

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

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

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

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

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

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

For Fiscal Year (FY) 2008 the non-entity assets representing the receivables and the associated cash and investment of undistributed balances collected, and an offsetting liability was reported on the balance sheet. As we understand, without the availability of judicial remedy, under SFFAS 31, this activity will not be categorized as fiduciary funds; therefore no additional changes are anticipated for FY 2009.

We are requesting confirmation that the controlling factor in Q6 (below for ready reference), dealing with court ordered payments, is the lack of judicial remedy, and that

assets would not be categorized as fiduciary in cases where the court orders these funds to be paid to the federal entity for distribution. If the scenario in Q6 is changed so that the court orders the payment to go to the Federal entity rather than the commercial bank, and the Federal entity controls the assets and distribution plan; would the classification of the assets be fiduciary?

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

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

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

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

For an activity to meet the definition of a fiduciary activity, the Federal entity has to:

- a) collect and receive fiduciary cash or other assets and
- b) subsequently perform one or more of the activities identified in the definition (manage, protect, account for, invest, and/or dispose of the fiduciary cash or other assets).

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