1973

Audits of brokers and dealers in securities (1973); Audit and accounting guide:

American Institute of Certified Public Accountants. Committee on Stockbrokerage Auditing

AICPA
American Institute of Certified Public Accountants

INDUSTRY AUDIT GUIDE

AUDITS OF BROKERS AND DEALERS IN SECURITIES

PREPARED BY THE COMMITTEE ON STOCKBROKERAGE AUDITING

NOTICE TO READERS

This audit guide is published for the guidance of members of the Institute in examining and reporting on financial statements of securities brokers and dealers. It represents the considered opinion of the Committee on Stockbrokerage Auditing (formerly known as the Committee on Stockbrokerage Accounting and Auditing), and as such contains the best thought of the profession as to the best practices in the industry. Members should be aware that they may be called upon to justify departures from the Committee's recommendations.

AUDITS OF BROKERS AND DEALERS IN SECURITIES

PREPARED BY THE COMMITTEE ON STOCKBROKERAGE AUDITING

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Additional copies of this booklet may be purchased
from the American Institute of CPAs.

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Preface

This audit guide has been prepared to assist the independent public accountant in conducting examinations of financial statements of securities brokers and dealers by describing those conditions or procedures unique to the industry and by illustrating the form and content of broker-dealer financial statements and informative disclosures pertaining thereto. The guide includes a discussion of brokerage transactions, accounting records, internal accounting controls and procedures for safeguarding securities, unique aspects of the examination, and illustrations of Answers to Financial Questionnaire and other financial statements.

The forms of financial reporting of broker-dealers, in accordance with requirements established by the regulatory or self-regulatory bodies, are intended to meet the needs of customers who do business with these securities concerns, the regulatory bodies and, in the case of firms with public ownership, the needs of stockholders.

Substantially all brokers and dealers in securities are subject to regulation under the Securities Exchange Act of 1934. Those that are members of the National Association of Securities Dealers, Inc., are subject to the rules of that Association and those that are members of securities or commodities exchanges are also subject to the rules of such exchanges. Some of these rules, as currently in effect, are discussed herein. However, changes in the rules, regulations, practices, and procedures of the securities industry have been frequent and extensive in recent years. Still further changes are under consideration as this guide goes to press and *it is imperative that the independent public accountant keep abreast of these changes.*

This publication is only a guide in determining the scope of the work for each individual audit. It is not intended to limit or supplant individual judgment, initiative, imagination, and vigilance. Programs for each audit should be designed to meet the requirements of the particular situation, giving careful consideration to the size and type of organization and the adequacy of internal control; this is a matter which can be determined only by the exercise of professional judgment in the light of circumstances present in a particular case.

The accounting practices recommended in the guide differ, in some instances, from those presently followed by the industry. In this connection, it is the considered opinion of the Committee that the financial statements of brokers and dealers, for fiscal periods ending after March 31, 1973, should conform to the recommended accounting practices as set forth herein.

This audit guide has been prepared under the auspices of the AICPA Committee on Stockbrokerage Auditing, and important contributions have been made by members of prior committees. The Committee wishes to acknowledge in particular the efforts of Carroll F. Davis, a retired practitioner, who has given unstintingly of his time and effort to this endeavor.

Committee on Stockbrokerage Auditing

February 1973

Section I

General

Introduction

A securities broker or dealer engages in two major activities. As a broker (in an agency capacity) it buys and sells securities or commodities for its customers charging a commission, and as a dealer or trader (in a principal capacity) it buys and sells for its own account (trading with customers or other dealers) for whatever profit or loss is made on the transaction.

While buying, selling, and settlement of accounts in industry are usually relatively simple, these same functions by brokers and dealers in securities are complicated by the many intermediate steps which occur between the execution and completion of a buy or sell transaction. These intermediate steps are graphically illustrated in the "System Level Flow of Security Transaction" which is shown on the following page. This illustration is subject to "Copyright American Stock Exchange 1969" and is reproduced with permission of that Exchange.

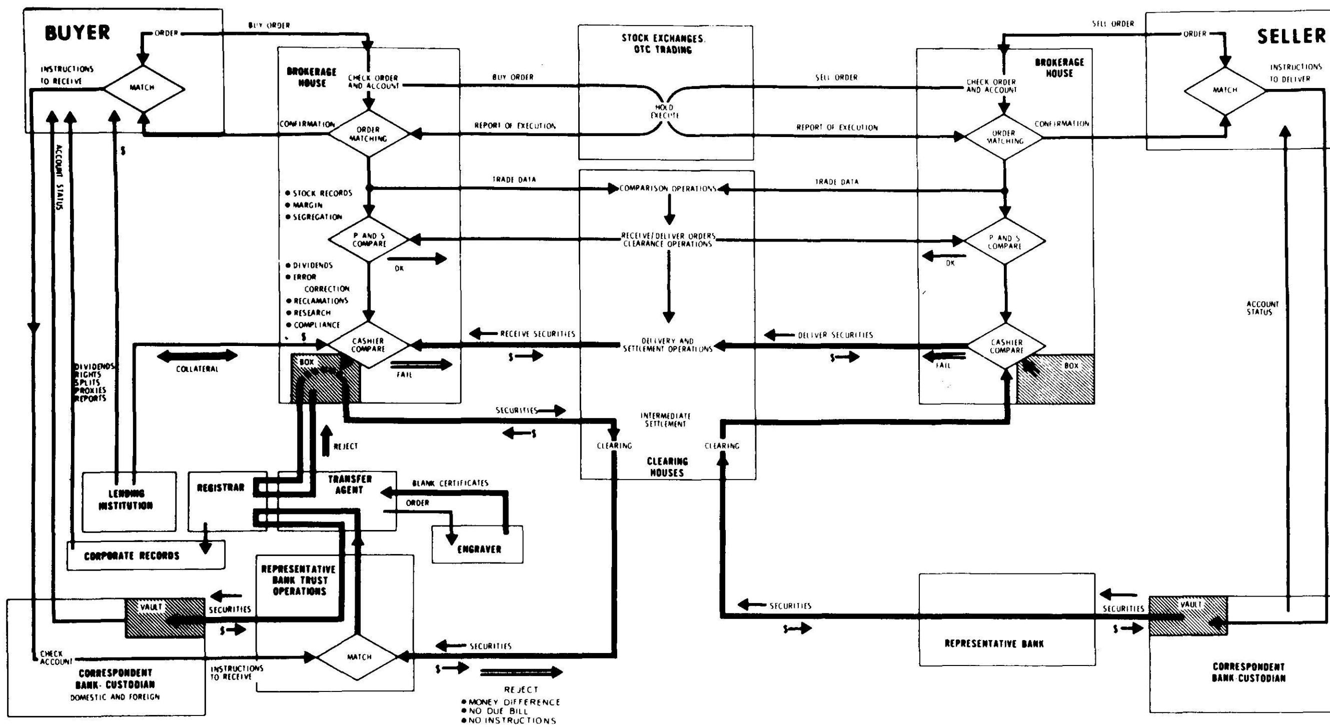

FIGURE 2—SYSTEM LEVEL FLOW OF SECURITY TRANSACTION

In addition to the major activities of buying and selling securities and commodities, a securities broker or dealer may underwrite or participate in group underwritings of new issues of securities. It may assist in the private placement of securities, offer investment advisory services, extend credit to customers who have purchased securities on margin, and act as a depository in holding large quantities of securities owned by its customers. Further, a securities broker or dealer may market oil and gas participations, real estate participations, cattle programs, etc., which are highly specialized activities and, except for the accounting principles pertaining to investments by brokers and dealers in such activities, are not covered in this guide.

Brokers and dealers in securities are regulated primarily by the Securities Exchange Act of 1934. The purpose of this Act is to provide for the regulation of securities exchanges and over-the-counter markets operating in interstate and foreign commerce and through the mails to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes.

The Securities and Exchange Commission has promulgated certain rules under the aforementioned Act. Some of the more important of these rules with which the independent public accountant should be familiar include 8c-1 and 15c2-1 regarding fraudulent practices and hypothecation of customers' securities, 15c3-1 regarding net capital requirements, 15c3-3 regarding maintenance of reserves with respect to customers' cash and standards concerning the physical possession or control of fully paid and excess margin securities of customers, 17a-3 regarding records to be maintained, 17a-4 regarding retention of records, 17a-5, 17a-10 and 17a-11 regarding reports to be filed with the Commission, and 17a-13 regarding quarterly security counts, verifications and comparisons.

In addition to a familiarity with the above rules of the Securities and Exchange Commission, it is necessary for the independent public accountant to have a working knowledge of Regulations T and U of the Board of Governors of the Federal Reserve System, and, if his client is a member of a stock exchange or the National Association of Securities Dealers, Inc., he should be familiar with the pertinent rules of those organizations. It is also considered advisable to review the applicable Accounting Series and other releases which are published from time to time by the Securities and Exchange Commission.

The report required under Rule 17a-5 is a response (Answers) to a Financial Questionnaire to be prepared in accordance with the instructions set forth in Form X-17A-5. This response is, in effect, an expanded statement of financial condition containing ledger balances, security valuations, and commodity gains and losses. Form X-17A-5, which sets forth the audit requirements, information required, and order of presentation, may be obtained from a local office of the Securities and Exchange Commission.

In addition to the Securities and Exchange Commission, national securities exchanges of which the broker or dealer is a member and, in some instances, state security commissions and other regulatory bodies also require the filing of financial information in the form of Answers to Questionnaires. In most instances an exchange will accept Answers to a Financial Questionnaire of a larger exchange with whom a broker or dealer may also have to file. The Securities and Exchange Commission will accept the Answers to a Financial Questionnaire filed with the principal national securities exchange of which the broker or dealer is a member provided such Answers meet the requirement of its Rule 17a-5.

In substance, the format of each questionnaire is similar to that of the Securities and Exchange Commission. However, each regulatory body in its individual questionnaire may have one or more additional parts, reporting requirements, etc., that would have to be complied with if the questionnaire being filed were the principal one for the particular broker or dealer.

Since the securities broker or dealer operates in a fiduciary capacity, financial strength is considered to be of utmost importance. For this reason emphasis is placed on the amount of protection afforded its customers who entrust it with large sums of money and securities. The Securities and Exchange Commission, national securities exchanges, and other regulatory bodies prescribe minimum capital requirements which limit aggregate indebtedness of the broker or dealer in securities to a specified percentage of net capital. As a means of increasing net capital, the brokerage concerns frequently borrow cash, and/or securities, under agreements which subordinate such borrowings to claims of general creditors. Such subordinated borrowings, if approved by the applicable regulatory authority are includable as capital under the capital rules.

