Municipal Securities Rulemaking Board

Financial Statements as of and for the
Years Ended September 30, 2012 and 2011, and
Independent Auditors' Report

MUNICIPAL SECURITIES RULEMAKING BOARD

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INDEPENDENT AUDITORS' REPORT

To the Audit Committee of
Municipal Securities Rulemaking Board
Alexandria, Virginia

We have audited the accompanying statements of financial position of Municipal Securities Rulemaking Board (the "Board") as of September 30, 2012 and 2011, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Board as of September 30, 2012 and 2011, and the changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

December 14, 2012

MUNICIPAL SECURITIES RULEMAKING BOARD

STATEMENTS OF FINANCIAL POSITION
AS OF SEPTEMBER 30, 2012 AND 2011

	2012	2011
ASSETS		
Cash	$ 2,685,687	$ 2,931,963
Accounts Receivable — Net of allowance for doubtful accounts of $305,654 and $272,039 in 2012 and 2011, respectively	8,063,300	6,247,626
Accrued Interest Receivable	24,505	-
Other Assets	393,609	440,613
Investments	32,461,736	19,320,350
Fixed Assets — Net of accumulated depreciation and amortization of $20,153,777 and $16,310,663 in 2012 and 2011, respectively	6,412,406	7,710,858
TOTAL	$ 50,041,243	$ 36,651,410
LIABILITIES AND NET ASSETS		
Accounts Payable and Accrued Liabilities	$ 1,526,331	$ 1,060,418
Accrued Vacation Payable	555,105	549,789
Deferred Rent	1,387,313	1,642,583
Deferred Compensation	177,932	59,684
Total liabilities	3,646,681	3,312,474
Undesignated Net Assets	38,872,594	30,502,641
Designated Technology Renewal Fund	7,521,968	2,836,295
Net assets — unrestricted	46,394,562	33,338,936
TOTAL	$ 50,041,243	$ 36,651,410

See notes to financial statements.

MUNICIPAL SECURITIES RULEMAKING BOARD

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
REVENUE:		
Underwriting assessment fees	$ 12,812,254	$ 11,368,394
Transaction fees	13,667,607	11,348,228
Technology fees	7,681,655	6,280,060
Rule violation fine revenue	2,771,735	1,983,833
Annual and initial fees	1,284,408	1,281,200
Data subscriber fees	1,481,011	1,021,412
Other income	193,668	196,362
Total Revenue	39,892,338	33,479,489
EXPENSES:		
Rulemaking and policy development	4,300,618	4,483,383
Board governance and rulemaking oversight	1,850,433	1,631,778
Market information transparency programs and operations	13,765,617	13,907,119
Market leadership, outreach, and education	1,619,691	1,367,044
Administration	5,300,353	4,686,555
Total Expenses	26,836,712	26,075,879
CHANGE IN NET ASSETS	13,055,626	7,403,610
NET ASSETS — Beginning of year	33,338,936	25,935,326
NET ASSETS — End of year	$ 46,394,562	$ 33,338,936

See notes to financial statements.

MUNICIPAL SECURITIES RULEMAKING BOARD

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2012 AND 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 13,055,626	$ 7,403,610
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Depreciation and amortization	4,343,818	4,058,819
Impairment of long-lived assets	32,158	37,835
Loss on disposal of long-lived assets	-	14,804
Net amortization of investment discounts	(9,523)	21,322
Unrealized loss on investments	325	27,726
Bad debt expense	52,111	41,073
Changes in assets and liabilities:		
Accounts receivable	(1,867,786)	(2,361,117)
Accrued interest receivable	(24,505)	72,998
Other assets	47,004	(231,809)
Accounts payable and accrued liabilities	465,913	(77,188)
Accrued vacation payable	5,317	(208,940)
Deferred rent	(255,270)	(172,396)
Deferred compensation	118,248	(54,568)
Net cash provided by operating activities	15,963,436	8,572,169
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of fixed assets	(3,077,524)	(4,236,002)
Purchases of investments	(33,402,188)	(30,545,764)
Maturities of investments	20,270,000	27,404,694
Net cash used in investing activities	(16,209,712)	(7,377,072)
NET (DECREASE) INCREASE IN CASH	(246,276)	1,195,097
CASH — Beginning of year	2,931,963	1,736,866
CASH — End of year	$ 2,685,687	$ 2,931,963

See notes to financial statements.

