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United States Government Accountability Office
Washington, DC 20548

March 29, 2011

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission

Subject: *Management Report: Improvements Needed in SEC's Internal Controls and Accounting Procedures*

Dear Ms. Schapiro:

On November 15, 2010, we issued our opinion on the U. S. Securities and Exchange Commission's (SEC) fiscal years 2010 and 2009 financial statements. We also issued our opinion on the effectiveness of SEC's internal controls over financial reporting as of September 30, 2010, and our evaluation of SEC's compliance with selected provisions of laws and regulations during fiscal year 2010.¹ In that report we identified material weaknesses in SEC's controls.

The purpose of this report is to present (1) more detailed information and our recommendations related to the material weaknesses we reported and discussed in our opinion report;² (2) less significant internal control issues we identified during our fiscal year 2010 audit of SEC's internal controls and accounting procedures, along with our related recommended corrective actions; (3) summary information on the status of the recommendations reported as open in our March 31, 2010, management report³ (see enclosure I), and (4) the status of the security weaknesses in information systems controls at SEC that we identified in public and "Limited Official Use Only" reports issued in 2005 through 2009,⁴ that were unresolved at the time of our March 31, 2010, management report⁵ (see enclosure II).

¹ GAO, *Financial Audit: Securities and Exchange Commission's Financial Statements for Fiscal Years 2010 and 2009*, GAO-11-202 (Washington, D.C.: Nov. 15, 2010).

² The material weaknesses and their underlying deficiencies are detailed in GAO-11-202, Appendix I: Material Weaknesses.

³ GAO, *Management Report: Improvements Needed in SEC's Internal Controls and Accounting Procedures*, GAO-10-443R (Washington, D.C.: Mar. 31, 2010).

⁴ GAO, *Information Security: Securities and Exchange Commission Needs to Address Weak Controls over Financial and Sensitive Data*, GAO-05-262 (Washington, D.C.: Mar. 23, 2005); *LIMITED OFFICIAL USE ONLY Information Security: Securities and Exchange Commission Needs to Address Weak Controls over Financial and Sensitive Data*, GAO-05-263SU (Washington, D.C.: Mar. 23, 2005); *Information Security: Securities and Exchange Commission Needs to Continue to Improve Its Program*, GAO-06-408 (Washington, D.C.: Mar. 31, 2006); *LIMITED OFFICIAL USE ONLY Information Security:*

Results in Brief

As part of our audit of SEC's fiscal years 2010 and 2009 financial statements, we identified two material weaknesses⁶ in internal control as of September 30, 2010.⁷ These material weaknesses concern SEC's (1) information systems controls and (2) controls over financial reporting and accounting processes. The material weakness we identified over information systems, including continuing deficiencies reported in prior audits, spanned both SEC's general support system and all key SEC financial reporting applications. The material weakness in financial reporting and accounting processes we identified encompassed deficiencies in five areas of SEC's operations and related reporting:

- financial reporting process,
- budgetary resources,
- registrant deposits,
- disgorgement and penalties, and
- required supplementary information.

These material weaknesses may adversely affect the accuracy and completeness of information used and reported by SEC's management. We are making a total of 30 new recommendations to address these material weaknesses.

We also identified other internal control issues that, although not considered material weaknesses or significant control deficiencies, warrant SEC management's consideration. These issues concern:

- proper and timely approvals of disbursements,

Securities and Exchange Commission Needs to Continue to Improve Its Program, GAO-06-407SU (Washington, D.C.: Mar. 31, 2006); *Information Security: Sustained Progress Needed to Strengthen Controls at the Securities and Exchange Commission*, GAO-07-256 (Washington, D.C.: Mar. 27, 2007); *LIMITED OFFICIAL USE ONLY Information Security: Sustained Progress Needed to Strengthen Controls at the Securities and Exchange Commission*, GAO-07-257SU (Washington, D.C.: Mar. 27, 2007); *Information Security: SEC Needs to Continue to Improve Its Program*, GAO-08-280 (Washington, D.C.: Feb. 29, 2008); *LIMITED OFFICIAL USE ONLY Information Security: SEC Needs to Continue to Improve Its Program*, GAO-08-279SU (Washington, D.C.: Feb. 29, 2008); *Information Security: Securities and Exchange Commission Needs to Consistently Implement Effective Controls*, GAO-09-203 (Washington, D.C.: Mar. 16, 2009); *LIMITED OFFICIAL USE ONLY Information Security: Securities and Exchange Commission Needs to Consistently Implement Effective Controls*, GAO-09-204SU (Washington, D.C.: Mar. 16, 2009).

⁵ GAO-10-443R.

⁶ A material weakness is a deficiency or combination of deficiencies in internal control, 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.

⁷ GAO-11-202.

- review of service providers' auditor reports, and
- controls over travel transaction documentation.

We are making a total of 3 new recommendations related to these less significant control deficiencies.

We are also providing summary information on the status of SEC's actions to address the recommendations from our prior audits as of the conclusion of our fiscal year 2010 audit. Specifically, as summarized in enclosure I, by the end of our fiscal year 2010 audit, we found SEC took action to fully address 17 of the 50 recommendations from our prior audits that were open at the time of our March 31, 2010, management report.⁸

Lastly, we are providing summary information on the status of SEC's actions to address previously reported information system security weaknesses. Specifically, as shown in the table 1 of enclosure II, as of the end of fiscal year 2010, we found SEC took action to address 18 of the 22 security weaknesses in information systems controls that were open at the time of our March 31, 2010, management report.⁹

In providing written comments on a draft of this report, the SEC Chairman stated that remediation of the agency's two material weaknesses is a top priority for SEC. The Chairman stated that SEC is taking a number of steps to address the material weaknesses this fiscal year; however, putting SEC's internal controls on a solid footing over the long term primarily requires significant investment in SEC's financial systems. The Chairman also stated that the centerpiece of SEC's remediation strategy is to migrate its core financial system and transaction processing to a Federal Shared Service Provider. SEC also provided technical comments which we incorporated as appropriate. We will evaluate SEC's actions, strategies, and plans as part of our fiscal year 2011 audit. SEC's written comments are reprinted in enclosure III.

Scope and Methodology

As part of our audit of SEC's fiscal years 2010 and 2009 financial statements, we evaluated SEC's internal controls over financial reporting and tested its compliance with selected provisions of laws and regulations. We designed our audit procedures to test relevant controls over financial reporting, including those designed to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles, and that assets are safeguarded against loss from unauthorized acquisition, use, or disposition. As part of our audit, we considered and evaluated the work performed and conclusions reached by SEC management in its

⁸ GAO-10-443R.

⁹ GAO-10-443R.

internal control assessment.¹⁰ Further details on our scope and methodology are included in our November 2010 report on our audits of SEC's fiscal years 2010 and 2009 financial statements and are summarized in enclosure IV.

We conducted our audit of SEC's fiscal year 2010 and 2009 financial statements in accordance with U.S. generally accepted government auditing standards. We believe our audit provided a reasonable basis for conclusions in this report.

Material Weaknesses over Information Systems, and Financial Reporting and Accounting Processes

During our fiscal year 2010 audit of SEC's controls over financial reporting, we identified two material weaknesses in internal control as of September 30, 2010. These material weaknesses concerned SEC's controls over (1) information systems and (2) financial reporting and accounting processes. Our findings related to each of these material weaknesses are discussed in the following sections, along with our recommended actions to address these weaknesses.

Material Weakness over Information Systems Controls

During fiscal year 2010, we found SEC had pervasive deficiencies in the design and operation of its information security and other system controls that spanned its general support system and all key financial reporting applications. These deficiencies were in the areas of (1) security management, (2) access controls, (3) configuration management, (4) segregation of duties, and (5) contingency planning. Many of these deficiencies were continuing deficiencies identified during our prior audits.

A material weakness in information systems increases the potential for undetected material misstatements in SEC's financial statements and inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction of its financial information and assets. Our conclusion that the information system control deficiencies we identified represent a material weakness is consistent with SEC's own 2010 attestation on the effectiveness of internal controls.¹¹ That is, SEC management's self-assessment identified information system control deficiencies in all key financial reporting applications and the general support system across all SEC's information system control areas. Many deficiencies SEC identified were similar to prior year GAO reported issues. For example, consistent with SEC's 2010 findings, GAO has previously reported that:

¹⁰ OMB Circular No. A-123 defines management responsibility for internal control in federal agencies and establishes requirements for documenting, testing, and making an assessment on internal controls.

¹¹ GAO-11-202.

- Controls were not adequate to ensure that an effective security audit log and monitoring capability have been implemented.
- Users' system access to a key financial application were not periodically (at least annually) recertified to ensure their access remains appropriate.
- System administrators had full access into a major financial application and the function of the system administration and security monitoring was not separated.
- SEC did not ensure timely remediation of identified vulnerabilities on a key financial application.
- Controls were not effective to ensure that SEC followed implementation procedures and processes of the enterprise configuration management plan in order to effectively support the change management life cycle of its general support systems.