On December 30, 1970, the Securities Investors Protection Act of 1970 was signed into law. The Act, which established the Securities Investor Protection Corporation (SIPC), requires registered broker-dealers, with few exceptions, to become members of SIPC and become subject to a fee assessment based upon annual gross revenues from the securities business beginning with the calendar year 1969. The Act, in effect, represents an amendment to the Securities Exchange Act of 1934. It provides the Securities and Exchange Commission with rulemaking authority relating to the custody and use of customers' securities, carrying and use of customers' deposits and credit balances and requires establishment of rules regarding the maintenance of reserves relating to customer deposits and credit balances.

The language of the securities industry includes many specialized terms and this guide contains a glossary of some of those most frequently encountered. A familiarity with these terms is essential to the independent public accountant contemplating an examination of a brokerage concern.

Brokerage Transactions

Transactions in Listed Securities. Transactions in listed securities may be in round lots (unit of trading specified by the exchange on which the security is listed, usually 100 shares) or in odd lots (quantities less than the unit of trading).

Transactions in securities listed on an exchange are usually initiated by a customer calling or otherwise communicating with a registered representative (salesman, customer's man or account executive) and requesting that a specified number of shares of particular securities be bought or sold at a stated price or at the market. This order is then communicated by the order room of the brokerage concern to its clerk who is stationed at the exchange where the security is traded. If the brokerage concern is not a member of the particular exchange, or has no member on the floor, the order is relayed to a correspondent broker who executes the trade.

In either case the order, once conveyed to the floor of the exchange, is given by the order clerk to the representative on the floor of the exchange who will attempt to execute it. Once executed, the details of the transaction (price, quantity, other broker with whom the transaction was consummated, etc.) are reported back to the order room of the brokerage concern which, in turn, transmits the data to its purchase and sale department. A confirmation of the trade is then prepared and sent to the customer.

Orders for a quantity less than the normal trading unit specified by the particular exchange may or may not be handled differently from round lot transactions. Where the exchange has no odd-lot dealers, as is the case on the American Stock Exchange, the procedures followed are the same as for round lots. Where there are odd-lot dealers, as is the case on the New York Stock Exchange, the transaction is executed and settled directly with one of them. Their compensation is the odd-lot differential which is included in the execution price. The odd-lot broker offsets these transactions by buying and selling round lots.

Most of the exchanges have related clearing organizations. For brokerage concerns who are members, deliveries (or receipts) of securities and the related cash settlements are made through these clearing organizations. The clearing organization usually offsets transactions between members so that only the net transactions for each day by each member require physical movement of securities. Brokers or dealers in securities operating through correspondent brokers settle their transactions through these correspondent (clearing) brokers who in turn settle the transactions through the clearing organizations.

Transactions in Unlisted (Over-the-Counter) Securities. A customer's order involving an unlisted security is filled by his broker or dealer locating and entering into a transaction with another broker or dealer who can make the security available. Such transactions are executed and settled directly between the respective brokers or dealers or cleared through the National Clearing Corporation.

At times, usually in the case of new issues and unlisted securities, the broker or dealer may act for his own account in a purchase or sale transaction with a customer or with another broker or dealer. On this type of transaction there is, of course, no commission but, instead, a profit or loss on the purchase or sale.

Cash Transactions. Cash account transactions are transactions for the purchase or sale of securities which are expected to be settled within the time limit prescribed by the Board of Governors of the Federal Reserve System in its Regulation T.

Margin Transactions. Margin account transactions are transactions for the purchase or sale of securities by customers on other than the regular cash settlement terms. A purchase on margin contemplates an extension of credit to the customer by the brokerage concern; the maximum amount of such credit is regulated by the Board of Governors of the Federal Reserve System through Regulation T. The brokerage concern, acting as agent for the customer, buys the securities ordered by the customer and borrows, if necessary, the additional funds from a bank to make payment. In so doing, the brokerage concern may pledge as collateral against the loan the securities so purchased or any other securities which it may rightfully hypothecate.

Additional margin deposits may be required (maintenance margin) if market fluctuations adversely affect the equity in the customer's account. Maintenance margin ordinarily is governed by the rules of the exchange of which the brokerage concern is a member rather than by Regulation T.

Commodity Transactions. Transactions in commodities are usually confined to one of the following three types:

1. *A spot transaction.* This involves the delivery of the commodity (usually accomplished by a warehouse receipt).
2. *A futures contract.* This is an agreement (executed on a commodity exchange) to buy or sell a definite quantity of a specified commodity of a certain grade in the future.
3. *A forward contract.* A contract for purchase or sale of a spot (cash) commodity for future delivery.

Customers of a brokerage concern are generally not interested in making or accepting delivery of the commodity itself; instead, they wish to trade in futures contracts only. Accordingly, on or before the delivery date specified in the futures contract, settlement generally is made by buying or selling an offsetting futures contract. Most commodity dealers and many processors have their own representatives on the floor of an exchange to enter into futures transactions.

When a customer places an order for a futures contract with a brokerage concern, he is required to provide a margin deposit which is credited to his account. Additional margin deposits may be required (maintenance margin) if the price of the commodity fluctuates adversely to the customer's financial interest. Commodity exchange rules require that, in addition to general guaranty funds, the brokerage concern must deposit margin with the clearing association of the exchange.

A brokerage concern, other than one which places its commodity transactions through a correspondent broker, actually deals with a clearing association when it buys and sells futures contracts for the account of its customers. Commodity transactions are generally executed between two brokers but are settled by each with the clearing association. As a result, offsetting transactions entered into by the same brokerage concern are immediately balanced against one another by the clearing association.

A commodity exchange establishes at the close of business each day a settlement price to which all contracts are to be adjusted, that is, marked-to-the-market. Each day all open contracts are listed, together with the quantity, contract price, and settlement price. The net difference is determined and settled in cash with the clearing association each day. The brokerage concern records the amount of the daily settlements in contract difference accounts from which gains and losses are transferred to the customers' accounts when final settlements are made.

The brokerage concern notifies the customer of the date for completing the futures contract as it nears so that the customer can complete the transaction, generally with the purchase or sale of an offsetting futures contract. When a "round turn" (offsetting purchase and sale) has been completed for the customer, the gain or loss can be determined and recorded in the customer's account.

For a more complete discussion of commodity transactions refer to the section "Commodity Transactions," elsewhere in this guide.

Option Transactions. Options (referred to in the trade as "puts" and "calls") give the holder the right to sell or buy a specified number of shares of stock at a specified price within a specified time. A put option gives the holder the right to sell the stock; a call option the right to buy the stock. A put option obligates the seller of the contract to take delivery of the stock and pay the specified price to the owner of the option within the time limit of the contract. A call option obligates the seller of the option to deliver the stock to the buyer of the contract at the specified price within the time limit of the contract. The price specified in a put or call option is usually close to the market price of the stock at the time the contract is made. Put and call options are written for 30, 60, 90 days, or longer. If the purchaser of a put or call option does not wish to exercise the option the price he paid for the option becomes a loss.

Options sold through the auspices of the National Put and Call Association bear the endorsement of a New York Stock Exchange member firm. Such endorsements constitute a guarantee of performance and, consequently, a contingent liability for the contract.

There are several variations of put and call options which are referred to as "straddles," "spreads," "strips," and "straps." For a description of these terms as well as more complete discussion of option transactions refer to the section "Option (Put and Call) Transactions," elsewhere in this guide.

Arbitrage Transactions. Arbitrage is (1) the buying of a security in one market and selling it in another, or (2) buying and selling of securities which are exchangeable, for the purpose of taking advantage of any price disparity that may exist between the markets of the exchangeable securities.

Opportunities for arbitrage exist in the following principal areas:

1. Securities which are traded on more than one exchange.
2. Securities which are traded in more than one country—called International Arbitrage.
3. Securities which are convertible. The arbitrage procedure involves purchasing the convertible security and selling "short" the appropriate amount of the security into which it is convertible. Delivery of the securities sold short is effected upon conversion. Similar procedures can be followed with rights and warrants.
4. Securities of companies which are merging or which are involved in reorganizations. The arbitrage procedure followed is similar to that of convertible securities described above.

Underwriting Transactions. Corporations and political subdivisions desiring to raise funds for various purposes through the sale of securities usually engage securities brokers or dealers to underwrite the security issues. Unless the transaction is on a "best efforts" basis the underwriter, or underwriters, agree to purchase the entire security issue from the issuer for a specified price and then proceed to sell the securities to the public at a slightly higher price.

Since the value of most new issues of securities and the consequent liability for successful marketing thereof is normally too great for any one brokerage concern to assume, group accounts, or syndicates, are formed in order to spread the risk. Additionally, selling groups, which may include brokerage concerns other than members of the underwriting group, are sometimes formed in order to obtain wider geographical distribution of the new issue.

The liability of the underwriting group may be divided or undivided. If the liability is divided, each member of the group has a specified maximum liability to take down a certain number of shares of stock or principal amounts of bonds. If the liability is undivided (usually in connection with security issues of political subdivisions), each member of the underwriting group has a designated percentage liability with respect to unsold securities in the underwriting account regardless of how many securities he has taken down and sold.

"When Issued" Transactions. Pending issuance of new securities which may arise through underwritings, exchanges, mergers, etc., brokerage concerns may enter into purchase and sale transactions after agreement to issue the securities has been effected but prior to the setting of a date for settlement. These purchase and sale transactions are made on an open contract basis referred to as "when issued" transactions, meaning that the contract is exercisable only when, as, and if the new securities are issued.

"Delayed Delivery" Transactions. "Delayed delivery" transactions are transactions for the sale by the brokerage concern of securities which are similar in all respects to regular-way transactions except that, by agreement, the date of consummation or settlement is extended.

Repurchase Transactions. Transactions of this type involve the sale and delivery of securities with a simultaneous agreement to repurchase them, with delivery and payment to be made at either a fixed or variable time in the future. As a rule, these transactions are in exempt securities and are another means of borrowing money.