1. NATURE OF OPERATIONS

The Municipal Securities Rulemaking Board (MSRB) was established in 1975 pursuant to authority granted by the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975 and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) of 2010, as an independent, self-regulatory organization charged with protecting investors, municipal entities, obligated persons, and the public interest by promoting a fair and efficient municipal securities market through rulemaking on the municipal securities activities of broker-dealers and banks (municipal securities dealers) and municipal advisory activities of municipal advisors (municipal securities dealers and municipal advisors are hereinafter referred to as regulated entities). Effective May 17, 1989, the MSRB became incorporated as a not-for-profit, non-stock corporation in the Commonwealth of Virginia. The MSRB also collects and disseminates market information, and operates the Electronic Municipal Market Access (EMMA®) website to promote transparency and widespread access to information and engages in significant education outreach and market leadership activities.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting — The MSRB's financial statements are prepared using the accrual basis of accounting in accordance with the accounting principles generally accepted in the United States of America (GAAP).

Investments — Investments are stated at fair value. Investments consist of United States (U.S.) Treasury notes, government-guaranteed agency securities, and a 457(f) Rabbi Trust that is comprised entirely of mutual funds.

Amortization and accretion of investment premiums and discounts are recorded as a component of investment return.

Accounts Receivable and Allowance for Doubtful Accounts — Accounts receivable are recorded at invoiced amounts and do not bear interest. Accounts receivable are reported net of an allowance for doubtful accounts in the statements of financial position. Management's estimate of the allowance for doubtful accounts is based on historical collection experience and ongoing reviews. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote.

Concentration of Credit Risk — Financial instruments that potentially subject the MSRB to a concentration of credit risk consist principally of cash and accounts receivable. As of January, 2011, the MSRB maintained cash primarily in a non-interest-bearing account with unlimited FDIC insurance. Accounts receivable consist of fees due from regulated entities and data subscribers. At times, there are certain significant balances due from regulated entities but the MSRB does not believe it is exposed to any significant credit risk on these balances. Four regulated entities accounted for 42% and 37% of total revenues in fiscal year 2012 and fiscal year 2011, respectively.

Use of Estimates — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used in accounting for, among other things, realization of accounts receivable, the carrying value of investments, and the impairment of long-lived assets. Actual results could differ from those estimates.

Fixed Assets — Furniture and fixtures, as well as computer and office equipment, are recorded at cost and are depreciated using the straight-line method over five years and three years, respectively. Leasehold improvements are amortized using the straight-line method over the shorter of the remaining lease period or the estimated useful life of the improvement. Improvements and replacements of fixed assets are capitalized. Maintenance and repairs that do not improve or extend the lives of fixed assets are charged to expense as incurred.

When assets are sold or retired, their cost and related accumulated depreciation are removed from the accounts, and any gain or loss is recognized in the statements of activities and changes in net assets.

Capitalized Software Costs — The MSRB capitalizes certain costs associated with computer software developed or obtained for internal use. The MSRB's policy provides for the capitalization of external direct costs of materials and services, and direct payroll-related costs incurred during the application development stage as well as costs related to upgrades and enhancements to internal use software provided it is probable that these expenditures will result in additional functionality. Costs associated with preliminary project stage activities, training, maintenance, and post implementation stage activities are expensed as incurred.

After all substantial testing and deployment are completed and the software is ready for its intended use, internally developed software costs are amortized using the straight-line method over three years.

Impairment of Long-Lived Assets — The MSRB's policy is to review its long-lived assets, such as fixed assets and capitalized software costs, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment, if any, is recognized in the period of identification to the extent the carrying amounts of an asset exceeds the fair value of such asset.

Leases — The MSRB leases office space and certain office equipment under non-cancelable operating leases and may include options that permit renewals for additional periods. Rent abatements and escalations are considered in the determination of straight-line rent expense for operating leases. Lease incentives are recorded as a deferred credit and recognized as a reduction to rent expense on a straight-line basis over the lease term.

Functional allocation of expenses — The costs of providing the various organizational activities and programs have been summarized on a functional basis in the Statements of Activities and Changes in Net Assets. Accordingly, certain costs have been allocated among the programs benefited.

Revenue Recognition:

Underwriting Assessment Fees — The underwriting assessment fee on municipal securities dealers acting as underwriters is equal to $0.03 per $1,000 of the face amount of municipal securities purchased by underwriters from an issuer as part of a new issue. Currently, commercial paper and municipal fund securities are exempt from the assessment.

Revenue from underwriting assessment fees is recognized in the month the underwriter files the offering document with the MSRB.