We continue to reaffirm our recommendations related to each of these previously reported weaknesses that SEC has not fully addressed. Because GAO did not report new deficiencies relating to access controls and configuration management in fiscal year 2010, deficiencies in these areas are not discussed further in this report. The following paragraphs provide additional details concerning deficiencies we identified in fiscal year 2010 in the areas of security management, segregation of duties, and contingency planning.

Security Management

We identified weaknesses in SEC's security management controls over key financial reporting systems. In this regard, we found that SEC did not adequately:

- implement all elements of an entitywide information security program consistent with Federal Information Security Management Act (FISMA)¹² requirements and National Institute of Standards and Technology (NIST) guidance ;
- remediate information system deficiencies timely consistent with SEC policy; or
- monitor system security audit logs.

Consistent with our findings, SEC management's 2010 self-assessment identified security management issues as part of its internal control evaluation over information system controls. For example, SEC identified that not all elements of an entitywide information security program plan were in place for the general support system (GSS), such as a vulnerability scanning process and information security metrics and reporting.

¹² FISMA was enacted as Title III, E-Government Act of 2002, Pub L. No. 107-347, 116 Stat. 2946 (Dec. 17, 2002) and the FISMA requirements for agencywide information security programs are codified at 44 U.S.C. § 3544(b).

Additionally, SEC management's 2010 self assessment found SEC did not monitor system security audit logs for its system used by SEC's budget office for the original entry of all budget information. Further, SEC did not resolve in a timely manner open issues on the Plan of Action and Milestones (POA&M) pertaining to its GSS and also missed its target completion dates.

These control weaknesses jeopardize the confidentiality, availability, and integrity of automated information processed by SEC's financial reporting systems and increase the risk of material misstatement in financial reporting.

Recommendations for Executive Action

In addition to completing actions that address the outstanding previously reported information system security-related weaknesses, we recommend that the Chairman direct the Chief Operating Officer (COO) and Chief Information Officer (CIO) to take the following specific actions:

1. Establish a mechanism to ensure current procedures for implementing all elements of an entitywide information security program for GSS are followed, consistent with FISMA requirements and NIST guidance.
2. Establish a mechanism to ensure current procedures to ensure timely follow up on outstanding GSS POA&M items are followed, consistent with SEC policy.
3. Establish a mechanism to ensure current procedures for audit logging and audit log monitoring activities are followed for all financial systems.

Segregation of Duties

The NIST Special Publication 800-53, *Recommended Security Controls for Federal Information Systems and Organizations*, provides that federal entities should establish appropriate divisions of responsibility and separate duties as appropriate to eliminate conflicts of interest in the assigned duties of individuals, and information systems access authorizations. NIST also provides that entities should develop, disseminate, and periodically review and update, as appropriate: (1) a formal, documented, personnel security policy that addresses purpose, scope, roles, responsibilities, coordination among organizational entities, and compliance; and (2) formal, documented procedures to facilitate the implementation of the personnel security policy and associated personnel security controls.

However, we found SEC did not always adequately segregate computer-related duties and functions. For example, we found that a human resource manager had access to both the reviewer and validator (timekeeper) functions in SEC's time and attendance system. Without appropriate enforcement of segregation of duties, personnel with inappropriate access to accounts unrelated to their duties and job requirements could jeopardize data integrity.

Recommendations for Executive Action

We recommend that the Chairman direct the COO and CIO to take the following specific actions:

4. Establish a mechanism to ensure current procedures to periodically review the information system access and roles of all SEC personnel for suitability and compliance with authorized security forms are followed, consistent with SEC policy.

Contingency Planning

SEC policy requires each major application (MA) and GSS to be covered by a business impact analysis (BIA). The BIA is an essential component of the SEC business continuity management program. The BIA links specific system components with the critical services they provide, identifying the consequences that disruption of the system's availability would have on the SEC mission. Further, NIST guidance on contingency planning¹³ provides that entities should consider the proximity of geographic distance from the organization's primary site to the alternate storage site and the probability of the alternate storage site being affected by the same disaster as the organization's primary site.

However, we found that SEC did not (1) perform a required BIA for the GSS or (2) conduct a cost analysis relative to the geographic separation of the primary Operations Center (OPC) and backup Alternate Data Center (ADC). Not performing a BIA on GSS, increases SEC's risk that critical operations continuity issues related to GSS will not be addressed in the event of a disaster. Further, because of the proximity of OPC and the ADC, both locations are potentially at risk in the event of a major disaster. SEC management has not conducted an analysis of the cost and benefits of relocating the ADC to a different geographical area in comparison to the cost of recreating data if a major disaster compromised data at both locations.

Recommendations for Executive Action

We recommend that the Chairman direct the COO and CIO to take the following specific actions:

5. Perform and document a BIA for the GSS in accordance with SEC policy.
6. Conduct an analysis of the cost and benefits of relocating the ADC to a different geographical area in comparison with the cost of recreating data if a major disaster compromised data at both OPC and ADC locations.

¹³ NIST Special Publication 800-34, Rev.1, *Contingency Planning Guide for Federal Information Systems*, NIST SP - 800-34 rev 1 (May 2010).

Material Weakness over Financial Reporting and Accounting Processes

During fiscal year 2010, we also identified deficiencies in internal control in five areas, which collectively comprised a material weakness over financial reporting and accounting processes. Specifically, as discussed in more detail in the following paragraphs, we found weaknesses in SEC's (1) financial reporting process, (2) budgetary resources, (3) registrant deposits, (4) disgorgement and penalties, and (5) required supplementary information. Some of these weaknesses were continuing deficiencies identified in our prior year audits. These continuing deficiencies and the newly identified deficiencies this year resulted in SEC not always identifying and correcting errors or omissions in its accounting records and financial reports. These financial reporting and accounting control weaknesses are particularly important because, as a result of the serious deficiencies in information system controls discussed previously, SEC was unable to rely on automated controls in its general ledger system or any of its key financial reporting applications to reliably account for and report on the results of its financial activities. Our findings in this area are consistent with SEC's fiscal year 2010 attestation on the effectiveness of internal controls.¹⁴

Financial Reporting Process

*Standards for Internal Control in the Federal Government*¹⁵ provides that internal control is not one event, but a series of actions and activities that occur throughout an entity's operations and on an ongoing basis. In addition, management should establish control activities to ensure that all transactions are completely and accurately recorded. Such activities may be applied in a computerized information system environment or through manual processes.

SEC carried out its financial reporting during fiscal year 2010 using numerous spreadsheets, databases, manual workarounds, and data handling that relied on significant analysis, reconciliation, and review to calculate amounts for the general ledger transaction postings. In general, these manual processes were resource intensive and prone to error, and coupled with the significant amount of data involved, increased the risk of materially misstated account balances in the general ledger. During 2010, we found SEC's financial reporting procedures were not always effective at ensuring the completeness and accuracy of the financial data obtained from the application systems or at detecting any errors or omissions in financial reporting activities. For example, our 2010 audit found:

¹⁴ As we reported in GAO-11-202, this year SEC performed this attestation under section 963 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 963(a), 124 Stat. 1376, 1910 (July 21, 2010) (*codified at* 15 U.S.C. § 78d-8).

¹⁵ GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

- SEC's procedures to prepare monthly financial statements and trial balance reports used transaction journals extracted from the general ledger (GL), the *GL Summary file*. During this year's audit, we found that a version of the *GL Summary file* was made available to and used by personnel for their calculation and preparation of manual adjustments even though over 57,000 records were missing from the file. Key users were eventually notified of the corrupted file and able to re-perform previously completed work using the corrected *GL Summary file*. However, until SEC establishes continuous controls over the completeness of the *GL Summary file*, SEC is at increased risk of material misstatement in financial reporting.
- SEC did not accurately and completely capture all of the appropriate accounts payable activity, resulting in an understatement of the accounts payable balance during certain months of the year. According to SEC's accounts payable policy,¹⁶ and in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 5,¹⁷ accounts payable accruals should be made for items when a good or service has been received but not yet paid. As we have reported in previous years,¹⁸ SEC's personnel manually extracted unliquidated obligations data from the general ledger and performed queries on the resulting file to calculate the monthly accounts payable accrual entry. However, we found that SEC's spreadsheet queries did not capture all appropriate organization codes for its accrual entries in March and April 2010, which understated payable accruals for those months. In addition, in its June 2010 accrual estimate, SEC's accrual process did not consider nearly \$3 million in unpaid invoices for which the related goods or services had been received and accepted. In each case, the invoices were entered into the general ledger system for tracking purposes, but were erroneously excluded from the data extracts used to calculate the accounts payable liability. These errors were not identified through SEC's spreadsheet control checks. Further, the resulting understatements were not detected by the supervisory review and approval of the entries that posted to the general ledger.
- SEC management's monthly review of its manual accounts receivable calculations related to its securities transaction revenue¹⁹ did not identify that SEC staff were using the wrong fee rate in the calculations for April, May, and June. Specifically, we noted that management's review was designed to ensure that the fee rate calculations were accurate but did not provide for assessing the propriety of data (e.g., fee rate) used in the calculation. As a result, SEC's initial calculation of its securities transaction revenue receivable balance as of June 30, 2010, was understated by \$54 million.