Accounting Records

Many brokerage concerns, particularly those concerns having operations in the New York area, record securities transactions in the financial accounts on settlement date rather than on the transaction (trade) date. This practice, which varies from the practice followed by other industries of recording transactions on the date of occurrence, is not in accordance with generally accepted accounting principles; however, this departure from generally accepted accounting principles is usually not material and is occasioned by the practical necessity of providing time for the orderly settlement of the transactions, including confirmation with the customer, comparison with the brokerage concern on the other side of the transaction, and for delivery of the securities. The effect of this departure on financial statements and the audit procedures relating thereto are discussed elsewhere in this audit guide.

Record keeping by securities brokers or dealers may be accomplished in a variety of ways ranging from completely hand prepared records to sophisticated electronic data processing systems, depending on the size of the brokerage concern's operations.

Under the manual system, trade confirmations may be prepared on bookkeeping machines or on typewriters and the information transcribed, together with other transactions, on hand-posted blotters. The stock record is usually in the form of a handwritten card for each security. Customer statements may be prepared by hand, on bookkeeping machines, or typewriters, and margin records may be in the form of hand-posted cards which are regularly updated by erasing and writing over, similar to "slate" records.

A manual system requires separate postings of each transaction to blotters, customer statements, margin records, stock records, etc., which increases the possibility of posting errors; whereas, mechanized systems usually provide only one posting or entry to the system which is then used to prepare all records.

In recent years, many brokerage concerns have adopted automated methods of recording transactions. One of the first steps toward automation was the introduction of punch card or "unit" record keeping. The unit record method utilizes punch cards and mechanical processing equipment in the preparation of records. The stock record, together with certain detail transaction data, is represented by files of punch cards which may be tabulated and printed. In addition, there is sometimes a duplicate file of cards in customer account order sequence called a "holder's file." Under this method daily blotters, stock records, customer statements, and various other reports are prepared mechanically and require minimal manual effort.

Most of the medium and large brokerage concerns have adopted computerized processing in various degrees of sophistication as a method of record keeping. In the more sophisticated systems, the stock record, details of customer transactions, margin records and, in many cases, the general ledger are placed on magnetic tape, discs, or other storage media until they are ready to be used in the production of reports. In computerized operations there are certain master files (principally security files and customer files) that are used in processing most of the work, together with programs for each operation. The security file includes code numbers to identify the security for machine processing, a sufficient description of the security to properly identify it in printed reports, and possibly its ticker symbol if it is a listed security. The customer file normally includes the customer account number, a number to identify the salesman that handles the account, the name and address of the customer, and, where desired, delivery instructions and possibly an indication to whom additional copies of confirmations or statements should be sent.

Some brokerage concerns using fully automated record keeping techniques have acquired their own electronic data processing equipment for "in-house" operations, thus necessitating the organization of an operations center and a systems department. Other firms use computer service bureaus such as those organized by stock exchanges, equipment manufacturers, and others.

Virtually all brokers or dealers in securities are governed by the rules and regulations of the Securities and Exchange Commission. Rule 17a-3 specifies those books and records which must be maintained and kept current. Rule 17a-4 specifies the period of time that the books and records under Rule 17a-3, as well as certain additional records, must be preserved. Also, the National Association of Securities Dealers, Inc., and many securities exchanges including the New York and American Stock Exchanges, in their constitutions and rules prescribe that members are required to keep certain books and records. There are, however, depending on the needs of the individual business, situations which may warrant the maintenance of certain additional records not specifically required under the rules of the various regulatory bodies. The prescribed records do not constitute an accounting system, but all accounting systems must include such records and they must be maintained on a current basis.

In instances where a broker-dealer operates as a sole proprietor, records must also be maintained of all assets and liabilities of the proprietor which are not related to the brokerage operation. Such records are necessary to permit determination of compliance with net capital requirements. In this connection reference should be made to Accounting Series Release No. 107 of the Securities and Exchange Commission.

Listed below are brief descriptions of the more important records which are incorporated in the accounting system of many brokerage concerns. The independent public accountant should recognize that the nomenclature as well as the form of these records may vary from concern to concern as in the case of computer-produced or hand-produced records.

Blotter Records. The basic records of original entry maintained by a broker or dealer in securities are known as "blotters." While the term "blotter" is used in the securities industry it is similar to a "journal" used in other businesses. Specifically, the blotters serve to record the details of cash receipts and disbursements, purchases and sales of securities (by market), receipts and deliveries of securities, and other appropriate debits and credits, such as a listing of floor brokerage receivables or payables, mutual fund commissions earned, and investment counseling fees. Blotters and related records of receipts and deliveries of securities generally indicate the quantity, description, and certificate numbers.

Stock Record. The stock record provides a composite listing of the long and short positions for each security for which the brokerage concern is responsible. A long position in the stock record indicates ownership of the security or the right to possession. The position sheet for each security shows the identity of each owner. These may be customers, brokerage concerns to or through whom a sale of securities but not delivery has been made, brokerage concerns or others from whom securities have been borrowed, or the brokerage concern itself if it has purchased securities for its own account.

Short positions in the stock record indicate either the location of the securities or the responsibility of other parties to deliver them to the brokerage concern. Every security owned or held by the brokerage concern must be accounted for as being in such locations as the active box, the safekeeping or segregation box, a branch office box, out with a transfer agent, in transit between offices of the brokerage concern, held by a bank as collateral to a loan, or due from other parties as indicated in the preceding sentence.

The long and short positions for each security should be in balance. In the event the total long and total short positions for a security are not equal, the amount required to balance is recorded in a difference account. Examples of some of the causes of out-of-balance positions would be a lag in processing the offset transaction, miscoding the transaction or the offset transaction, or misfiling of a security movement ticket. The use of difference accounts is an aid to brokerage concerns in isolating problems for subsequent investigation. In line with this, EDP (electronic data processing) programs for the preparation of stock record reports are frequently designed to record automatically any differences in difference accounts.

The speed and accuracy required in the maintenance of comprehensive listings, such as the stock record, has led to the widespread use of EDP equipment. Moreover, EDP equipment has provided a greater latitude and versatility in obtaining information and recasting it in various formats. For example, data as to securities held in segregation or safekeeping may be shown on the same stock record, through the use of an additional column or memo field beyond the original long and short positions, thus eliminating the need for a separate listing or summary. The entire stock record tabulation is generally prepared on a weekly basis with a tabulation of changes produced on a daily basis.

Example of an EDP Produced Stock Record

Account			*XYZ Corp.–Common Stock*			
Description*	Number	Date of Last Activity	Long	Short	Seg	SK
Active box	0-00001-8-0	4/28		890		
Transfer	0-00003-4-0	4/28		42		
Segregated box	0-00005-9-0	2/17		100	100CR	
SK box (customer name)	0-00006-7-0	1/17		250		250CR
Central Certificate Service	0-00007-6-0	4/28		100		
Fail to deliver	0-00009-0-0	4/28	1880			
Fail to receive	0-00011-7-0	4/28		959		
Customer and partner accounts	1-05451-6-1	4/25	100			
	1-10476-9-1	3/28		275		
	1-41200-6-1	2/01	100		100	
	1-52720-9-1	12/14	250			250
	5-84438-6-1	4/26	20			
	6-11002-7-0	3/21	15			
	6-15511-1-0	4/22	15			
	6-23002-5-0	4/25	226			
Difference account	9-99999-6-1	4/25	10			
Total			2616	2616	0	0

* In most systems the account description is not printed out.

In firms that use a manually prepared stock record the usual type of record is a large card for each security which is filed in alphabetical order in metal trays or binders. The card generally has a section at the top which is used to post long positions and a section at the bottom which is used to post short positions. The cards usually have lines running across and down resulting in spaces somewhat like boxes. Each column running across the card is used to record the date and the new balance for each account affected. Only the new balance is recorded, not the entry. Such card must be analyzed to determine the actual, by line, positions at any point in time, since usually at the time of an entry the unchanged balances are not brought forward as only the balance of the changed positions are entered.

In manual systems, the total long and total short positions should be checked periodically to make certain that they are equal. Out-of-balance differences are not usually set up in a separate account in a manual system, whereas procedures in most mechanized systems result in a balanced record.

In some firms, a separate stock record is maintained for securities held in safekeeping for customers. Under such a system the regular stock record is reduced in size with the elimination of these accounts. The safekeeping stock record sets forth positions only in customers' accounts (long) and in the safekeeping box (short).

Failed to Receive and Failed to Deliver Records. A "fail to receive" is a buy transaction where the security has not been received from the broker on the other side of the transaction by or on the settlement date and shows "short" on the stock record. A "fail to deliver" is a sale where delivery of the security has not been made to the broker on the other side of the transaction by or on the settlement date and shows "long" on the stock record.

Generally the cashier's department is responsible for keeping track of all unsettled security transactions with other brokerage concerns. One method of accomplishing this record keeping under manual systems is to have the P & S department send copies of the trade confirmation tickets to the cashier's department. These tickets are filed in alphabetical order by settlement date. If the security is not received in or delivered out by the

Example of a Manually Prepared Stock Record
XYZ Corp.—Common Stock

19X1 FWD 1/27	1/31	2/1	2/6	2/8	2/10	LONG					
200						John Doe					
	500					Richard Roe					
		100				Henry Hoe					
			300		200	Failed to Deliver					
					100	Stock Borrowed					
				100		Firm Accounts					
200						Total					
						SHORT					
			300	200	100	James Smith					
	500	0		100		Active Box					
100						Safekeeping Box					
100						Segregation Box					
		500				Bank Loans					
		100		200	300	Transfer					
200						Total					

settlement date, the open tickets are transferred to the fail to receive or deliver files. When the security is delivered out or received in, a copy of the confirmation ticket is sent to the accounting department as the basic bookkeeping entry to record the security movement.

Some brokerage concerns develop "fail" items through a daily check of the various blotters to determine which items are fails. Under this system, for each such item the fail clerk prepares a memo slip indicating the date of the fail, the broker on the other side of the transaction, the number of shares and the description of the security, the unit price of the security, and the total dollar value of the transaction. The fail clerks usually keep a file of fail slips in alphabetical order by security and by date of the fail, within each security. The securities and money balances listed on these slips or punch cards, as explained below, provide the supporting detail for the brokerage concern's stock record fail security positions and the general ledger fail money balance controls.

In brokerage concerns using electronic data processing systems, a copy of the fail slip is usually sent to the data processing department for recording the fail in the mechanized records. The data processing department may then prepare a punch card for each fail with all the applicable details on the transaction keypunched into the card and then route the card back to the fail clerk. The fail clerk will then maintain a punch card file of all open fail items for utilization as an "out-of-fail" entry.

