behalf of harmed investors.

### Office of Inspector General (OIG) Employee Suggestion Program

As required by Section 966 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, this program allows employees to submit suggestions concerning improvements in the SEC's work efficiency, effectiveness, productivity, and use of its resources. The OIG also receives allegations by employees of waste, abuse, misconduct, or mismanagement within the SEC through the program.

### Office of Management and Budget (OMB)

Helps the President oversee the federal budget and supervise federal agencies.

### *OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control*

Defines management's responsibilities for enterprise risk management and internal financial controls, including administrative and program activities as well as financial activities.

### *OMB Circular A-136, Financial Reporting Requirements*

Establishes a central point of reference for all federal financial reporting guidance.

### Performance and Accountability Report (PAR)

An annual report that provides program performance and financial information that enables Congress, the President, and the public to assess an agency's performance and accountability over entrusted resources.

### Ponzi Scheme

A fraudulent scheme in which returns are paid to established investors with funds from new investors rather than from profits.

### Public Company Accounting Oversight Board (PCAOB)

A nonprofit corporation established by Congress to oversee the audits of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB also oversees the audits of broker-dealers, including compliance reports filed pursuant to federal securities laws, to promote investor protection.

### Pump-and-Dump Scheme

An investment scheme in which promoters tout a company's stock through false or misleading statements that often includes claiming to have inside information. Once the stock price is "pumped," the promoters sell—or "dump"—their shares, thus dropping the overall value.

### Regulation Best Interest

A proposed rulemaking package that aims to ensure broker-dealers act in the best interest of their retail customers.

### Regulation Systems Compliance and Integrity (Regulation SCI)

Aims to strengthen the technology structure of the securities market.

### Reserve Fund

A fund established by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that may be used by the SEC to obligate amounts up to \$100 million in one fiscal year as the SEC determines is necessary to carry out its functions.

### Retail Investor

An individual who buys securities for personal benefit (e.g., to purchase a home, save for retirement, or send a child to college) rather than for the benefit of an organization.

### Retail Strategy Task Force

Develops data-driven, analytical strategies focused on identifying adverse practices in the securities markets, and uses this information to support investor advocacy and outreach efforts.

### Sarbanes-Oxley Act of 2002

Legislation aimed at enhancing corporate responsibility and financial disclosures, and fighting corporate and accounting fraud that created the Public Company Accounting Oversight Board.

### Section 31 Fees

Transaction fees paid to the SEC based on the volume of securities that are sold on various markets. These fees recover the costs incurred while supervising and regulating the securities markets and securities professionals.

### Securities Act of 1933 (Securities Act)

One of the primary federal securities laws, its basic objectives are to ensure investors receive financial and other significant information about securities being offered for public sale, and to prohibit deceit, misrepresentation, and other fraud in the sale of securities.

### Securities Exchange Act of 1934 (Exchange Act)

A law governing the secondary trading of securities (stocks, bonds, and debentures) in the United States. It was this piece of legislation that established the SEC.

### Self-Regulatory Organization (SRO)

An organization that exercises some degree of regulatory authority over an industry or profession. The regulatory authority could be applied in addition to some form of government regulation, or it could fill the vacuum of an absence of government oversight and regulation. The ability of an SRO to exercise regulatory authority does not necessarily derive from a grant of authority from the government.

### Statement of Cash Flows

Reports a company's inflows and outflows of cash over time by classification.

### Strategic Plan

Defines an agency's mission, long-term goals, strategies planned, and the approaches it will use to monitor its progress in addressing specific national problems, needs, challenges, and opportunities related to its mission.

### Thinly-Traded Securities

Securities that cannot be easily sold or exchanged for cash without a significant change in price; are exchanged in low volumes; and often have limited numbers of interested buyers and sellers.

### Transfer Agent

A trust company, bank, or similar financial institution assigned by a corporation to maintain records of investors and account balances; as such, the transfer agent issues and cancels certificates to reflect changes in ownership and handles lost, destroyed, or stolen certificates.

### Volcker Rule

A law that prohibits banking entities from engaging in proprietary trading, and from owning or controlling hedge funds or private equity funds.

### Whistleblower

A person who, alone or jointly with others, provides the Commission with information related to a possible violation of the federal securities laws (including any rules or regulations thereunder) that has occurred, is ongoing, or is about to occur.

### eXtensible Business Reporting Language (XBRL)

XBRL defines or "tags" data using standard definitions to establish a consistent structure of identity and context for financial information, which can then be recognized and processed by a variety of different software applications.