Transaction Fees — Prior to January 1, 2011, the transaction fee on municipal securities dealers was $0.005 per $1,000 par value of bonds sold and was levied on both customer and interdealer transactions as specified in MSRB Rule A-13. As described in this rule, certain transactions are exempt from this fee. Effective January 1, 2011, the transaction fees paid by municipal securities dealers increased from $0.005 per $1,000 par value to $0.01 per $1,000 par value.

Transaction fee revenue is recognized as sales transactions are settled.

Technology Fees — Effective January 1, 2011, the MSRB established a new technology fee on municipal securities trades reported to the MSRB. Municipal securities dealers are required to pay an assessment of $1.00 per transaction for all sales transactions. As further described in Note 11, the MSRB board of directors has designated the use of the funds generated by these fees to update, maintain, and replace MSRB technology systems.

Technology fee revenue is recognized as sales transactions are settled.

Rule Violation Fee Revenue — The Dodd-Frank Act provided, as of October 1, 2010, that fines collected by the Securities and Exchange Commission (SEC) for violations of the rules of the MSRB shall be equally divided between the SEC and the MSRB and that one-third of fines collected by the Financial Industry Regulatory Authority (FINRA) allocable to violations of the rules of the MSRB will be paid to the MSRB, although the portion of such fines payable to the MSRB may be modified at the direction of the SEC upon agreement between the MSRB and FINRA. Fine revenue is recorded in the month earned.

Annual and Initial Fees — With respect to each fiscal year of the MSRB in which a regulated entity conducts business, the regulated entity is required to pay an annual fee of $500 pursuant to Rule A-14. Revenue is recognized when regulated entities are billed annually in October, or when received upon initial registration with the MSRB to conduct business.The initial fee is a onetime fee of $100, which is to be paid by every regulated entity upon registration with the MSRB under Rule A-12. Initial fee revenue is recognized when received.

Data Subscriber Fees — The MSRB collects, stores, and provides access to information pertaining to the municipal securities market. The MSRB operates four computer-based information systems that offer data subscription service for a fee: an electronic document and data system for the collection, processing, storage, and dissemination of official statements, advance refunding documents, and related data (the EMMA® Primary Market Disclosure System); an electronic document and data system for the collection, processing, storage, and dissemination of continuing disclosure documents and related data from municipal securities issuers, obligated persons, and their agents (the EMMA® Continuing Disclosure System); an electronic data system for the collection, processing, storage, and dissemination of data on all municipal securities transactions for purposes of price transparency and surveillance (the Real Time Transaction Reporting System); and an electronic document and data system for the collection, processing, storage, and dissemination of data on short-term obligation rate reset data and related documents (the Short-term Obligation Rate Transparency System). Information processed by these systems on a current basis is sold to subscribers on an annual basis, with the annual subscription fee billed on a quarterly basis and revenue recognized as billed. In addition, the MSRB sells annual historical collections of information from these systems, with the fee billed and recognized at the time of purchase. Furthermore, the MSRB maintains files for public access of information submitted by municipal securities dealers in connection with political contributions and municipal securities business under MSRB Rule G-37. Although information provided under Rule G-37 is generally available to the public for free on the MSRB website, copying fees are levied at the time of use for the reproduction of any documents in paper form upon request by any user.

Professional Qualification Examination Fees —Rule A-16 established an examination fee of $60 assessed on persons taking certain qualification examinations.These examinations include the Series 51 (Municipal Fund Securities Limited Principal Qualification Examination), Series 52 (Municipal Securities Representative Qualification Examination), and Series 53 (Municipal Securities Principal Qualification Examination). Professional qualification examination fees are recognized in the month the exams are given and for the years ended September 30, 2012 and 2011, was $141,840 and $122,520, respectively and included in other income in the accompanying statements of activities and changes in net assets.

New Accounting Pronouncement

In May 2011, the Financial Accounting Standards Board issued amendments to the guidance pertaining to fair value measurement and disclosure. The amendments create a common definition of fair value for GAAP and International Financial Reporting Standards (IFRS) and align the measurement and disclosure requirements. These amendments provide further guidance on some of the principles for measuring fair value and expand the disclosure requirements specifically for Level 3 fair value measurements. The new requirements are effective prospectively for annual periods beginning after December 15, 2011. MSRB adopted these new requirements in fiscal year 2012 with no resulting material impact on its changes in net assets or financial position.