In other data processing systems, a punch card is prepared in advance for each transaction and is sent to the fail clerk. The cards for transactions which clear on the settlement date are destroyed. The remaining cards, representing fails, are returned to the data processing department for entry in the stock record (securities) and general ledger (money). The data processing department usually reproduces the fail cards and returns the reproduced cards to the fail clerk for filing in the open fail card file. When the fail is cleared (securities having been either received or delivered versus payment), the fail clerk notes the date of the clearance and then routes the applicable punch card to the data processing department so that the fail position may be cleared from the brokerage concern's records.

Where punch cards comprise the details of open fails, these cards can also be used to compare the cashier's department detailed records to related stock record positions and general ledger money balances.

Brokers or dealers clearing transactions through correspondent brokers located in exchange centers usually maintain fail to receive and fail to deliver records only in connection with transactions initiated by their trading departments with over-the-counter brokers or dealers. In some instances these records are maintained as ledger accounts in the same form as the accounts maintained for customers.

Securities Borrowed and Securities Loaned Records. Generally, details of securities borrowed from or loaned to brokers and others are recorded in a stocks borrowed and loaned ledger or on individual borrowed and loaned information sheets. The cashier's department records will contain all applicable details of the borrowed and loaned transactions, such as date, description of the security, quantity, total amount of the deposit made (stocks borrowed) or received (stocks loaned) and from whom borrowed or to whom loaned. As with fails to receive and deliver items, these records will provide the supporting details for the stock record borrowed and loaned security positions and the general ledger money control of amounts due to and from others with respect to these transactions.

In electronic data processing systems, a punch card may be prepared for each loaned and borrowed position and retained in the cashier's department for utilization as an "out-of-loaned" or "out-of-borrowed" entry and in the comparison of cashier's department records with the stock record and general ledger.

Collateral Loan Records. A separate record should be maintained in the cashier's department for each bank loan. This record should indicate the name of the bank, the dollar amount of the loan, the interest rate and the quantity, description, and market value of securities held by the bank as collateral. In certain data processing systems a separate punch card file of securities out as collateral may be maintained in the cashier's department. The loan records or, where applicable, the punch card file represent the supporting detail for the general ledger dollar amounts and the stock record collateral loan security positions.

When collateral loan securities are recalled from the bank or when additional securities are forwarded to the bank, either in substitution for securities recalled or as additional collateral, entries are prepared by the cashier's department and forwarded to the bookkeeping or data processing department for entry in the stock record.

In some systems, particularly electronic data processing systems, separate accounts are maintained in the general ledger for each loan with separate positions being maintained in the stock record for the securities collateral to each loan. In other systems, usually manual systems, the stock record may contain only one collateral loan position for each security instead of a separate position for each loan.

Transfer Records. The margin department of a brokerage concern usually prepares and forwards to the transfer department written security transfer instructions on a multipart form which includes the following information:

1. Name in which the new certificates are to be registered and the customer's mailing address for securities to be registered in a customer's name.
2. Customer's name and/or account number.
3. Number of shares or principal amount and description of the securities, and
4. Instructions indicating whether the new certificates are to be sent to the customer or held by the broker for the customer's account.

Generally, the instructions are separated between those covering securities to be transferred into the brokerage concern's name or that of its nominee and those to be transferred into the customer's name. In addition, instructions for securities sent out of town for transfer sometimes are filed separately.

The transfer clerk records on the instruction ticket the date the security was received in the transfer department and the certificate numbers of the securities to be submitted to the transfer agent for transfer. Also, the transfer department may record on the instruction form, or on a separate information slip, the name and address of the transfer agent to whom the securities are sent.

A copy of the instruction ticket is sent to the stock record department or, where applicable, to the data processing department for recording the security as in transfer on the stock record.

The transfer department usually keeps one copy of its instruction form in an open transfer ticket file which constitutes the supporting detail for the stock record transfer position. At least one additional copy of the instruction form is sent to the transfer agent with the securities to be transferred. In exchange centers such as New York, the brokerage concern usually prepares so-called "broker originated window tickets" for securities going into transfer. These tickets are numbered and are generally in triplicate. Two copies accompany the security going to transfer and the other is retained by the brokerage concern. The agent returns one with the security and retains the other for reference purposes. The use of these tickets facilitates the proper identification of transfer items received from the transfer agents and permits the brokerage concern to question the transfer agent regarding specific items.

Under manual accounting systems, the security received from transfer is matched against the applicable open transfer instruction and a copy of the instruction sent to the stock record department to be used as the basis for removing the open transfer position from the stock record.

In data processing systems multipart transfer instruction forms which set forth all information required by the transfer department and the transfer agent are sometimes prepared. At the same time, punch cards may be produced for each security going into transfer. Such cards are maintained in the transfer department as an open card file in security and date order. As securities are received from transfer agents, they are matched against the applicable punch cards on file and the cards used as out-of-transfer entries to be sent to the data processing department for removal of the open transfer positions from the brokerage concern's stock record. At any time the remaining cards in the transfer department should represent the detail in support of the transfer positions in the stock record.

Active Securities Records. Active securities are those that are used by the brokerage concern in carrying out its daily business. These include customers' securities not paid for, securities purchased by customers on margin which collateralize funds advanced against the purchase price, securities owned by the brokerage concern, and other proprietary securities.

In some brokerage concerns the cage personnel prepare records showing the daily movements in and out of the active box. Forms used for recording daily activity are normally referred to as "in-box" sheets and "out-box" sheets. At the end of each day, copies of these sheets are sent to the stock record department or to the data processing department (where applicable) in order that entries can be made reflecting the security movement in the brokerage concern's records.

Some brokerage concerns, however, use copies of the receipt and delivery tickets, in lieu of the "in-box" and "out-box" sheets referred to above, as instructions to notify the stock record department of the security movement.

Safekeeping and Segregation Securities Records. Safekeeping securities are customers' securities which are fully paid for and held in custody by the firm for the accounts of customers. Safekeeping securities are usually registered in the name of the customer.

Segregation securities are securities registered in the name of the brokerage concern and which are set aside for customers who have fully paid for such securities, or which represent securities of margin customers in excess of those required as margin. Segregated securities may be specifically identified as to customers but in most cases they are segregated in bulk on a fungible basis.

Normally, securities are placed into or removed from safekeeping and segregation on the basis of instructions prepared by the margin department. The margin department records on an instruction ticket the customer's name, the quantity and description of the security, the date of the preparation of the instructions and, if applicable, the customer's account number. A multipart form may be used as the instruction ticket with one copy being retained by the margin department and a copy being sent to the cashier's department. Additional copies may be provided for other uses depending upon the system in use. For example, a copy may be forwarded to the stock record department or to the data processing department to record the security movement when changes take place in safekeeping or segregation securities.

Under a non-bulk (specifically identified) segregation system, the margin department instruction ticket is usually maintained in an open or pending file in the cage awaiting the receipt of the security in proper form for placing in the vault. When the securities are received and placed in the vault, the pending segregation instruction ticket is pulled from the open file and the certificate numbers and the date the securities were actually placed in the vault are recorded on the instruction ticket. Securities pending safekeeping or segregation (securities for which the margin department has issued instructions that such securities are to be placed in safekeeping or segregation) are securities which may currently be fail to receive items, transfer items, or items located elsewhere, such as in the active box, out on loan to another broker, or collateral for bank loans.

In some EDP systems, the data processing department prepares punch cards as instructions to the cashier's department on the basis of the "into-segregation" or "into-safekeeping" instructions prepared by the margin department. The cards are reproduced; one set of the cards is sent to, and retained by, the margin department for use as release instructions and the other set is sent to and used by the cage as the instruction to "lock up" the security. A copy of the original instruction is filed by the margin department and an additional copy may be sent to the cashier's department, with the punch card instructions, to be attached to the securities as the customer identification for safekeeping and non-bulk (specifically identified) segregation.

In manually operated systems of bulk segregation, the ownership of the segregated securities is usually shown by copies of the into-segregation instructions which are filed in security order sequence, by customer. A separate record is sometimes maintained for each security showing the total number of shares or principal amount of bonds in bulk segregation which should agree with the total quantities shown on the copies of the into-segregation instructions and the segregation position in the stock record. Under EDP systems the ownership of bulk segregation is usually indicated by means of additional columns in the stock record. (See example of an EDP produced stock record elsewhere in this guide.)

Another method of bulk segregation is sometimes utilized by brokerage concerns operating EDP equipment. Under this method, instructions for the segregation or the release of segregation securities are likewise issued by the margin department. These instructions are processed into the brokerage concern's stock record and a comparison of customer segregation requirements is made with the quantity of specific securities presently in segregation. This comparison generates a report to the cashier's department indicating, by issue, the number of shares pending (which must be placed in segregation by the cashier) and the number of shares in excess of requirement (which may be removed from segregation by the cashier). The cashier's department then concentrates on accomplishing the instructions generated by this comparison which is usually produced on a daily basis by the EDP department. Since this bulk system does not relate certificates to specific customers, it is not feasible to determine in the case of a pending segregation condition the particular customer for whom segregation has not been accomplished.

Security Difference Records. Securities differences may result from a number of factors, including inaccurate record keeping on the part of a brokerage concern and errors in receipt and delivery of securities. Such differences are generally disclosed through periodic counts of securities on hand and examination or confirmation of items such as transfers, fails, etc.

When a security difference is discovered, it should be recorded in a security difference account, pending research as to the cause of the difference. When the difference is resolved, entries are made clearing the difference position from the stock record. If the difference is not resolved after appropriate research, the brokerage concern may, subject to any legal requirements, buy in the shortages and sell the overages.

Rule 17a-13 under the Securities Exchange Act of 1934 (effective January 1, 1972) requires, among other things, that brokerage concerns subject to the rule shall, at least once in each calendar quarter (other than the calendar quarter during which the date of its annual report of financial condition pursuant to Rule 17a-5 falls),

1. physically examine and count all securities held;
2. account for all securities subject to its control and direction, but not in its possession, by examination and comparison of

the supporting detail records with the appropriate ledger accounts;

3. verify all items described in (2) above which have been in said status for longer than 30 days;
4. compare the results of the count and verification with its records; and
5. within seven business days after each required quarterly security examination, count and verification, record in a security difference account all unresolved differences setting forth the security involved and the date of comparison.