# APPENDIX D: ACRONYMS AND ABBREVIATIONS

AFR	Agency Financial Report	FFMIA	Federal Financial Management Improvement Act
APR	Annual Performance Report	FINRA	Financial Industry Regulatory Authority
CAT	Consolidated Audit Trail	FISMA	Federal Information Security Modernization Act of 2014
CEO	Chief Executive Officer	FMFIA	Federal Managers' Financial Integrity Act of 1982
CFO	Chief Financial Officer	FOIA	Freedom of Information Act
CFTC	U.S. Commodity Futures Trading Commission	FSSP	Federal Shared Service Provider
CM	Continuous Monitoring Program	FTE	Full-Time Equivalents
COR	Contracting Officer's Representative	FY	Fiscal Year
CSRS	Civil Service Retirement System	GAAP	Generally Accepted Accounting Principles
DHS	U.S. Department of Homeland Security	GAO	U.S. Government Accountability Office
DNP	Do Not Pay	HCF	Human Capital Framework
DSW	Data Science Workstation	ICFR	Internal Control over Financial Reporting
EDGAR	Electronic Data Gathering, Analysis, and Retrieval System	ICO	Initial Coin Offering
EIS	Electronic Information Sources	IOSCO	International Organization of Securities Commissions
ERM	Enterprise Risk Management	IPERA	Improper Payments Elimination and Recovery Act of 2010
ETF	Exchange-Traded Funds	IPERIA	Improper Payments Elimination and Recovery Improvement Act of 2012
FAF	Financial Accounting Foundation	IPF	Investor Protection Fund
FASAB	Federal Accounting Standards Advisory Board	IPIA	Improper Payments Information Act of 2002
FASB	Financial Accounting Standards Board	IPO	Initial Public Offering
FBWT	Fund Balance with Treasury	IRA	Individual Retirement Account
FCPA	Foreign Corrupt Practices Act	IT	Information Technology
FCPIA	Federal Civil Penalties Inflation Adjustment Act	MSRB	Municipal Securities Rulemaking Board
FECA	Federal Employees' Compensation Act		
FERS	Federal Employees Retirement System		
FEVS	Federal Employee Viewpoint Survey		

NAL	No-Action Letters	S/L	Straight-Line
NASAA	North American Securities Administrators Association	SBR	Statement of Budgetary Resources
NEP	National Examination Program	SEC	U.S. Securities and Exchange Commission
NIST	National Institute of Standards and Technology	SIPA	Securities Investor Protection Act of 1970
NRSRO	Nationally Recognized Statistical Rating Organization	SIPC	Securities Investor Protection Corporation
OMB	U.S. Office of Management and Budget	SORN	System of Records Notices
OPM	U.S. Office of Personnel Management	SRO	Self-Regulatory Organization
POA&Ms	Plans of Actions and Milestones	TCP	Technology Controls Program
PCAOB	Public Company Accounting Oversight Board	TRACER	Technology Risk Assurance, Compliance, and Examination Report
PII	Personally Identifiable Information	TSP	Thrift Savings Plan
RSI	Required Supplementary Information	XBRL	eXtensible Business Reporting Language
SALI	SEC Action Lookup for Individuals		





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The SEC's FY 2018 Agency Financial Report was successfully produced through the efforts of our talented staff. To these individuals, we offer our sincerest appreciation. We would also like to acknowledge the Government Accountability Office and the SEC's Office of Inspector General for the professional manner in which they conducted the audit of the FY 2018 financial statements. Finally, we would like to extend our gratitude to the SEC Historical Society for their generous contributions. To comment on this report, please send an email to [SECAFR@sec.gov](mailto:SECAFR@sec.gov).





U.S. Securities and  
Exchange Commission  
100 F Street NE  
Washington, DC 20549  
[SEC.gov](http://SEC.gov)

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Orice Williams Brown, Managing Director, [WilliamsO@gao.gov](mailto:WilliamsO@gao.gov), (202) 512-4400, U.S. Government Accountability Office, 441 G Street NW, Room 7125, Washington, DC 20548

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## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800 U.S. Government Accountability Office, 441 G Street NW, Room 7149 Washington, DC 20548

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## Strategic Planning and External Liaison

James-Christian Blockwood, Managing Director, [spel@gao.gov](mailto:spel@gao.gov), (202) 512-4707 U.S. Government Accountability Office, 441 G Street NW, Room 7814, Washington, DC 20548



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