¹⁶ Office of Financial Management (OFM) Reference Guide Chapter 02-01, *Accounts Payable: Accrual Process*.

¹⁷ SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, states that a liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events.

¹⁸ GAO-10-443R.

¹⁹ SEC collects securities transaction fees paid by self-regulatory organizations (SRO) to SEC for stock transactions. SEC calculates the fees due and bills the SROs based on actual transaction volume reported on a monthly basis by SROs to SEC and fee rates established by SEC's Division of Risk, Strategy, and Financial Innovation.

- Several of SEC's key spreadsheets used for its financial disclosures contained errors, which were not detected by supervisory reviews. For example, we found errors in SEC's spreadsheet used for calculating future lease payments, which resulted in a \$40 million understatement of lease payments disclosed in the draft notes accompanying the financial statements, and errors in its formula for calculating gross cost with the public, which resulted in a \$21 million misstatement in the draft notes.
- SEC's accounting process over its investment of disgorgements and penalties collections in U.S. Treasury securities with the Bureau of Public Debt (BPD) was not effective at ensuring the accuracy and validity of recorded investment balances. Specifically, in 2010, SEC did not record investment purchase and withdrawal transactions in the general ledger as the transaction requests were submitted to BPD or utilize internal data when recording investment activity in the general ledger. Rather, SEC recorded monthly adjustments to its investment balance utilizing reports provided by BPD, without reconciling the investment activity to the related purchase and withdrawal transactions. Consequently, SEC's monthly adjustment did not identify an investment withdrawal transaction that was erroneously processed by BPD as an investment purchase. We also found that SEC was improperly using BPD reports in its calculation of interest receivable. Consequently, SEC's interest receivable balances were misstated for a majority of the fiscal year.
- SEC's review procedures over journal vouchers (JV) transactions were not operating effectively to assure the accuracy and validity of JVs entered into the general ledger. SEC used JVs for recording transactions, corrections, and adjustments into its general ledger system. Monthly, responsible preparers copy and paste JV transaction data into a consolidated spreadsheet, the *JV Log*, for processing into the general ledger. Under SEC's process for ensuring the accuracy of JV entries processed into the general ledger, a senior accountant is to review the totals for each set of JVs within the batch file to verify that the data was entered appropriately. However, we found this control was not being implemented.
- SEC's unliquidated obligation review process did not identify inaccuracies in the *Open Obligations Review Reports* relied on to certify the accuracy of recorded SEC obligations. To support the accuracy of obligated balances presented on SEC's Statement of Budgetary Resources (SBR), SEC requires all divisions and offices to periodically review and certify all unliquidated obligations meeting certain aging criteria. In fiscal year 2010, SEC developed a report within its general ledger system, the *Open Obligations Review Report*, and decentralized responsibility for oversight of the review process to the various divisions and offices. Specifically, under the revised process,²⁰ personnel from the various offices are to generate the *Open Obligations Review Report* for their organization code and use this report to certify the accuracy of obligations that fall under their

²⁰ OFM Reference Guide Chapter 12-2, *Unliquidated Obligation Review Process*, defines obligations with no recent activity as individual lines of an obligation (i.e., a task order) that has had no activity for 120 days for current budget fiscal year obligations (BFY) or 60 days for prior BFY obligations.

authority. However, we found the *Open Obligations Review Reports* used by the various offices in conducting their reviews were not reliable as a result of systemic errors in the report's logic. This breakdown in controls over the completeness of reports used in this process by the various offices inhibits SEC management's ability to effectively manage unliquidated obligations and increases the risk of misstatement in obligated balances presented in the financial statements.

Recommendations for Executive Action

To address the deficiencies in internal control over the financial reporting and accounting processes we reaffirm our open recommendation from our prior audits related to the development of useful reports within SEC's general ledger system. In addition, we recommend that the Chairman direct the COO and Chief Financial Officer (CFO) take the following specific actions:

7. Augment policies and procedures to ensure the completeness of the *GL Summary file* used to prepare monthly trial balance reports, including procedures for identifying and notifying management and key users of any errors or omissions detected in the report.
8. Augment existing control procedures over the *GL Summary file* by requiring documented approval by SEC management before making the file available to key users to calculate manual adjustments.
9. Develop and implement procedures over the preparation of the monthly accounts payable accrual calculation and entry to provide assurance that all organization codes are included in the calculation.
10. Augment procedures over the preparation of the monthly accounts payable accrual entry to provide for identification of all instances in which a good or service has been received and accepted but has not yet been paid prior to month-end.
11. Augment policies and procedures concerning SEC's monthly review and recalculation of securities transaction fee assessments to include procedures to ensure that the appropriate fee rate is used in the calculation of accounts receivable.
12. Augment policies and procedures concerning supervisory review of key spreadsheets used for financial disclosures to provide assurance that calculations within the spreadsheets are accurate.
13. Develop and implement policies and procedures to record investment activity in the general ledger using investment purchase and withdrawal requests submitted to BPD.
14. Develop and implement policies and procedures to reconcile investment balances reported by BPD to SEC records of investment purchase and withdrawal transactions processed during the reporting period.
15. Develop and implement policies and procedures to reconcile SEC's calculated interest receivable to interest receivable amounts reported by BPD.

16. Augment existing control procedures over the processing of JV transactions to provide assurance that JVs processed into the general ledger reflect transactions approved by management. Such procedures should provide for accurate JV transaction posting at the account, fund, organization, and budget object class level.
17. Develop and implement reconciliation, validation, and analytical procedures to ensure the reliability of the *Open Obligations Review Reports* used by the various SEC divisions and offices in their review of unliquidated obligations.

Budgetary Resources

During our fiscal year 2010 audit, we continued to find the same types of deficiencies in SEC's accounting for obligations²¹ and related budgetary transactions that we have reported in prior years. Specifically, we continued to find that budgetary transactions (1) were not always recorded within prescribed time frames; (2) did not follow U.S. Standard General Ledger (USSGL) posting configurations; and (3) were not always supported by valid documentation. These control deficiencies increase the risk of processing errors and misstatements related to budgetary activities in SEC's SBR. SEC has not yet fully addressed three of our prior recommendations in this area. The following paragraphs present an overview of our fiscal year 2010 audit findings related to SEC's accounting for budgetary resources and our related recommendations.

Timely Recording of Budgetary Transactions

In accordance with OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, an obligation is incurred when an agency places an order, signs a contract, awards a grant, purchases a service, or takes other actions that require the government to make payments. An obligation is a legally binding agreement that will result in outlays, immediately or in the future.²² According to the circular, downward adjustments²³ to previously incurred obligations should be recorded when there is documentary evidence that the price is reduced. In addition, *Standards for Internal Control in the Federal Government* provides that transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions.

SEC did not have adequate controls for timely recording of budgetary transactions. Such controls are critical to ensure that obligations do not exceed budget authority and that

²¹ An obligation is a definite commitment that creates a legal liability of the government for the payment of goods and services ordered or received, or a legal duty on the part of the United States that could mature into a legal liability by virtue of actions on the part of the other party beyond the control of the United States.

²² The standards for the proper reporting of obligations are found in 31 U.S.C. § 1501(a), which are summarized in the definition for "Obligation" in GAO, *A Glossary of Terms Used in the Federal Budget Process*, GAO-05-734SP, at 70 (Washington, D.C.: September 2005).

²³ Downward adjustment refers to an agency's cancellation or deobligation of previously incurred obligations.

any excess budget authority is made available to meet SEC's other operational needs. For example, we found:

- Seven of 20 miscellaneous purchase order documents (MO) we tested were recorded as obligations in the general ledger system after the period of performance had begun. In one instance, the obligation was recorded after the period of performance had expired. Unlike other obligations, MOs do not require prior recording of purchase requisitions for reserving funds for obligations. However, SEC officials informed us that their undocumented practice was to record MOs on the same day they were approved for obligation to preclude over-obligation of funds, which could result in Antideficiency Act violations.²⁴ The delays in recording obligations were due to inadequate procedures necessary to ensure the timely recording of obligations, including the lack of specified back-up procedures to be followed when responsible employees are unable to perform their assigned responsibilities due to illness or other reasons, and lack of effective coordination procedures with other SEC offices to ensure timely submission of obligating documents to the Office of Financial Management (OFM) for processing.
- Seven of the 10 deobligation transactions that we reviewed were approved during SEC's April 30, 2010, unliquidated obligations review process but were not deobligated as of June 30, 2010. Similarly, our review of recorded downward adjustment transactions found two instances in which the downward adjustment to a purchase contract was not recorded in the same accounting period in which they were approved for deobligation. As a result of these delays in recording of deobligations, ending obligations reported in SEC's SBR at September 30, 2010, was overstated by about \$6.4 million. In our view, the delayed recording of deobligations resulted from conflicting SEC regulations and transaction processing guidance. Specifically, SEC's process for reviewing unliquidated obligations for deobligation provides that transactions are to be reviewed at the individual contract line item level to determine whether a contract line item should remain open or be deobligated. In contrast, SEC's business process guidance provides that a deobligation is to be recorded based on closing out the contract for all contract lines. This may take a significant amount of time to complete because of the amount of review required on each contract to determine whether the contract should be closed out.
- Twenty travel obligations we tested did not have their voucher submitted within the five business days allotted by Federal Travel Regulation (FTR). Although SEC's procedures for travel²⁵ provide that—consistent with the FTR—the traveler is to complete a travel voucher for the actual cost of the trip within 5 days after travel has occurred,²⁶ SEC did not have related control procedures detailing steps

²⁴ Antideficiency Act, *codified, in part, at* 31 U.S.C. § 1341(a).