Related reporting requirements of Form X-17A-5 provide that the valuations of security differences bought and sold since the previous X-17A-5 filing are to be stated in a footnote; therefore, appropriate accounting records must be maintained to provide such information.

Cash Receipts and Disbursements Records. Checks or cash are received from customers, brokers and banks through the "window" by messengers or by mail. In some brokerage concerns, cash receipts are entered by hand on the daily cash blotter. In others, a cash receipts journal is prepared on a bookkeeping machine. In still other concerns, a receipt form is typed, and, as part of the output, a paper punch tape is prepared which is later used to produce, among other things, a daily cash receipts blotter.

Disbursements are made almost exclusively by check or draft. Checks to customers are prepared on the basis of check requests received from the margin department. The cash disbursements journal, or blotter on which the transactions have been entered, is sent to the data processing, bookkeeping, or controller's department for entry.

Receipts and disbursements for the day are totaled on the journals or blotters and the closing balance for each bank account is determined. A summary of the postings is prepared showing the distribution to the control accounts in the general ledger. The summary is agreed with the totals of the various source documents and related items in the summaries prepared by the receive and deliver departments. In addition to the settlement and cash journal summaries, some brokerage concerns prepare an overall summary of cash transactions processed by the cashier's department. Generally, this cash summary sheet contains numerous descriptive categories and columns to which the cash movements (totals) and settlement values of all security movements are posted. Entries are compiled by summarizing appropriate working documents, i.e., blotters, journals, drafts, and various miscellaneous receive and deliver and receipt and disbursement forms. The totals of all cash debits and credits on this cash balancing sheet must equal in order to balance.

Central Certificate Service (CCS) Records. The Central Certificate Service is a custodian operation of the Stock Clearing Corporation, a subsidiary of the New York Stock Exchange, Inc., whose facilities are available to member organizations. It provides for physical custody of certain securities and settlement of security transactions without the physical movement of securities. Securities on deposit at CCS may be pledged to banks as loan collateral without the physical transfer of certificates.

CCS prepares daily reports for member organizations showing activity by security and the balance on deposit. Monthly, a statement is sent to each member showing the entire CCS security positions of such member. In connection with security movements at CCS, member organizations use specific forms to make deposits or authorize withdrawals. If regular security settlements are made through CCS, a settlement sheet is provided each member.

It is the responsibility of the brokerage concern to disclose on its records whether the securities held at CCS are available for use as collateral or should be held in segregation. The disclosure of the status of CCS-held securities may be indicated on the records of the brokerage concern in the detail information shown on a computer-maintained stock record or in separate records kept to support the total stock record position shown for CCS.

Margin Department Records. The margin department usually has the overall responsibility for the proper maintenance of customer accounts and control of the extension of credit. Although the form of their records will vary depending upon whether the accounts are maintained manually or on mechanized accounting systems, the information contained in margin department records is generally the same. At all times the margin department records should indicate the complete status of the customer's account on a trade date basis. The margin department's records are posted from copies of transaction tickets received from the purchase and sale, cashier, dividend and accounting departments.

The margin card, or supplementary records in the margin department, will ordinarily indicate as to each margin customer the market value of the securities, the money balance of the account, excess or deficient margin, transfer, safekeeping and segregation instructions, and the special miscellaneous account balance of the customer calculated in accordance with Regulation T.

Since the margin department's main function is checking the credit status of customers, it is responsible for initiating margin calls, maintenance margin calls, extensions of time for cash account customers to pay for securities purchased, and instructions for placing securities into or taking them out of safekeeping or segregation. Copies of documents relating to these transactions are maintained in the margin department.

Other records and information which may be maintained by the margin department are standing customer instructions regarding the delivery of securities, the disposition of cash from the sale of securities or the receipt of dividends and interest, and guarantees of customers' accounts.

Dividend Department Records. The dividend department has the responsibility for records relating to all types of distributions made on securities including cash dividends, stock dividends, rights, splits, etc. It may also handle proxy material for customers.

Listings are supplied to the dividend department showing registered holder and location of each security on the dividend record date. The record will indicate how the securities are registered, i.e., in the name of the brokerage concern, its customers, or in the name of another brokerage concern or individual from whom claim for the dividend must be made. In order to reduce the number of dividend claims, it is normal procedure for the dividend department to notify the cashier's department on a daily basis as to securities approaching dividend record dates a few days hence. The cashier's department of the brokerage concern will then check for securities on hand that are registered in a name other than its own and will attempt to deliver such securities to the transfer agent so that the registration may be transferred to its own name as of the record date. Frequently, brokerage concerns with EDP systems use magnetic tapes or punch cards provided by dividend reporting services to disseminate record date information.

For each dividend distribution, the dividend department prepares a memo proof to ascertain the total receipts and disbursements which it will process for that distribution.

Prior to payable date, the dividend department instructs the accounting department or the data processing department as to who should be credited or charged for the dividend on the payable date. The offsetting entry is made to a dividend receivable or payable account. When the money or stock certificates are received or paid, the dividend accounts are offset. Differences between the amount received and the amount receivable represent items which must be investigated by the dividend department. Dividends received by a brokerage concern for securities registered in a customer's name at the brokerage concern's address are generally credited directly to the customer's account upon receipt.

The dividend department also maintains a record of securities which the firm is failing to receive or deliver on the dividend record date. Securities received or delivered against "fails" which were open on the ex-dividend date should be accompanied by due bills. It is usually the responsibility of the dividend department to effect collection or authorize payments for transactions of this nature. Brokerage concerns should maintain dividend records for each security by individual declaration date and not combine all dividends received for each security over a period of time. For example, Company X declares a dividend on its stock to holders of record January 2 and later declares another dividend to holders of record on April 1. The brokerage concern might have a receivable of $5,000 for the January 2 dividend, but received $5,500. This would normally indicate that the brokerage concern was failing to deliver and owes brokers $500. For the April 1 dividend the brokerage concern might have had a receivable of $6,000, but received only $5,200. The dividend department would have to determine which brokers owed them $800 on securities which the brokerage concern was failing to receive and seek collection. The dividend record would show a payable of $500 for the January 2 item and a receivable of $800 for the April 1 dividend.

Dividends which are not paid or credited on the payable date are considered to be unclaimed dividends and are normally paid only upon receipt of valid claims. Balances remaining in dividends payable may be subject to abandoned property laws.

Customers' Securities Account Records. A separate account must be maintained for each customer and a statement of the account should be sent to the customer, at least quarterly, as required by the regulatory bodies. Transactions in the account cover both money and securities, with the security transaction generally recorded on the settlement date. The account should itemize all purchases, sales, receipts and deliveries of securities and all other debits and credits, including dividends and interest received or charged, investment counseling fees, etc. The accounts are generally maintained so that money and security balances are clearly indicated.

A customer may have many different accounts. Those most commonly encountered are as follows:

1. *Cash account.* The special cash account is used to record cash transactions expected to be cleared within the time limit prescribed by Regulation T of the Board of Governors of the Federal Reserve System. Cash account purchases are limited by Regulation T to those situations in which sufficient funds are already held in the account, or in reliance upon an agreement that the customer will promptly make full cash payment for the security, and that the customer does not contemplate selling the security prior to making such payment. Cash account sales are similarly limited to those situations in which the security is held in the account or in reliance upon an agreement that the customer owns the security and will make prompt delivery.

   As a general rule, full cash payment must be made within seven business days after the date on which the security is purchased. Thus, assuming a five-day settlement period, full cash payment must be made no later than two business days after settlement date. However, if a customer purchases a security with the understanding that the security will be promptly delivered and that the full cash payment will be made promptly against such delivery, the time period for making payment is not to exceed thirty-five calendar days. Failure to make timely payment would ordinarily require the prompt cancellation or liquidation of the transaction. In exceptional cases, the seven-day and thirty-five day periods may be extended for one or more limited periods upon application to a committee of a national securities exchange or to the National Association of Securities Dealers, Inc.

It is important to note that certain of the regulatory agencies restrict the acceptance of sales orders, other than short sales, unless there is a reasonable prospect of making prompt delivery (not defined in Regulation T) of securities against the sale. It is presumed that a brokerage concern will cancel or liquidate the transaction in the event that the customer fails to make the securities available within a reasonable period of time.

2. *Margin account.* The margin account is used to record transactions which result in a borrowing by the customer from the brokerage concern. Thus, for a purchase transaction the brokerage concern is expected to extend credit. The amount of credit extended on a purchase transaction is subject to the limits prescribed by Regulation T of the Board of Governors of the Federal Reserve System. This regulation establishes the maximum loan value of the securities in the account and requires the brokerage concern to obtain, as promptly as possible, and in any event, before the expiration of five full business days following the date of the transaction, a deposit into the account of cash or securities necessary to eliminate any deficiency. Assuming a five-day settlement period, the deposit would thus be required no later than the settlement date. In exceptional cases, the five-day period may be extended for one or more limited periods upon application to a committee of a national securities exchange or to the National Association of Securities Dealers, Inc. Maximum loan values for securities are prescribed from time to time by means of a supplement to Regulation T. In addition, certain securities exchanges have rules establishing minimum maintenance margin requirements. A brokerage concern may establish initial or maintenance margin requirements which are greater than those required by the rules and regulations of the regulatory bodies.

3. *Income account.* The income account is sometimes utilized to accumulate the interest and dividends received on securities maintained in other accounts.

4. *Short sale account.* The "short" sale account is used to record

transactions in securities sold "short." Such transactions are also governed by the margin requirements of Regulation T of the Board of Governors of the Federal Reserve System. On a short sale transaction, the brokerage concern is expected to lend or arrange for the lending of the security to the customer for the purpose of effecting delivery.

5. *Other accounts.* Other special accounts are provided for (a) the purchase of securities through the exercise of a right evidenced by a warrant, (b) bond transactions in exempted and registered nonequity securities purchased on margin, and (c) transactions in convertible debt securities purchased on margin which are convertible into margin stock or carrying a right to subscribe to or purchase such stock. Regulation T prescribes different loan values and the length of time on which credit can be extended in these accounts.

Commodity Department Records. A description of certain of the books and records maintained by brokerage concerns dealing in commodities is set forth below:

1. *Commodity contract book.* At the time a customer enters into a futures commodity contract, which is an agreement to buy or sell at some future date, no entries are made in the brokerage concern's general ledger accounts other than to record the amount of any margin deposit made by the customer. Nevertheless, a record in the form of a contract book is maintained by commodity and by maturity date. When an offsetting purchase or sale contract is made, the open trade in the contract book is so noted and an account purchase-and-sales form is prepared and sent to the customer.