3. INVESTMENTS

Investments as of September 30, 2012 and 2011 consist of the following:

	2012	2011
U.S. Treasury notes	$ 9,917,692	$ -
Government-guaranteed agency securities	22,474,722	19,263,486
Mutual funds	69,322	56,864
	$32,461,736	$19,320,350

Investment return for the years ended September 30, 2012 and 2011, consists of the following, which is included in other income in the accompanying statements of activities and changes in net assets:

	2012	2011
Interest and dividends	$41,352	$ 87,871
Unrealized losses	(325)	(27,726)
	$41,027	$ 60,145

4. FAIR VALUE MEASUREMENTS

The carrying amounts of financial instruments, including cash, receivables, accounts payable, and accrued expenses, approximate fair value as of September 30, 2012 and 2011, because of the relatively short duration of these instruments.

The MSRB's policy defines fair value, uses a framework for measuring fair value, and provides a fair value hierarchy based on observable inputs.

Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect assumptions that market participants would use in pricing the asset or liability based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the transparency of inputs as follows:

Level 1 — Valuation based on quoted prices available in active markets for identical assets or liabilities as of the report date.

Level 2 — Valuations based on inputs, other than quoted prices included within Level 1, that are observable, either directly or indirectly.

Level 3 — Valuations based on significant inputs that are unobservable and reflect management's best estimate of what market participants would use as fair value.

The MSRB considers observable market data to be readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market. The categorization of a financial instrument within the hierarchy is based upon the pricing transparency of the instrument and does not necessarily correspond to the entity's perceived risk of that instrument.

The MSRB's Level 1 investments include mutual funds.

The MSRB's Level 2 investments include U.S. treasury notes and government-guaranteed agency securities.

The MSRB bases the fair value on pricing obtained from the MSRB's investment brokers. The MSRB does not adjust for or apply any additional assumptions or estimates to the pricing information it receives from its broker. The brokers' pricing is compared to industry standard data providers (e.g., Bloomberg) for reasonableness. The MSRB considers this the most reliable information available for the valuation of investments.

Investments were recorded at fair value as of September 30, 2012 and 2011, based on the following levels of hierarchy:

2012	**Level 1**	**Level 2**	**Level 3**	**Total**
U.S. Treasury Notes	$ -	$ 9,917,692	$ -	$ 9,917,692
Government-guaranteed agency securities		22,474,722		22,474,722
Mutual funds	69,322			69,322
	$ 69,322	$ 32,392,414	$ -	$ 32,461,736

2011	**Level 1**	**Level 2**	**Level 3**	**Total**
Government-guaranteed agency securities	$ -	$ 19,263,486	$ -	$ 19,263,486
Mutual funds	56,864			56,864
	$ 56,864	$ 19,263,486	$ -	$ 19,320,350

5. ACCOUNTS RECEIVABLE

Accounts receivable as of September 30, 2012 and 2011, consist of the following:

	2012	2011
Billed accounts receivable	$4,542,194	$4,619,887
Unbilled accounts receivable	3,826,760	1,899,778
	8,368,954	6,519,665
Less allowance for doubtful accounts	(305,654)	(272,039)
	$8,063,300	$6,247,626

Unbilled receivables consist primarily of September transaction and technology fees revenue billed in October. The 2012 unbilled receivables balance, in addition to the transaction and technology fees, includes $1.9 million of rule violation fine revenue.

6. FIXED ASSETS

Fixed assets as of September 30, 2012 and 2011, consist of the following:

	2012	2011
Leasehold improvements	$ 1,845,584	$ 1,936,517
Computer and office equipment	2,445,996	2,236,216
Furniture and fixtures	1,625,375	1,662,357
Capitalized software costs	20,649,228	18,186,431
	26,566,183	24,021,521
Less accumulated depreciation and amortization:		
Leasehold improvements	(1,066,953)	(1,001,730)
Computer and office equipment	(1,802,950)	(1,500,319)
Furniture and fixtures	(1,383,305)	(1,362,580)
Capitalized software costs	(15,900,569)	(12,446,034)
	(20,153,777)	(16,310,663)
	$ 6,412,406	$ 7,710,858

Depreciation and amortization expense during the fiscal years 2012 and 2011 are as follows:

	2012	2011
Depreciation expense	$ 570,681	$ 486,077
Amortization expense for capitalized software cost and leasehold improvements	3,773,137	3,572,742
	$4,343,818	$4,058,819

Impairment of long-lived assets — Through regular review of long-lived assets, in fiscal year 2012 and 2011 an estimated impairment loss of $32,158 and $37,835, respectively, was recognized.