²⁵ OFM Reference Guide Chapter 14-03, *Travel: Travel Payments Process Document*.

²⁶ According to the Federal Travel Regulation (FTR), unless the agency administratively requires employees to submit travel claims within a shorter time frame, travel claims must be submitted within 5 working days after completion of the trip or period of travel. See FTR, 41 C.F.R. § 301-52.7.

required to ensure liquidation and/or deobligation of remaining travel obligations after the completion of the travel itself. Our testing found that between 4 to 16 months had elapsed from the time travel was completed until the deobligations were recorded in the general ledger. Further, our testing of unliquidated obligations at June 30, 2010, found that six of the eight travel obligations we reviewed were not liquidated upon completion of the travel. These and other travel obligations we reviewed included amounts for several SEC officials who had not worked at the agency for a year or longer.

Recommendations for Executive Action

To help address the deficiency in control over the recording of MOs, we reaffirm the recommendation from our prior audit to require an approved purchase requisition before certifying fund availability. In addition, we recommend that the Chairman direct the COO and CFO take the following specific actions:

18. Augment existing policies and procedures for recording obligations to include, at a minimum:
 - a. back-up procedures for the recording of obligations in the event that responsible employees are unable to perform their assigned duties; and
 - b. controls designed to ensure that SEC offices submit obligating documents to OFM for processing as obligations are incurred.
19. Augment guidance in SEC's *Unliquidated Obligation Review Process* to provide, at a minimum:
 - a. clarifying and communicating the responsibilities for recording deobligations; and
 - b. clarifying when to deobligate unliquidated obligations with no recent activity for financial reporting purposes and for contract close-out purposes for completed contracts to be consistent with applicable federal financial reporting guidance and OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*.
20. Develop and implement documented control procedures to ensure liquidation and/or deobligation of remaining travel obligations after the completion of the travel.

Posting Configuration Limitations

The Treasury Financial Manual (TFM) provides guidance on accounting for transactions and events to be followed by all federal entities, including a basic framework for organizing transactions and consistently accounting for financial events. *Standards for Internal Control in the Federal Government* provides that control activities should be established to ensure that all transactions are completely and accurately recorded.

As we reported in November 2010 on the results of our SEC financial audit,²⁷ we continued to find posting configuration errors in SEC's general ledger system related to recorded budgetary transactions. Twenty-one of the 50 downward adjustment transactions we tested did not follow valid posting models prescribed in Treasury's guidance. The initial erroneous transaction postings were recorded in October 2009. Based on our findings, the related correcting entries to reduce affected balances to appropriate amounts were recorded in December 2009. For the 9-month period ended June 30, 2010, SEC posted \$39 million of adjustments to correct for these posting limitations. Until correcting entries were recorded, certain balances in the interim SBR were significantly misstated.

Recommendation for Executive Action

We recommend that the Chairman direct the COO and CFO to take the following specific action:

21. Until such time that SEC is able to correct configuration limitations of its general ledger system, implement procedures to prepare and post correcting budgetary transactions prior to the close of the monthly accounting period.

Supporting Documentation and Authorization for the Recording of Obligations

Standards for Internal Control in the Federal Government provide that all transactions and other significant events need to be clearly documented and that the documentation should be readily available for examination to provide evidence of execution of these activities.

As we reported in November 2010,²⁸ our fiscal year 2010 audit found that obligations were not always supported by documentation evidencing approval by an authorized individual. For example, SEC recorded three MOs which were not supported by valid obligating documents. In each instance, the obligation documents used for recording the transactions did not include any evidence that the responsible organization approved the recorded obligations. For example, OFM's budget analyst approved several aggregated credit card requests as a valid obligation without confirmation from the responsible SEC office to verify the acceptance of the charges. We also found one obligation, related to training, which did not reflect any supervisory approval on the obligation document. Without adequate documented approval from the responsible office, it is unclear to what extent the recorded obligation represented valid obligations as defined by OMB Circular No. A-11.

²⁷ GAO-11-202.

²⁸ GAO-11-202.

Recommendation for Executive Action

We recommend that the Chairman direct the COO and CFO to take the following specific action:

22. Augment existing policies and procedures to provide for supporting documentation for MOs consistent with applicable guidance provided in OMB Circular No. A-11.

Registrant Deposits

Registrant deposits represent collections from registrants for securities registration, tender offer, merger, and other fees (filing fees). SEC records filing fee collections in a registrant deposit liability account until earned by SEC from a future filing. These collections, when earned, provide the resources SEC uses to fund its own operations. Section 202.3a(e) of Title 17, *U.S. Code of Federal Regulations*, provides that funds held in any filing fee account in which there has not been a deposit, withdrawal or other adjustment for more than 180 calendar days (dormant accounts) will be returned to the account holder, and account statements will not be sent again until a deposit, withdrawal, or other adjustment is made with respect to the account. SEC's fiscal policy for the processing of registrant deposits requires a review of registrant account balances over \$1,000 prior to issuance of a refund.

During our fiscal year 2010 audit, we continued to find the same problems in SEC's controls over the registrant deposit liability account that we reported in fiscal year 2009. Specifically, similar to our 2009 findings, we noted that SEC reported over \$25 million in deposit accounts that were dormant for 180 calendar days, or more as of September 30, 2010, but were not returned to registrants as required by federal regulations. Our audit also identified amounts in the registrant deposit liability account that SEC earned in prior years and therefore should have been recognized as revenue in those years.

In addition, our testing of filing fees transactions in fiscal year 2010 found that SEC's procedures to recalculate and verify that the correct registrant fee was recognized as revenue was not consistently applied. Specifically, for 48 of the 53 filing fee transactions we reviewed, SEC did not verify that the correct registrant fee was collected. In one instance, SEC's review did identify an incorrect registrant fee submission but did not take the necessary steps to follow through to properly recognize \$3.2 million in revenue pertaining to this submission until approximately 6 months after the error was discovered, and only after being notified by the filer upon the filer's review of its account statement.

SEC management has not yet fully implemented our fiscal year 2009 recommendations to address the significant deficiency in controls over the registrant deposit liability account. SEC updated its policy for the registrant deposit liability accounts to raise account balance thresholds to perform a review of accounts dormant for more than 180 days. SEC also hired contractors in 2010 to research and verify registrants' contact information for the dormant accounts to ensure delivery of refunds. However, without dedicating additional resources to conducting the labor-intensive reviews of dormant accounts, SEC's efforts to reduce the backlog of dormant accounts are likely to be limited. For example, in fiscal year 2009 the backlog was \$27 million. Even after the contractor's assistance, SEC reported the backlog was \$25 million as of the end of fiscal year 2010. In addition, the resource constraints hinder the verification procedures to determine that filing fee transactions are properly recognized. Until SEC allocates sufficient resources to timely review the registrant deposit accounts and verify the filing fee transactions, SEC is at risk of misstating cash and liability balances for amounts that should have been refunded and misstating revenue for amounts that have been earned but not recorded. As a result, SEC's ability to effectively comply with applicable federal regulations on dormant accounts²⁹ is still significantly impaired.

Recommendations for Executive Action

To address the significant deficiency in control over the registrant deposit liability account, we reaffirm our open recommendations from prior audits regarding (1) the allocation of resources to resolve registrants' deposit liability balances, (2) development and implementation of controls to ensure registrant filings and deposits are consistently matched on an ongoing basis, and (3) development and implementation of procedures to facilitate oversight of registrant deposit accounts.

Disgorgement and Penalties

As part of its enforcement responsibilities, SEC issues orders and administers judgments ordering, among other things, disgorgement, civil monetary penalties, and interest against violators of federal securities laws.³⁰ SEC recognizes a receivable when SEC is designated in an order or a final judgment to collect the assessed disgorgement, penalties, and interest. At September 30, 2010, the gross amount of disgorgement and penalties accounts receivable SEC reported was \$657 million, with a corresponding allowance of \$575 million.

During our audit of SEC's fiscal year 2010 financial statements, we identified a significant deficiency concerning SEC's accounting for disgorgement and penalty transactions.

²⁹ 17 C.F.R. § 202.3a(e) (Return of Funds from Inactive Accounts).

³⁰ A disgorgement is the repayment of illegally gained profits (or avoided losses) for distribution to harmed investors whenever feasible. A penalty is a monetary payment from a violator of securities law that SEC obtains pursuant to statutory authority. A penalty is fundamentally a punitive measure, although penalties occasionally can be used to compensate harmed investors.