   In manual systems, there is usually a separate page in the contract book for each delivery month and space to note the completion of the transaction. In mechanized systems listings can be made in chronological order periodically, and posting space and order requirements are rather flexible.

2. *Commodity blotter.* This is a record in which the actual purchase or sale at the completion of what is called a "round turn," i.e., a purchase or sale offsetting an existing open contract, is entered. In addition to entering a description of the transaction, the amount of the resulting gain or loss to the customer is also recorded.

3. *Open contract position record.* This record is maintained separately on the basis of up-to-date information concerning the positions in each commodity carried for a brokerage concern's customers or for its own account. It shows an up-to-date balancing of futures contracts by customers offset by the net position with the carrying broker or with the clearing association.
4. *Customers' commodity ledger.* This ledger is used to record commodity transactions for each customer and carrying broker. Completed transactions are posted daily, both as to money and contracts, from the regular blotter record of cash receipts and disbursements and from the commodity blotter as to gains and losses and commissions.

Interest Records. Brokerage concerns charge their margin customers with interest on unpaid balances and some brokerage concerns pay customers interest on credit balances under certain conditions. In a manual operation, an interest sheet is prepared periodically for each customer's margin or short sale account resulting in a net debit balance during the period. The interest sheet becomes the basis for computing the amounts to be taken into interest income and interest expense, if any, of the brokerage concern by charges or credits to its customers' accounts.

In an automated operation the computation of interest is usually made by utilizing data processing equipment specifically programmed to perform the computations.

Trading and Investment Account Records. Securities are often purchased and sold for the account of the brokerage concern. Trading securities are considered as inventory or stock-in-trade, whereas investment securities are purchased or sold with the expectation of capital gain. To qualify for capital gain treatment under the present Internal Revenue Code, the brokerage concern's records must clearly indicate, before the expiration of the 30th day after purchase, that the security is held for investment and not for trading purposes.

Brokerage concerns may purchase securities for investment which are not readily marketable or which are restricted as to sale by the purchase terms. These securities should be recorded separately in the accounts of a brokerage concern and clearly designated.

The trading department maintains separate records on a trade date basis. It is extremely important that the brokerage concern reconcile these records periodically with the accounting department records and the stock record.

Underwriting Department Records. A brokerage concern which participates in underwriting activities will normally function as either the managing underwriter or a participating underwriter. A managing underwriter, in addition to being a participating underwriter, usually negotiates the transaction with the issuer of the security and maintains the records of the underwriting group.

The managing underwriter maintains daily position listings of the entire issue and ascertains the status of securities subscribed to and whether they have been delivered to the participating underwriters. Expenses associated with each underwriting are accumulated in the general ledger in separate accounts. When the underwriting is completed, the profit or loss on the particular underwriting is determined and distribution made to the participating underwriters.

The participating underwriters will maintain records of each underwriting participation but are concerned only with their portion of the total underwriting.

Other Records. The brokerage concern is also required to make a record of each brokerage order, each purchase and sale of securities, each cash and margin account, and proofs of ledger accounts in the form of trial balances, as well as certain other records as set forth in Rule 17a-3 of the Securities Exchange Act.

General Ledger. The general ledger of a brokerage concern is not significantly different, as to form and principal purpose, from the general ledger of any other business concern. For purposes of illustration, the following is a listing of the accounts which may appear in the general ledger. All of the account titles may not appear in the general ledger of every brokerage concern and the general ledger of others may include accounts not shown in the list. Certain accounts listed as assets may, on occasion, be liability accounts or vice versa, i.e., customers' accounts or accounts carried by other brokerage concerns may contain either debit or credit balances at any given time.

Assets

Cash in banks—general funds
Petty cash
Cash in transit
Cash in bank—segregated pursuant to Commodity Exchange Act requirements
Cash in bank—segregated for exclusive benefit of customers
Commodity margins:
- Regulated commodities
- Non-regulated commodities

Guaranty funds, deposits and contributions to clearing associations
Deposits with clearing associations—account of intermediate clearances
Good faith deposits
Settlement balances receivable:
- Commodities:
  - Regulated commodities
  - Non-regulated commodities
- Security clearing associations

Failed to deliver
Securities borrowed
Accounts receivable—securities shipped draft attached
Accounts receivable—securities shipped free
Customers' accounts:
- Securities
- Regulated commodities
- Non-regulated commodities
- Spot commodities

Partners' and/or officers' and directors' accounts:
- Securities
- Regulated commodities
- Non-regulated commodities
- Spot commodities
- Personal and/or drawing accounts

Joint trading accounts
Margin deposits with others—joint trading accounts
Firm accounts:
- Investment securities
- Trading securities

Trading commodities futures
Trading spot commodities
Underwriting—syndicate accounts:
Managers' accounts
Managed by other brokerage concerns
Clearing association stock
Commissions receivable
Commodity difference accounts
Coupons receivable
Dividends receivable
Accrued interest receivable
Floor brokerage receivable
Capital demand notes
Cash value of life insurance policies
Advances to employees
Miscellaneous accounts receivable
Tax stamp accounts
Prepaid expenses
Exchange memberships
Furniture and equipment
Allowance for depreciation of furniture and equipment
Leasehold improvements
Allowance for amortization of leasehold improvements
Investments and advances—subsidiary companies

Liabilities

Money borrowed from banks:
Secured by customers' collateral
Secured by collateral belonging to firm and/or partners
Accounts carried by other brokerage concerns (correspondent brokers):
Securities:
Customers' transactions
Transactions of firm and/or partners
Regulated commodities:
Customers' transactions
Transactions of firm and/or partners
Non-regulated commodities:
Customers' transactions
Transactions of firm and/or partners
Failed to receive

Securities loaned
Unclaimed coupons
Unclaimed dividends
Underwriting–syndicate accounts payable
Commissions payable
Floor brokerage payable
Margin deposits by others–joint trading accounts
Good faith deposits by others–syndicates
Taxes withheld on dividends
Social security taxes withheld
Federal, state and/or city income taxes withheld
Federal income taxes payable (corporation)
State and local income and franchise taxes payable
Accrued commissions
Accrued payroll
Accrued property taxes
Miscellaneous accrued expenses
Subordinated borrowings:
  Cash
  Securities

Capital

Capital accounts:
  Partnership or proprietorship:
    Cash
    Securities
  Corporations:
    Capital stock:
      Common
      Preferred
    Capital in excess of par value of capital stock (capital surplus)
    Retained earnings
Undistributed profit and loss

Income

Exchange commissions earned:
  Securities
  Commodities
Over-the-counter commissions earned
Floor brokerage received
Clearance fees received

- Trading profits
- Underwriting and selling group profits
- Investment profits
- Income from mutual funds
- Interest received:
  - Customers' accounts
  - Trading and investment accounts:
    - Exempted
    - Non-exempted
- Dividends received:
  - Trading accounts
  - Investment accounts
- Investment advisory fees
- Proxy solicitation fees
- Miscellaneous fees
- Service charges
- Postage and registered mail charged to customers
- Miscellaneous

Expense

- Advertising
- Amortization of leasehold improvements
- Bad debts
- Charitable contributions
- Clearance fees paid
- Commissions paid to other brokerage concerns
- Commissions paid to registered representatives
- Commission fees paid to exchanges
- Dues
- Entertainment
- Errors
- Exchange dues and assessments
- Floor brokerage paid
- Group insurance
- Insurance—general
- Interest paid:
  - Bank loans:
    - Customers' collateral
    - Firm collateral:
      - Exempted
      - Non-exempted

Omnibus accounts carried by other brokers (correspondents)
Partners' capital
Subordinated loans
Leased wires
Licenses and taxes
Life insurance premiums–officers' (or partners')
Payroll:
Office salaries
Officers' (or partners') salaries
Payroll taxes
Postage and registered mail insurance
Professional fees
Profit sharing and retirement
Provision for depreciation
Quotation boards
Rent of premises
Rent of equipment
Repairs and maintenance
Stationery and supplies
Statistical and research
Subscriptions to periodicals
Telephone and telegraph
Tickers and projectors
Travel
Underwriting–syndicate expense
Miscellaneous

Section 2

Financial Statements and Reports

Report of Financial Condition—(Questionnaire)

A report of financial condition, referred to as a questionnaire, containing information requested in Form X-17A-5, Parts I and II, is required to be filed with the Securities and Exchange Commission by each brokerage concern described in the following sentence, as of a date during each calendar year. The report must be filed by every member of a national securities exchange who transacts a business in securities directly with or for other than members of a national securities exchange, by every broker or dealer (other than a member) who transacts a business in securities through a medium of any member of a national securities exchange, and by every broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934. The report is due to be filed within 60 days (effective December 31, 1972, pursuant to Release No. 9658 of the Securities and Exchange Commission) after the date of the report of financial condition and the reports for two consecutive years shall not be as of dates within four months of each other.

Reports on financial condition required of members of national securities exchanges and other regulatory bodies generally conform in all material respects with Form X-17A-5 and may be filed with the Securities and Exchange Commission in lieu of Form X-17A-5 provided they meet the requirements of its Rule 17a-5.

Questionnaire answers are to be submitted on an unconsolidated basis in order to present proper information for the computation of net capital.

Since the information presented in the answer to Part I must be sufficient to permit determination of the financial condition of the respondent, all footnotes, valuations, and classification of data deemed necessary to a fair presentation of financial condition must be included. Footnotes and classification of data in Part II must also be included in Part I if their inclusion is deemed necessary to a fair presentation of financial condition. This must be done whether or not the respondent elects to have the information in Part II accorded confidential treatment by having such Part II bound separately as provided in Section (b) (3) of Rule 17a-5 of the Securities and Exchange Commission.

Part I—(Financial Questionnaire)

The response (Answers) to Financial Questionnaire is prepared in columnar form as required by the general instructions. Replies to Questions 14, 15, and 16 are not included in the totals. The questions should be numbered as set forth in the form except that no caption need be shown for items and conditions which are not present. If no answer is made to a question or subdivision thereof, it shall constitute a representation that the respondent has nothing to report. See Exhibit B of this guide for an example of Answers to Financial Questionnaire and Exhibit A for examples of the independent public accountant's report which is to be submitted therewith.