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of September 30, 2012 and 2011, consist of the following:

	2012	2011
Accounts payable	$ 797,242	$ 368,306
Salaries, taxes, and benefits payable	388,433	531,889
Other accrued expenses	340,656	160,223
	$1,526,331	$1,060,418

8. COMMITMENTS

Operating Leases — The MSRB leases office space and certain office equipment under operating lease arrangements. In May 2001, the MSRB entered into a lease for office space in Alexandria, Virginia, which will expire in fiscal year 2016. The operating lease agreement for this office space contains provisions for future rent increases. The total amount of rental payments due over the lease term is being charged to rent expense on a straight-line basis over the term of the lease. The difference between rent expense recorded and the amount paid is credited or charged to deferred rent, which is included in the liabilities in the accompanying statements of financial position.

Future minimum lease payments under non-cancelable operating leases are as follows:

Years Ending September 30	
2013	$1,833,336
2014	1,897,512
2015	1,963,920
2016	998,844
2017	
Total minimum lease payments	$6,693,612

Total rent expense for office space and equipment for the years ended September 30, 2012 and 2011, was $2,164,988 and $2,206,315, respectively.

Employment Agreements — In accordance with the executive director's employment agreements, a 457(f) deferred compensation plan is maintained and annual contributions as defined by the agreements are made. The organization maintains a mutual fund where the contributions are invested; this account is reflected as a component of the MSRB's investments. Contributions and the related earnings and interest vest at the end of each three year contract. As of September 30, 2012 and 2011, the MSRB has recorded a deferred compensation liability related to the 457(f) plan of $177,932 and $59,684, respectively.

In fiscal year 2011, the MSRB entered into separation agreements with former employees, and as of September 2011, the MSRB has recorded a liability related to these agreements of $208,403 in salaries, taxes, and other benefits payable.

9. RETIREMENT PLAN

The MSRB has a defined contribution pension plan for all employees. Participation commences upon date of hire as described in the plan document. For all active participants employed on the first day of the calendar quarter, the MSRB makes a quarterly contribution as required by the plan document. These contributions are based on the participants' quarterly compensation for the calendar quarter immediately preceding the first day of the calendar quarter. The contribution percentage ranges from 7% to 9% depending on the length of vested service as scheduled in the plan document. Effective October 1, 2011, the contribution percentages for the defined contribution pension plan were reduced from a range of 9% to 12% to a range of 7% to 9%, depending on the length of vested service as scheduled in the plan document.

Each employee is fully vested upon being credited with three plan years of service. Employees may also make voluntary contributions to the plan. The MSRB made contributions to the plan totaling $695,954 and $831,881 for the years ended September 30, 2012 and 2011, respectively.

All administrative expenses of the plan are paid by the MSRB. Administrative expenses total $7,174 and $14,544 for the years ended September 30, 2012 and 2011, respectively.

10. INCOME TAXES

The MSRB is exempt from federal and state taxes on income (other than unrelated business income) under Section 501(c)(6) of the Internal Revenue Code and applicable income tax regulations of the Commonwealth of Virginia. The MSRB files an annual informational tax form, Form 990, with the Internal Revenue Service. The MSRB realized no unrelated business income in fiscal years 2012 and 2011 and no provision for income taxes has been made as of September 30, 2012 and 2011.

The MSRB addresses uncertain tax positions in accordance with ASC Topic 740, *Income Taxes*, which provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in financial statements. During the years from 2009 to 2012, which represent the years management considers to be open for examination by taxing authorities, management did not identify the existence of any uncertain tax position.

11. BOARD-DESIGNATED NET ASSETS

By policy, prior to January 1, 2011, the MSRB maintained sufficient cash and investments at a level not to exceed one-year of expenses. Unrestricted net assets were designated for future capital projects, including technology systems, and to fund reserves for operating expenses.

Beginning January 1, 2011, a board-designated technology renewal fund was established to provide funds for capital expenditures, such as the replacement or acquisition of computer hardware and software. The technology renewal fund is credited with all revenue derived from the technology fee and depleted by technology information capital expenses. With the establishment of the technology renewal fund, the undesignated net assets provide for operating capital in the event of a revenue shortfall or for significant unplanned expenditures.

	2012	2011
Balance - Beginning of year	$ 2,836,295	$ -
Technology fees	7,681,655	6,280,060
Technology capital expenditures	(2,995,982)	(3,443,765)
Designated technology renewal fund	$ 7,521,968	$ 2,836,295

12. SUBSEQUENT EVENTS

The MSRB evaluated its September 30, 2012, financial statements for subsequent events through December 14, 2012, the date the financial statements were available to be issued. The MSRB is not aware of any subsequent events that would require recognition or disclosure in the financial statements.

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