Specifically, we found errors resulting from the inaccurate or untimely processing of disgorgement and penalty receivables, collections, and distributions transactions. Although most errors did not materially affect the balances reported or were subsequently detected and corrected, such errors present a risk that significant errors could occur and not be detected. Contributing to these errors is the (1) ineffective communication and coordination between SEC staff responsible for various portions of disgorgement and penalty activity and (2) lack of comprehensive policies and procedures to effectively address all accounting events associated with disgorgement and penalty activities. To compensate for these issues, SEC performs multiple labor-intensive reconciliations and reviews between source information and data maintained in the various case management and financial systems.

Currently, SEC records and tracks information on disgorgement and penalties through a case-management system. The Division of Enforcement is responsible for entering and maintaining receivable data into that system. However, as we reported in fiscal year 2007,³¹ the case-management system is not designed for financial reporting purposes and is not integrated with the general ledger. To compensate for limitations in the system, SEC implemented an accounts receivable module within its general ledger system in fiscal year 2008 and established guidance for entering disgorgement and penalties transaction information into the general ledger. Under the revised procedures, OFM uses weekly data extracts from the case-management system to record disgorgement and penalties receivable transactions in its general ledger. These data extracts include new and updated disgorgement receivable information that was recorded in the case-management system since the last data extract was run for OFM. Through our review of disgorgement and penalty transactions during fiscal year 2010, we found that such procedures did not address all accounting events related to disgorgement and penalties to allow for the consistent and accurate recording of disgorgement and penalty transactions in the general ledger. Specifically, SEC did not have clear formalized policy, communication, and coordination procedures between its Office of Financial Management and its Division of Enforcement, both of which are responsible for various portions of disgorgement and penalty activity. For example:

- SEC's procedures for entering disgorgement and penalty accounts receivable transactions into its general ledger system did not provide effective controls over the accuracy of financial data. All disgorgement and penalty transactions entered into the case-management system by Enforcement staff were to undergo three levels of management review to ensure the accuracy of disgorgement and penalty data.³² However, we found that the extracts used by OFM staff to record receivable transactions in the general ledger included transactions that had not undergone Enforcement's review procedures, which were not required to be completed within the reporting period. Consequently, any corrections to receivables identified through Enforcement's review process resulted in

³¹GAO, *Financial Audit: SEC's Financial Statements for Fiscal Years 2007 and 2006*, GAO-08-167 (Washington, D.C.: Nov. 16, 2007).

³²*Standards for Internal Control in the Federal Government* provide that an agency's control activities should be established to ensure that all transactions are completely and accurately recorded.

correcting entries being posted in the general ledger system, thereby inhibiting the accuracy of SEC's receivable balances at any given point in time and increasing the risk that a financial reporting misstatement may occur and not be identified. Eight of 31 receivable transactions we tested were corrections or required additional corrections processed to adjust for erroneous postings. In one instance, we found that a correcting entry was recorded before reversal of the original posting, which resulted in receivable transactions being double counted for a period of time.

- SEC procedures did not require posting a receivable transaction into the case-management system or general ledger when a court order is made initiating the transfer of monies remaining after a distribution has occurred to the SEC (transfer orders). Such transactions could be significant. For example, we identified a \$58 million transfer order that was erroneously omitted from SEC's disgorgement receivable balances. The lack of established procedures specifying steps required to account for transfer orders increases the risk that SEC's receivable balances could be understated at any given point.
- OFM did not have procedures requiring periodic calculation and accrual of amounts of post-judgment interest collectible on district court judgments. According to the judgments establishing these receivables, defendants were to pay statutorily required post-judgment interest on any delinquent amounts.³³ As of June 30, 2010, we found that approximately \$464 million in post-judgment interest receivable was designated as delinquent. Due to a system limitation in Enforcement's case-management system and OFM's reliance on such data to update related records in the general ledger, post-judgment interest is not recorded until amounts are collected. As a result, SEC's accounts receivable balance as of September 30, 2010, is understated for post-judgment interest. Further, the related footnote disclosure was omitted from the financial statements. According to SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, and OFM Reference Guide Chapter 08-01: *Investment and Disgorgement Management*, a receivable should be recognized when a federal entity establishes a specifically identifiable, legally enforceable claim to cash through its established assessment processes to the extent the amount is measurable or an amount can be reasonably estimated. Moreover, until the interest payment requirement is officially waived by the government entity or the related debt is written off, interest accrued on uncollectible accounts receivable should be disclosed.
- SEC's standard operating procedure for recording check collections is to record the collection in the general ledger after SEC receives confirmation from the bank that the check was deposited. However, bank deposits could take several days from the date the check was initially received by SEC. Further, SEC does not have a compensating procedure to ensure that checks received at, or close to, the

³³ Under 28 U.S.C. § 1961, post-judgment interest is available on federal money judgments recovered in a district court whether or not affirmatively sought in litigation. Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the weekly average 1-year constant maturity Treasury yield for the calendar week preceding the date of the judgment, and shall be compounded annually.

end of an accounting period are recorded in the proper period. We identified unrecorded checks at both interim and year-end. For example, we found checks totaling about \$2.8 million that were received at or close to year-end but not recorded in the general ledger until fiscal year 2011, that resulted in misstatements and miscalculations of SEC's allowance for loss until corrected.

- SEC's Liability for Disgorgement and Penalties line item represents cash, accounts receivables, and investments that are pending distribution to a harmed investor or to the general fund of the U.S. Treasury. The line item is made up of two general ledger accounts (GLAC): (1) 2990, *Other Liabilities without Related Budgetary Obligations*, and (2) GLAC 2400, *Deposit Suspense Liability- Non Fed*. In accordance with the USSGL, SEC uses GLAC 2400 to temporarily account for disgorgement and penalty transactions that are awaiting disposition or reclassification, such as cash receipts for which SEC has not recorded a related receivable. As of September 30, 2010, SEC reported balances for GLAC 2400 of \$123 million. However, we found the balance included amounts that have already been disbursed and therefore is significantly overstated. Specifically, as of September 30, 2010, \$102 million of amounts reported in GLAC 2400 had been transferred to Treasury by year-end. This overstatement of reported balances is attributed to SEC's posting models which recorded the \$102 million in disbursements to the general fund of the U.S. Treasury by reducing related balances in GLAC 2990 rather than account 2400. As a result, management was unable to readily identify the amount of disgorgement and penalty collections pending disposition or reclassification.

Standards for Internal Control in the Federal Government require that agencies establish controls to ensure that transactions are recorded in a complete, accurate, and timely manner. Management is responsible for developing detailed policies, procedures, and practices to fit the agency's operations and to ensure that they are built into and are an integral part of operations to meet the agency's objectives. Moreover, the standards provide that internal control should be clearly documented through management directives, administrative policies, or operating manuals and the documentation should be readily available for examination. Not having clear, comprehensive policies and procedures increases the risk that disgorgement and penalty transactions will not be completely, accurately, timely, and consistently recorded and reported and impedes SEC management's ability to effectively oversee operations.

Recommendations for Executive Action

We recommend that the Chairman direct the COO and CFO, in coordination with the Director of Enforcement as applicable, to take the following actions:

23. Augment current procedures to require that Enforcement's reviews of disgorgement and penalty data in the case-management system be completed prior to closing the accounting period.

24. Develop and implement policies and procedures to identify and post receivable transactions for court orders initiating the transfer of monies to the SEC after a distribution has occurred in accordance with generally accepted accounting principles.
25. Develop and implement policies and procedures to calculate and accrue for post-judgment interest amounts collectible prior to closing the accounting period in accordance with generally accepted accounting principles.
26. Develop and implement procedures to provide for footnote disclosures concerning post-judgment interest amounts accrued on uncollectible accounts receivable in accordance with generally accepted accounting principles.
27. Establish and implement procedures for recording all check collections in the general ledger in the same fiscal period they are received in accordance with generally accepted accounting principles.
28. Revise existing posting configurations to account for amounts disbursed from SEC's Deposit Suspense Liability accounts in accordance with the USSGL.
29. Until posting configurations for amounts disbursed from SEC's Deposit Suspense Liability accounts are corrected, establish and implement interim procedures to evaluate balances residing in SEC's Deposit Suspense Liability accounts and adjust related accounts for amounts that have already been disbursed prior to the close of each accounting period.

Required Supplementary Information

OMB Circular No. A-136, *Financial Reporting Requirements* (Revised Sept. 29, 2010), provides that the annual financial statements of a reporting entity include the basic statements, related notes and required supplementary information (RSI). In accordance with this circular—which represents generally accepted accounting principles (GAAP) for federal reporting entities—reporting entities should present disaggregated budgetary information for each of their major budget accounts presented in the SBR as RSI. The major accounts and the aggregate of small budget accounts should, in total, agree with the amounts reported on the face of the SBR.