Submitted below are comments relative to the various questions comprising Part I.

1. *Bank Balances and Other Deposits.* Each kind of deposit (cash and/or market value of securities) is to be separately stated under this question with adequate description. Included are cash on hand; cash in banks representing general funds subject to immediate withdrawal; cash in banks subject to withdrawal restrictions; funds segregated pursuant to regulations of any agency of the federal government, any state, any national securities exchange or national securities association; contributions to clearing organizations incident to membership; deposits with clearing organizations in connection with commitments; guaranty and margin deposits; good faith deposits; drafts with securities attached deposited for collection.

Deposits not connected with security or commodity transactions, such as airline, lease, and utility deposits, are reported in Question 13, "Other Accounts."

If cash in banks contains uncollected funds resulting from immediate credit received for drafts deposited for collection with securities attached, the amount should be disclosed as a contingent liability under Question 16 with a notation as to collections subsequent to the audit date.

Bank overdrafts should not be offset against bank balances in other banks or restricted deposits in the same bank but should be reported under Question 13 since the credit balances in these accounts are considered a part of "aggregate indebtedness" for purposes of computing capital requirements.

Good faith deposits are sometimes outstanding after the related syndicate or underwriting account has been closed. Since good faith deposits are required to be identified with commitments shown in Question 14, those relating to closed accounts should be stated separately.

2. *Money Borrowed, and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured by or Containing Customers' Collateral.* The amount of money borrowed is reported as a ledger credit balance. The market value of the securities and warehouse receipts (supporting "spot" commodities) pledged as collateral will appear in the "short" valuation column.

Accounts carried by other banking or brokerage houses may contain either debit or credit ledger balances and either or both long and short security valuations.

Accounts carried by a regional clearing house under continuous net settlement arrangements may contain either net debit or net credit ledger balances and long or short security positions. The amounts may be reported under a separate subcaption in either Question 2, 3 or 4 as "Settlement Balances with Clearing Organizations."

3. *Money Borrowed, and Accounts Carried for Respondent by Other Banking and Brokerage Houses, Unsecured, or Secured Entirely by Collateral Owned by Respondent and Its Partners or Officers and Directors or by Securities Covered by "Satisfactory Subordination Agreements."* The amount of money borrowed is reported as a ledger credit balance. The market value

of the securities and warehouse receipts (supporting "spot" commodities) pledged as collateral will appear in the short valuation column.

Accounts carried by other banking or brokerage houses may contain either debit or credit ledger balances and either or both long and short security valuations.

Separation of borrowings secured by customers' collateral (Question 2) and by respondent's collateral (Question 3) is necessary since borrowings in the latter category are not considered "aggregate indebtedness" in computing capital requirements. However, unsecured borrowings, borrowings secured in whole or in part by non-exempted collateral owned by officers or directors (Question 8) and borrowings not adequately collateralized are considered part of "aggregate indebtedness."

Note particularly the word "entirely" in the Question 3 caption. If any portion of the collateral in a borrowing reported under this question is owned by customers, the whole borrowing will be classified as a Question 2 borrowing and, unless the borrowing is collateralized entirely by exempted securities, will constitute a part of "aggregate indebtedness." Reference is made to Rule 15c2-1 of the Securities Exchange Act of 1934 relating to hypothecation and commingling of customers' securities.

It should be noted that for purposes of the financial questionnaire, securities sold by the respondent as principal under a repurchase agreement are deemed to be securities owned by the respondent and are required to be reported separately and clearly under Question 10. In such instances the offsetting credit and short valuation are reportable separately in response to Question 3.

4. *Other Open Items With Brokers and Dealers.*

   a. *Securities borrowed*—The ledger debit balance represents the amount advanced to lending brokers or dealers as collateral for the borrowed securities (market value of security at time of transaction plus or minus subsequent marks-to-market) and thus the amount to be received when the borrowed security is returned. The related long value represents the current market value of the securities borrowed.

b. *Securities failed to deliver*—The ledger debit balance represents amounts receivable from buying brokers or dealers covering the purchase price of securities sold but not yet delivered. The related long value represents the market value of the securities which the brokerage concern is obliged to deliver.

Data concerning age of fail to deliver transactions must be disclosed in accordance with applicable rules.

c. *Securities loaned*—The ledger credit balance represents the cash collateral advanced by the borrowing brokers or dealers (market value of securities at time of transaction plus or minus subsequent marks-to-market) and thus the amount to be repaid upon return of the securities loaned. The related short value represents the current market value of the securities loaned to the borrowing broker.

Loaning securities to other brokers or dealers provides, in most instances, an interest-free loan.

Customers' securities may not be used for lending purposes unless specific written consent is obtained from the customer. The consent to lend securities held for margin is generally included in margin account agreements; however, in order to lend excess margin or fully-paid-for securities a specific written agreement designating the particular securities to be loaned must be obtained.

d. *Securities failed to receive*—The ledger credit balance represents the amount payable to selling brokers or dealers for securities purchased by the brokerage concern but which have not yet been received. The related short value represents the current market value of the securities which the selling broker or dealer is obliged to deliver. The form requires failed to receive items for proprietary accounts to be shown as either sold or unsold at the date of the report to obtain proper treatment under capital Rule 15c3-1.

Failed to receive items classified as unsold in proprietary accounts of the respondent are excluded from "aggregate indebtedness."

Data concerning age of fail to receive transactions must be disclosed in accordance with the applicable rules.

5. *Valuation of Securities and Spot (Cash) Commodities in Box, Transfer and Transit.* The valuation of fully-paid-for securities in safekeeping and segregation or in transfer (specifically identified to customers) may be, and usually are, omitted in the Answers to Financial Questionnaire. The valuations included in the answer to this question relate to negotiable securities in the box or which will find their way into the box when received from transfer or transit and to securities not segregated which are held by Central Certificate Service or other depositories.

   In-transit items are those which have been shipped from or to the respondent's offices and which have not yet reached their destination.

6. *Customers' Security Accounts.* After equity statements have been prepared, as described elsewhere in this guide, the accounts of customers are summarized into the various classifications set forth in this question.

   For the purpose of classification under Question 6, all accounts of any one customer (other than regulated commodity accounts) may be combined and reported under any appropriate section other than Section A. Customers' accounts related by bona fide written guarantees may also be combined.

   Accounts reportable in Section A are "bona fide cash accounts," defined in Form X-17A-5 as accounts having both unsettled money balances and positions in securities which are current items within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System. The form also provides that cash accounts which are not "bona fide cash accounts" shall be reported under Sections B, C or D, as appropriate.

   Present practices of the brokerage industry provide for the maintenance of customers' accounts on the "net balance forward" basis which does not provide details of the individual open items comprising such balance in a form through which all transactions can be readily aged and summarized at a given point in time for classification purposes. Accordingly, it may be time-consuming and costly for the brokerage concern to comply with this classification requirement and extremely difficult for the independent accountant to ascertain that "all" transactions included in accounts which are classified as "bona fide" cash accounts are current.

Secured accounts reportable under Section B are accounts which liquidate to an equity and are for the most part margin accounts. To qualify as a secured account, one of the following conditions must exist:

a. The valuation of securities "long" in the account must be equal to or greater than the debit balance.
b. The valuation of securities "short" in the account must be equal to or less than the credit balance.
c. If the account contains both "long" and "short" securities:
    1. The valuation of the long securities must be equal to or greater than the debit balance plus the valuation of the short securities.
    2. The valuation of the long securities plus the credit balance must be equal to or greater than the valuation of the short securities.

In determining whether an account is secured, consideration may be given, if necessary, to the valuation of securities in segregation, if any, for the account of the specific customer provided such securities are in negotiable form.

Partly secured accounts reportable under Section C are accounts, other than those reportable under Section A, which liquidate to a deficit; i.e., opposite the conditions of equity set forth above for secured accounts.

Unsecured accounts reportable under Section D are accounts having only debit balances and/or short security positions.

Accounts with credit balances which contain open contractual commitments are reportable under Section E. The credit balance may or may not constitute a specific deposit against the commitment or commitments.

Free credit balance accounts reportable under Section F are accounts subject to payment on demand. If such accounts contain "long" securities which are not segregated, the valuation of such securities are to be reported in Section G.

Fully paid securities not segregated which are reportable under Section G include, in addition to those in accounts with free credit balances as indicated above, long securities positions in accounts with no debit balance, no short securities positions and no open contractual commitments. The valuation reported in this section may also include securities for which instructions to segregate have been issued but which have not been accomplished as of the financial questionnaire date. This portion of such valuation may be separately disclosed.

Upon review of the Answers to Financial Questionnaires, exchange member organizations are often asked to explain the reason for unsegregated securities and to indicate the location of such securities in the Answers to Financial Questionnaire. It should be noted that it is not possible to specifically identify the location of the unsegregated securities unless the brokerage concern's record keeping procedures provide for such identification, a condition rarely encountered. Under these conditions, and because there are no established rules in this area, location allocation is arbitrary, and it is suggested that such information not be included in the questionnaire answers. If this information is requested by a regulatory agency of a respondent, consideration should be given to providing such information in a letter to the respondent, clearly describing the location priority used (to be furnished by respondent), the arbitrary nature of such location priority, and the limited reliance that should be placed thereon.

Significant changes may be made in the reporting requirements relating to fully paid securities not segregated as a result of the adoption of Rule 15c3-3 announced on November 10, 1972 which became effective January 15, 1973.

Joint accounts which are carried by the respondent and in which the respondent has an interest, including deposits received by the respondent from other members of the joint account, are reportable under this question. Attention is directed to note 3 of this question, as to the proper method of reporting such accounts.

Attention is also directed to notes 4 and 5 of this question regarding open contractual commitments carried for accounts reportable under Section B, C, D, and E. This information is necessary for the purpose of determining net capital under the capital requirement rules.

7. *Customers' Commodity Accounts.* Customers' commodities accounts are classified either as regulated commodities accounts (regulated under the Commodity Exchange Act) or non-regulated commodities accounts. Valuations of "spot" (cash) commodities are entered in the long and short valuation columns as the case may be, whereas gains and losses on future commodity contracts are entered in the gain and loss columns. Valuations of future commodity contracts are not entered in Part I of the financial questionnaire.