Our fiscal year 2010 audit found that SEC management's review of the draft annual financial statements did not detect the omission of the RSI required under OMB Circular No. A-136. Specifically, SEC omitted \$452 million in disaggregated SBR financial information related to the Investor Protection Fund (IPF).³⁴ Consequently, SEC's draft financial statements were not in compliance with GAAP. After we brought our findings

³⁴ In fiscal year 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act established the new Investor Protection Fund, which resulted in the need for a new Treasury Account Symbol in SEC's fund accounting structure to account for activities of the SEC Investor Protection Fund. The Investor Protection Fund (Fund) provides funding for a whistleblower award program, in which SEC makes award payments from the Fund to eligible people who provide original information to SEC that leads to SEC's successful enforcement of a judicial or administrative action in which monetary sanctions exceeding \$1 million are imposed. The Dodd-Frank Act requires an annual report to Congress, including a complete set of audited financial statements. See Dodd-Frank Act, Pub. L. No. 111-203, § 922(a), 124 Stat. 1376, 1844 (July 21, 2010) (*codified at* 15 U.S.C. § 78u-6(g)).

to SEC management's attention, SEC took action to provide the required supplementary information in its September 30, 2010, financial report.

Recommendation for Executive Action

We recommend that the Chairman direct the COO and CFO to take the following specific action:

30. Augment procedures concerning SEC's review of its financial statements to specify review steps necessary to ensure that all applicable financial statements, related notes, and required supplementary information required under OMB Circular No. A-136 are presented.

Other Less Significant Control Issues

In addition to the recommended actions related to the two material weaknesses we identified in our opinion report, we also identified less significant deficiencies warranting management's attention. The following sections present each of these less significant deficiencies identified in our fiscal year 2010 audit and our related recommendations for corrective action.

Proper and Timely Approvals of Disbursements

In accordance with SEC's Administrative Regulation (SECR) 10-15, *Contract Administration Positions* (August 12, 2009), a Contracting Officer's Technical Representative (COTR) or an Inspection and Acceptance Official (IAO) shall be appointed by a Contracting Officer, at the Contracting Officer's discretion, to assist in monitoring the contractor's progress in fulfilling the technical requirements specified in the contract. Among other responsibilities, the COTR and IAO are to review and submit approved invoices or vouchers to OFM within the time required to avoid Prompt Payment Act penalties and interest payments³⁵ and to maintain copies of their appointment/designation letters.

³⁵ The Prompt Payment Act, 31 U.S.C. § 3902(a), is codified, as amended, at 31 U.S.C. ch. 39, and OMB has prescribed implementing regulations, which are codified, as amended, at 5 C.F.R. pt. 1315. OMB implementing regulations on determining the due date generally provide that the required payment date is (a) the date payment is due under the contract for the item of property or service provided; or (b) 30 days after a proper invoice for the amount due is received if a specific payment date is not established by contract. 5 C.F.R. § 1315.4(g).

Our fiscal year 2010 audit found that invoices are not always approved by a properly-designated COTR or IAO in accordance with SEC regulations. Specifically, during our testing of non-payroll disbursements through June 30, 2010, we noted that 37 of 67 disbursements tested were not supported by an invoice approved by a COTR/ IAO or other designated person. Of these items, 22 disbursements were approved by individuals who were not contracting officers and were without approved appointment letters to support their designation as the COTR or IAO for the contract to which the disbursement was associated. Further, 15 disbursements—all lease payments—were approved by either a Project Manager (PM) or non-Contracting Officer (CO). Although SEC officials told us that lease payments can be approved by a PM or non-CO, SEC did not provide any documentation authorizing them to approve these invoices as of June 30, 2010. Additionally, we noted one other disbursement that was approved by an individual prior to the date that individual was appointed as the COTR for that contract. Moreover, through our testing of non-payroll disbursements and consistent with our prior findings in this area as part of our previous years' audits, we continued to find instances in which SEC did not process invoices for payments in accordance with the time lines designated in the Prompt Payment Act. For example:

- 21 disbursements were not approved within the 5 business days allotted for return to OFM to assure the timely processing of the payment. Of those, 6 resulted in Prompt Payment Interest being paid to the vendor.
- 2 disbursements which were returned timely to OFM by the invoice approver, were not processed for payment until after the due date, resulting in Prompt Payment Interest being paid to the vendor.
- 1 invoice was misrouted to an incorrect department for approval, thereby resulting in delayed approval and Prompt Payment Interest being paid to the vendor.

Although SEC Administrative Regulation (SECR) 10-15, establishes responsibilities for COTRs and IAOs, including the documentation and tracking of invoices from the time of receipt until the payment is issued, such procedures were not consistently implemented in fiscal year 2010. Until such controls are operating as intended, SEC will likely continue to use a significant amount of resources paying interest penalty charges and continue to be in violation of SEC's own internal regulations and OMB guidance.

Recommendation for Executive Action

We reaffirm our prior recommendation that SEC investigate the causes of late payments and develop and implement any necessary corrective action. We also recommend that the Chairman direct the COO and CFO to take the following specific action:

31. Establish a mechanism to monitor compliance with the documentation requirements under SEC regulations to ensure proper, consistent approval of invoices by COTRs, IAOs, and other designated persons and retention of their appointment letters, if applicable.

Review of Service Providers' Auditor Reports

A significant portion of SEC's payroll processing relies on the Department of the Interior (DOI) National Business Center (NBC), a payroll service provider. As such, SEC places significant reliance on reports generated by NBC to determine whether its payroll disbursements are complete, valid, accurate, and timely.

NBC contracted with an independent auditor to perform an audit of controls related to its personnel and payroll operations under Statement on Auditing Standards (SAS) No. 70, *Service Organizations*. SAS No. 70 provides authoritative guidance for service organizations to disclose their control activities and processes to their customers and their customers' auditors in a uniform reporting format. The issuance of a service auditor's report prepared in accordance with SAS No. 70 signifies that a service organization has had its control objectives and control activities examined by an independent accounting and auditing firm. The service auditor's report includes valuable information regarding the service organization's controls and the effectiveness of those controls.

In accordance with OMB Circular No. A-123, agency management should review the scope of the SAS No. 70 report in the context of their overall internal control assessment and take timely and effective actions to address any deficiencies identified.

However, our review of SEC's SAS No. 70 review process, found that SEC did not include steps requiring the review and consideration of the SAS No. 70 report in terms of whether SEC has compensating controls in place to address any open exceptions in the report that affect SEC's payroll processing. As a result, SEC's assurance that controls relied upon in processing its payroll transactions are operating as intended is impaired.

Recommendation for Executive Action

We reaffirm our prior recommendation that SEC establish procedures to comprehensively identify and assess risk related to SEC's payroll-related activities, including risk associated with user controls identified by its payroll service provider in SAS No. 70 reports. We also recommend that the Chairman direct the COO and CFO to take the following specific action:

32. Establish and implement procedures requiring review of the payroll service provider SAS No. 70 report to include consideration of whether compensating controls are needed to address any open exceptions in the report that affect SEC's payroll processing.

Inadequate Controls over Travel Transaction Documentation

During our fiscal year 2010 audit, we observed that SEC did not require, and consequently did not maintain adequate supporting documentation for several travel-related disbursement transactions in accordance with federal travel regulations. For example, we found that SEC did not require transportation receipts, that is, ticket and/or boarding passes, to be submitted prior to payment of transportation charges through its central billing account (CBA). Moreover, SEC did not establish a business process for ensuring that the approved travel was actually taken. We identified one instance in which SEC could not provide documentation to support that a previously billed and disbursed travel payment was refunded to SEC upon cancellation of the travel authorization.

According to the Federal Travel Regulation (41 C.F.R. § 301-52.4), travelers must substantiate their claimed travel expenses by providing a lodging receipt and a receipt for every authorized expense over \$75, or provide a reason acceptable to the agency explaining why the traveler was unable to furnish the necessary receipt(s). Further, pursuant to the Federal Travel Regulation (41 C.F.R. § 301-11.25), hard copy receipts should be submitted with the electronic travel claim in accordance with the agency's policies, to support a claimed travel expense.

SEC did not have procedures detailing the steps and documentation required to effectively control and monitor travel expenses paid through the CBA, including required procedures for ensuring receipt of refunds for travel/tickets that were previously billed and paid but subsequently canceled. Lacking such procedures increases SEC's risk of fraud or misuse of government resources. Such conditions also impair SEC's ability to ensure the validity of travel expenses reported in SEC's financial statements.

Recommendation for Executive Action

We recommend that the Chairman direct the COO and CFO to take the following specific action:

33. Develop and implement policies and procedures detailing the steps and documentation required to effectively control and monitor travel expenses paid through the central billing account, including steps required to ensure

documented receipt of refunds or credits for travel/tickets that were previously paid for by SEC but subsequently canceled.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. § 720 to submit a written statement on actions taken on the recommendations to the Senate Committee on Homeland Security and Governmental Affairs and the House Committee on Oversight and Government Reform not later than 60 days from the date of this report. A written statement also must be sent to the House and Senate Committees on Appropriations with your agency's first request for appropriations made more than 60 days after the date of this report.

This report is intended for use by SEC management. We are sending copies of this report to the Chairman 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, this report is available at no charge on GAO's Web site at <http://www.gao.gov>.

We acknowledge and appreciate the cooperation and assistance provided by SEC management and staff during our audit of SEC's fiscal years 2010 and 2009 financial statements. If you have any questions about this report or need assistance in addressing these issues, please contact me at (202) 512-3133 or 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

Enclosures - 4

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report

This enclosure presents the status of the 50 recommendations reported as open in GAO's March 31, 2010, management report. The weaknesses are grouped according to the deficiency area.

Table 1: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report at the end of GAO's Audit of SEC's Fiscal Year 2010 Financial Statements.

Audit area	Year initially reported	Status of corrective action	
		Completed	In progress
Disbursement and penalties			
1. Develop and implement improved safeguarding procedures within SEC's Operations Center for checks received or establish a lockbox for the submission of checks to OFM and instruct defendants to mail checks to the lockbox.	2009	X	
2. Reconfigure the disbursements and penalty accounts receivable module to enable production of an accounts receivable aging report.	2010		X
3. Develop and implement an automated solution that will eliminate the manual process of reentering disbursement and penalties data from Phoenix into the general ledger system accounts receivable module.	2010		X
4. Develop and implement an automated sub-ledger that interfaces with the general ledger for investment and disbursement and penalty liability transaction activity.	2010		X
5. Until SEC is able to establish and implement procedures for fully integrating its detailed investment and disbursement liability activity into its general ledger, establish and implement procedures for documenting data reliability checks at the enforcement case level for data extracted from non-integrated subsidiary systems to include appropriate supervisory reviews.	2010		X
Financial statement preparation and reporting			
6. Develop and implement a desktop procedures manual that provides detailed instructions for performing each key accounting process preceding the general ledger closing process; the associated internal control to be followed for each step, as applicable; and the manner for documenting compliance with these controls.	2009	X	
7. Reconfigure the general ledger system to produce reports necessary to both prepare the financial statements and support managing operations, such as a consolidated trial balance report and undelivered order aging report, respectively, on an ongoing basis.	2010		X
8. In coordination with the DOI's National Business Center (NBC), establish and implement a cost effective procedure for accurately recording student loan payments and employee awards in the general ledger.	2010		X
9. Establish and implement procedures for performing a comprehensive review of all posting configurations and recurring correcting journal entries to identify and address any additional departures from Treasury's prescribed posting models.	2010		X
10. Develop and implement policies and procedures to identify, evaluate, and account for contingencies related to any litigation, claims, and assessments against SEC as part of the routine preparation of financial statements in conformity with generally accepted accounting principles.	2010	X	
11. Develop and implement control and verification procedures to ensure all of SEC's contingency and intragovernmental liability transactions comply with SEC's Accounts Payable Accrual As-Is Process documentation.	2010		X
12. Revise the SV Creation and Modification process document to clearly define the purpose and use of SV transactions; the process for entering SV transactions into the general ledger system, including the performance and documentation of supervisory review; and monitoring procedures to ensure that SV transactions post to the general ledger system as intended.	2010	X	
13. Develop and implement procedures to provide for a review of all transactions resulting in prior period corrections, including filing fee revenue and property and equipment transactions, and to quantify the cumulative effect of known and likely prior period corrections in the current fiscal year.	2010	X	

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report

Table 1: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report at the end of GAO's Audit of SEC's Fiscal Year 2010 Financial Statements.

Audit area	Year initially reported	Status of corrective action	
		Completed	In progress
14. Develop and implement a standardized financial statement closing schedule with cutoff dates for key month-end accounting transactions that should be completed prior to the closing of an accounting period.	2010		X
15. Develop and implement control procedures to ensure prior period accrual accounting entries are reversed in the following accounting period and current period accrual accounting entries are recorded prior to the accounting period closing date.	2010	X	
16. Develop and implement policies and procedures to ensure that only designated senior staff and management (such as branch chief level and above) have the authority to reopen previous accounting periods. Such procedures should provide for (a) documenting the required protocols to follow for requesting to reopen a closed accounting period and approval of such request, (b) specifying required documentation for situations that caused a closed accounting period to be reopened, and (c) as applicable, documenting any corrective actions that were taken to preclude such circumstances from reoccurring.	2010	X	
17. Develop and implement a process for reliably preparing accurate pro forma financial statements and updating the notes that accompany financial statements prior to year-end, preferably with the third quarter reporting.	2010		X
18. Augment current procedures to provide specific steps for ensuring the consistency of related information reported in the MD&A and the financial statements and related notes.	2010	X	
Property and equipment			
19. Reconfigure the property and equipment module to enable production of a property register report.	2010	X	
20. Establish and implement procedures to properly record property and equipment receipt transactions using capitalizable project and budget object class codes within the general ledger system.	2010		X
Controls over fund balance with Treasury (FBWT)			
21. Develop and implement procedures for timely performing, reviewing, and documenting reconciliation of SEC's FBWT accounts with balances reported by Treasury.	2010	X	
22. Develop and implement procedures for timely resolving any identified differences in FBWT activity reported by Treasury and FBWT activity recorded by SEC.	2010	X	
Risk assessment and monitoring processes			
23. Reevaluate the risk assessment and monitoring processes to ensure they consider all key elements of SEC's financial reporting control environment, including information systems and service providers.	2010	X	
24. Establish and implement procedures for performing and documenting risk assessment and monitoring processes in a timely manner throughout the year, based on the frequency and sensitivity of certain control activities.	2010		X
25. As part of the risk assessment process, document the evaluation of the design effectiveness of key controls.	2010	X	
26. Enhance risk assessment and mitigation control procedures to include maintaining a list of any internally identified control breakdowns that occur during the year, documenting an evaluation of financial reporting impact as a result of any such control breakdown, and any corrective actions taken.	2010		X
27. Establish and implement procedures to monitor and update policy and procedure documents in a timely manner to ensure key risks and corresponding controls are documented for each key process.	2010		X
Registrant deposits			
28. Design and implement controls to ensure registrant filings and deposits are consistently matched timely on an ongoing basis.	2010		X
29. Allocate sufficient resources to fully resolve current registrants' deposits liability balances in accordance with SEC policy and with federal regulations.	2010		X

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report

Table 1: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report at the end of GAO's Audit of SEC's Fiscal Year 2010 Financial Statements.

Audit area	Year initially reported	Status of corrective action	
		Completed	In progress
30. Develop and implement procedures to include the use of periodic (i.e., weekly and monthly) system generated reports to facilitate oversight of registrant deposits accounts, such as developing and using exception reports of registrant account activity.	2010		X
Controls over payroll processing and reporting			
31. Update the time and attendance system to establish preset active activity and project codes for all activities used by SEC in its process for allocating gross costs to program costs by the strategic goals presented in its Statement of Net Cost.	2010	X	
32. Modify existing policy and procedures to require all employees to report labor hours using preset activity and project codes within the time and attendance system and establish and implement applicable controls to ensure compliance.	2010		X
33. Revise and implement procedures over the preparation of the Statement of Net Cost to utilize actual data reported by employees on their biweekly time and attendance reports.	2010		X
34. Establish and implement procedures for documenting evidence of monitoring of time card certifications and include procedures to document any identified exceptions.	2008		X
35. Develop procedures for implementing management's policy on the authorization and validation of personnel actions and the timely processing of such actions.	2009		X
36. Establish procedures to comprehensively identify and assess risk related to SEC's payroll-related control activities, including risk associated with user controls identified by its payroll service provider in SAS No. 70 reports.	2010		X
37. Develop and implement written procedures that (a) standardize required documentation related to resolution of NBC's biweekly payroll exception reports and (b) extend the retention period for supporting documentation long enough to facilitate internal and external audit or review, such as a period of 18 months after payment.	2010		X
38. Develop and implement controls over access rights in the time and attendance system to prevent or timely correct any excessive access in the system.	2010		X
Accounting for budgetary resources			
39. Correct general ledger system configurations to properly account for upward and downward adjustments of prior years' undelivered orders in accordance with the <i>U.S. Standard General Ledger</i> .	2008		X
40. Clarify administrative control of funds guidance and document the responsibilities of the staff performing obligation-related activities with regard to recording obligations in accordance with the recording statute.	2008	X	
41. Establish and implement controls to ensure that SEC staff adheres to existing policies and procedures to prevent violations of the recording statute.	2008		X
42. Strengthen existing control procedures for recording miscellaneous purchase order documents by requiring an approved purchase requisition before certifying fund availability.	2010		X
Information system security controls			
43. Reevaluate existing automated information system security controls in light of the risks identified in SEC's October 2009 certification and accreditation procedures for the general ledger system and supporting processes.	2010	X	
44. Establish and implement appropriate controls to mitigate any additional risks that were identified as a result of this reevaluation.	2010		X
Controls over non-payroll disbursement and accrual transactions			
45. Develop or update and implement policies and procedures for reconciling any SEC intragovernmental expense and payable amounts reported by GSA to internal SEC data records prior to recording an accrual in SEC's general ledger for financial statement reporting.	2010		X
46. Investigate the causes of late payments and any interest penalties incurred and develop and implement any necessary corrective actions.	2010		X

Enclosure I: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report

Table 1: Status of Recommendations from Prior Audits Reported as Open in GAO's 2009 Management Report at the end of GAO's Audit of SEC's Fiscal Year 2010 Financial Statements.

Audit area	Year initially reported	Status of corrective action	
		Completed	In progress
47. Develop and implement procedures to provide for appropriately documented COTR review of all vendor invoices prior to payment in compliance with SEC regulation.	2010		X
48. Establish and implement procedures to provide periodic training to COTRs and project managers regarding their responsibilities for reviewing and approving invoices.	2010	X	
Security over sensitive employee information			
49. Review current usage of social security numbers as a personal identifier for federal employees in agency systems and programs and establish and implement alternative procedures to eliminate any such usage.	2010		X
Policies and procedures documentation			
50. Finalize the policies and procedures for the procurement and purchases and Section 31 revenue processing to include incorporating any changes needed to resolve all recommendations or deficiencies identified during the development of these draft documents.	2010		X

Source: GAO analysis of SEC data.

Enclosure II: Status of Previously Reported Information Technology Weaknesses

This enclosure presents the status of the 22 information technology weaknesses in information system controls at SEC that we identified in public and “Limited Official Use Only” reports issued in 2005, 2007, 2008, and 2009 that were reported as open in GAO’s March 31, 2010, management report. The weaknesses are grouped according to control areas—access controls, configuration management, and security management—specified by our Federal Information System Controls Audit Manual.

Table 2: Status of Previously Reported Information Technology Weaknesses Reported as Open in GAO’s 2009 Management Report at the end of GAO’s Audit of SEC’s Fiscal Year 2010 Financial Statements.

Control area	Year initially reported	Action completed	Action in progress
Access controls			
<i>Identification and authentication</i>			
1. SEC did not always enforce strong password settings on its enterprise database servers.	2008	X	
<i>Authorization</i>			
2. SEC did not adequately document access privileges for the EDGAR application.	2007	X	
3. SEC did not properly document or maintain approval of user access privileges to the Momentum system.	2009	X	
4. SEC did not adequately restrict user privileges to two of its database systems.	2009	X	
5. SEC did not sufficiently restrict remote access to the EDGAR and Fee Momentum database servers.	2009	X	
6. SEC did not sufficiently prevent users from running long reports during critical times of the day, thus monopolizing database system resources.	2009	X	
<i>Cryptography</i>			
7. SEC did not always provide approved, secure transmission of data over its network.	2008		X
<i>Audit and Monitoring</i>			
8. SEC did not always produce, review, and document reviews of Momentum security reports in a timely manner.	2008	X	
9. SEC did not keep an adequate audit trail record of user activities in the enterprise database environment.	2008	X	
<i>Segregation of duties</i>			
10. SEC did not adequately segregate computer-related duties and functions.	2009	X	
11. SEC did not always adequately separate network management traffic from general network traffic.	2009	X	
Configuration management			
12. SEC did not effectively implement patch management on certain Unix servers.	2005	X	
13. SEC lacked procedures to periodically review application code to ensure that only authorized changes were made to production.	2005	X	
14. SEC did not always protect its major enterprise database applications from command injection attacks.	2008	X	
15. SEC did not consistently apply patches or upgrade its database servers to the current software versions to support the processing of financial data.	2009	X	
16. SEC did not adequately document the test plans associated with the Momentum scripts.	2009	X	
17. SEC did not adequately document or approve changes to the requirements, design, and scripts associated with the upgrade to Momentum.	2009		X
18. SEC did not establish or maintain a configuration baseline for Momentum.	2009	X	
19. SEC did not periodically conduct configuration audits to verify and validate the extent to which the actual configuration items for the Momentum upgrade reflect the required physical and functional characteristics specified by requirements.	2009		X
20. SEC did not have a detailed configuration management plan associated with the Momentum upgrade.	2009	X	

Enclosure II: Status of Previously Reported Information Technology Weaknesses

Table 2: Status of Previously Reported Information Technology Weaknesses Reported as Open in GAO's 2009 Management Report at the end of GAO's Audit of SEC's Fiscal Year 2010 Financial Statements.

Control area	Year initially reported	Action completed	Action in progress
21. SEC did not adequately implement tools to manage configuration items for the Momentum upgrade.	2009		X
Security Management			
22. SEC did not certify and accredit a key intermediary subsystem that supports the production of its financial statements.	2009	X	

Source: GAO analysis of SEC data.

Enclosure III: Comments from the Securities and Exchange Commission



THE CHAIRMAN

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

March 17, 2011

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 respond to the draft report entitled *Management Report: Improvements Needed in SEC's Internal Controls and Accounting Procedures* (GAO-11-348R). The report contains a number of helpful recommendations to strengthen the SEC's internal controls over financial reporting.

Remediation of the agency's two material weaknesses (one with regard to information systems and the other concerning financial reporting and accounting processes) is a top priority for the SEC. Under the leadership of our Chief Operating Officer, Chief Financial Officer, Chief Information Officer, and new Chief Accounting Officer, the agency has launched a series of initiatives to address the agency's deficiencies in internal control.

As you know, these two material weaknesses both are closely connected to gaps in the security and the functionality of our financial systems. Although we are taking a number of steps to address these gaps this fiscal year, we believe that putting our internal controls on a solid footing over the long term primarily requires significant investment in our financial systems. That is why the centerpiece of our remediation strategy is to migrate our core financial system and transaction processing to a Federal Shared Service Provider, the Department of Transportation's Enterprise Services Center (ESC). Through this initiative, the SEC will fill gaps in the functionality of the current system, eliminate many manual processes that are inherently prone to error, and enhance financial and management reporting. The SEC has now signed an Interagency Agreement with the Department of Transportation for the implementation of the new system, with a cutover planned for April 2012.

While the SEC focuses attention and resources on ensuring a successful system migration, the agency also is working this fiscal year on a number of steps aimed to address deficiencies identified in your report. These efforts include:

- Updating security patches on SEC systems, strengthening user access controls, and remediating self-identified security deficiencies;
- Enhancing the agency's internal control monitoring program;

Enclosure III: Comments from the Securities and Exchange Commission

Mr. James R. Dalkin
Page 2

- Conducting a comprehensive assessment of the spreadsheets and databases used by the agency, and tightening controls over those applications based on risk;
- Strengthening our process for de-obligating funds from completed contracts, and ensuring we incorporate appropriate accounting adjustments for these amounts;
- Reevaluating our processes for reviewing filing fees paid by registrants, and reducing our backlog of inactive registrant deposit accounts;
- Tightening controls over the recording of subsequent orders, post-judgment interest, and deposits in transit related to disgorgements and penalties;
- Instituting a number of reforms to our processes for handling miscellaneous obligating documents; and
- Performing an assessment to ensure that the SEC's financial statements and notes comply with all relevant requirements, including with respect to items like Required Supplementary Information.

The SEC is committed to investing the time and resources to put its internal controls over financial reporting on a strong, sustainable path, so that these material weaknesses are eliminated and do not recur. I look forward to continuing to work with you in the coming months as these efforts unfold.

If you have any questions, please do not hesitate to contact Kenneth A. Johnson, the SEC's Chief Financial Officer, at (202) 551-4306.

Sincerely,



Mary L. Schapiro
Chairman

Enclosure IV: Summary of Audit Scope and Methodology

To fulfill our responsibilities as auditor of the financial statements of the Securities and Exchange Commission (SEC), we did the following:³⁶

- Examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessed the accounting principles used and significant estimates made by SEC management;
- Evaluated the overall presentation of the financial statements;
- Obtained an understanding of SEC and its operations, including its internal control over financial reporting;
- Considered SEC's process for evaluating and reporting on internal control over financial reporting that SEC is required to perform by 31 U.S.C. § 3512(c), (d), commonly known as the Federal Managers' Financial Integrity Act of 1982; and section 963, Annual Financial Controls Audit, of the Dodd-Frank Wall Street Reform and Consumer Protection Act;
- Assessed the risk that a material misstatement exists in the financial statements and the risk that a material weakness exists in internal control over financial reporting;
- Evaluated the design and operating effectiveness of internal control over financial reporting based on the assessed risk;
- Tested relevant internal control over financial reporting; and
- Tested compliance with selected provisions of the following laws and regulations: the Securities Exchange Act of 1934, as amended; the Securities Act of 1933, as amended; the Antideficiency Act; laws governing the pay and allowance system for SEC employees; the Debt Collection Improvement Act; the Prompt Payment Act; the Federal Employees' Retirement System Act of 1986; the Financial Services and General Government Appropriations Act, 2010; and the Dodd-Frank Wall Street Reform and Consumer Protection Act.

We requested comments on a draft of this report from the SEC Chairman. We received written comments from SEC and summarized the comments in our report.

We conducted our audit of SEC's fiscal years 2010 and 2009 financial statements in accordance with U.S. generally accepted government auditing standards. We believe our audit provided a reasonable basis for our conclusions in this report.

³⁶ For a further, more detailed explanation of our audit scope and methodology, see the discussion in our related financial audit report (GAO-11-202).

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