   Separation of regulated and non-regulated accounts is important as liabilities arising from regulated accounts for which funds have been properly segregated are excluded from "aggregate indebtedness" in computing capital requirements. The independent public accountant should, therefore, establish that the aggregate of the segregated amounts consisting of cash or qualified securities deposited in segregated bank accounts or with clearing organizations, and equities with other brokers who carry customer trades on an omnibus basis (see Question 2B), are sufficient to cover the equities in regulated commodity accounts. Equities (liabilities) or deficits (receivables) in commodity accounts are determined by applying the unrealized gains or losses on open contracts to the ledger balances in each account.

8. *Accounts of Officers and Directors.* Accounts of officers and directors are classified in the same manner as customers' accounts. The account of an officer who is also a director should be classified as that of an officer.

9. *General Partners' Individual Accounts.* Accounts of general partners are on occasion covered by agreements which provide that cash, securities, commodities or equities recorded in the accounts are to be included as partnership property and may be included as capital under the capital rules provided that such agreements are acceptable to the applicable regulatory bodies. Such accounts are reported separately in an-

swer to Question 9A. The total valuations of "exempted securities" (securities exempted from registration under the Securities Exchange Act of 1934, otherwise than by specific action of the Securities and Exchange Commission) are to be stated separately. This information may be reported parenthetically. Non-capital accounts are classified in Question 9B in the same manner as customers' accounts.

The non-capital accounts of limited or special partners are to be included with customers' accounts.

10. *Trading and Investment Accounts of Respondent.* Long and short positions are both reportable under this question. The ledger balances with respect to all security accounts and "spot" (cash) commodities may be combined. Short positions of unlike securities, however, should not be netted against long positions and the valuations of each should be shown separately.

Securities sold by the respondent as principal under a repurchase agreement are deemed to be securities owned by the respondent and are to be separately and clearly shown as such under this question with the offsetting credits and security valuations reported under Question 3A. In submitting this information the cost to repurchase should be shown as the ledger debit and the market value of the securities should be shown as the long valuation.

Long and short positions which are exchangeable within thirty days may be reported separately under this question in order to minimize the capital charge effect of the respondent's securities.

11. *Capital Accounts.* In partnerships it is not unusual for partners to contribute securities as capital. In most instances, however, it is only the use of the securities that is contributed and the partner retains the right to receive the dividends and interest, the gains and losses on sales, and the right to substitute other securities. Also, it is not unusual in such instances for the partner to set a limit on the value of the securities to be considered as capital. If the market value of the securities exceeds the limitation, this condition must be reported in the answer to this question.

As indicated in the note to this question, the valuation of "exempted securities" should be stated separately. This information may be reported parenthetically.

12. *Subordinated Accounts and Borrowings.* Any subordinated account reported under Question 12 must be subject to an agreement which complies with the requirements of Rule 15c3-1 (c)(7) under the Securities Exchange Act of 1934 or, if the respondent is a member of an exchange whose members are exempt from Rule 15c3-1 by subparagraph (b)(2) thereof, complies with the rules regarding subordination agreements of all the exchanges therein listed of which respondent is a member.

    Note 1 to this question states that the valuation of "exempted securities" shall be stated separately. As in the case of a similar requirement with respect to other questions, this information may be reported parenthetically. With respect to answers submitted by a member of the New York Stock Exchange, subordinated borrowings under agreements which have not been filed with and approved by the exchange are not reported under this question but must be reported separately in the answers to other questions.

13. *Other Accounts.* The types of accounts to be included under this caption are set forth in the printed instructions. Accounts which cannot be classified under Questions 1 through 12 are reported under this question.

    The market value of security differences, overages (long) and shortages (short) are reported in the security value columns under this question giving the details specified by the Questionnaire. Adequate provision should be made for possible losses in connection with security differences. Adequate provision should also be made for possible losses in connection with uncollected dividend and interest claims, unsecured and partly secured customer accounts, unverified transfer items, market exposure on aged fails, items in suspense accounts, aged items on bank reconciliations, and any other items the collectibility of which is in doubt.

    The commodity difference account, if any, is reported in the commodity gain or loss column, as the case may be, of this question and should result in balancing the gains or losses reported in response to the previous questions.

The note to this question requires that any liability reported under this question which is secured by collateral in any form shall be identified by reference to the related collateral.

14. *Contractual Commitments That Are Not Recorded in a Ledger Account for Money.* Contractual commitments to be reported in this question are defined in General Instruction B .11 of Form X-17A-5. The instructions do not specify the form which the answer is to take, but any presentation that clearly discloses the information requested is acceptable. A form of presentation will be found in Exhibit B of this guide.

In reporting the respondent's underwriting commitments under this question, care must be exercised in reporting the entire commitment. In some underwritings, particularly tax-exempt issues, the respondent's liability is undivided, which means that the member is responsible for his proportionate share of any unsold securities in the underwriting account regardless of the amount of the securities which he has taken down or sold. This information can be obtained from the syndicate managers. Likewise, in the case of divided accounts, the syndicate managers may reserve part of the respondent's commitments for sales to selected dealers or may enter into directed sales for the account of the respondent. In such instances, the reporting of the respondent's interest in the entire account would include these amounts. In other instances where the settlement date has been fixed and bridges the audit date, the transactions may have been entered on settlement blotters for entry after the audit date. These items are not "regular way" transactions and should also be reported as a part of the respondent's entire commitment.

In many instances, brokerage concerns which may or may not be members of underwriting groups enter into buy and sell transactions in "when issued" securities on a principal basis with other brokerage concerns which may or may not be members of the underwriting groups. Such transactions should be stated separately as "when issued" transactions and not included as purchases and sales affecting the "underwriting" commitment.

The respondent may enter into contracts to buy or sell on a "delayed delivery" basis securities which may be either short or long in the trading and investment accounts. This information should be reported as respondent's transactions under the caption delayed delivery contracts under this question and, if the offsetting position is either "long" or "short" in the trading and investment accounts, this fact should be noted in the answer to this question and in the detail supporting Question 10 in Part II of the financial questionnaire.

If the respondent is acting as syndicate manager of an underwriting group in unissued securities, only the respondent's portion of the commitment should be reported in the answer to this question.

Information reported in answer to this question may be presented in summary form or in detail. If a summary is presented, the details must be reported in Part II of the financial questionnaire.

15. *Participations of the Respondent in Joint Trading and Investment Accounts Carried by Others That Are Not Recorded in a Ledger Account for Money.* Items reportable under this question deal with joint accounts in *issued* rather than "when issued" securities.

Two or more brokerage concerns may enter into joint account arrangements whereby each member will carry specified securities for the joint account. In such instances consolidation of the information carried in the records of each member of the joint account is necessary to construct the entire account. The portion carried by the other brokerage concern is reported under this question. The portion of the joint account carried by the respondent, if any, appears under the proper classification in Questions 6 and 7 and, together with the information reported under this question, should constitute the entire account.

The answer to this question is usually in summary form with the details reported in Part II of the financial questionnaire.

16. *Unrecorded Assets, Liabilities, and Accountabilities.* The answer to this question requires the submission of a separate schedule containing a description of any assets, liabilities and accountabilities of the respondent, actual or contingent, which are not included in a ledger account or reported in answer to Questions 14 and 15. Only such items which in the aggregate are material in relation to net capital need be reported. Accountabilities shall include cash and/or other property, including securities held for customers by or on behalf of respondent, which are not included in a ledger account. Contingent liabilities may include lawsuits pending against the respondent, accommodation endorsements, rediscounted notes, guarantees of accounts of others, lease obligations, and uncollected funds included in cash in bank as a result of immediate credit given for securities shipped draft attached. The information furnished in response to this question should be sufficient to permit determination of appropriate treatment in the net capital computation.

Part II—(Supplementary Information)

Items (a), (b), and (c) of Part II of the financial questionnaire call for the details supporting various questions in Part I. Item (d) requests information with respect to amounts authorized or proposed to be distributed or withdrawn from the proprietary accounts reported in Question 11 of Part I within six months following the questionnaire date. If the amount is material, the information must also be reported in Part I, either as a separately identified amount or as a footnote. Item (e) requests information concerning liabilities of a sole proprietor which are not reflected in the answers to Part I which would materially affect net worth as reported. Here again, this information must also be set forth as a footnote to Part I.

Since the respondent may not want to divulge certain details submitted in Part II by including them with Part I (a public document which is available for inspection at the Securities and Exchange Commission and the principal office of the brokerage concern) confidential treatment will be accorded to the schedules furnished pursuant to the requirements of items (a), (b), and (c) of Part II in those instances where such data is bound separately.

Part III—(Supplementary Information Required by National Securities Exchanges for Computation of Net Capital Under Capital Requirement Rules)

Most national securities exchanges require information in addition to that provided in Parts I and II of Form X-17A-5 for use in connection with computations of net capital under capital requirement rules. The information is usually submitted as a separate section of the Answers to Financial Questionnaire. An example of the type of information required is to be found in Part III of the financial questionnaire of the New York Stock Exchange, Inc. Brokerage concerns reporting only to the Securities and Exchange Commission are not required to supply the information required in Part III.

Statement of Financial Condition

Most national securities exchanges[1] require that their members make available to customers a statement of financial condition. In the majority of cases this statement is as of the date of its most recent Answers to Financial Questionnaire. If it is as of the date of the audited Answers to Financial Questionnaire pursuant to Rule 17a-5 of the Securities and Exchange Commission or the equivalent rule of the national securities exchange of which the brokerage concern is a member, the statement is accompanied by the usual short-form report of the independent public accountant. If the financial statement is as of the date subsequent to the date of the audited Answers to Financial Questionnaire, it shall be one which, in the opinion of the organization, presents fairly the financial condition of such organization. If the organization is a member of the national securities exchange, an exact copy of the financial statement which the organization intends to submit to its customers is usually required to be filed with the exchange.

Examples of statements of financial condition (corporate and partnership forms) are shown in Exhibits E and K, respectively, of this guide. Accompanying notes to statement of financial con-

[1] The Securities and Exchange Commission has adopted an amendment to Rule 17a-5 (SEC Release No. 9658) effective for quarters ending on and after September 30, 1972, requiring brokerage concerns to furnish statements to their customers on a quarterly basis.

dition (corporate and partnership forms) and accountant's report are shown in Exhibits I, O, D, J, and P, respectively.

It should be noted that in Exhibits E and K no separation of assets and liabilities as between current and non-current is made. For the typical brokerage concern, such a distinction has little meaning and requires arbitrary decisions which might be misleading. For example, margin debit balances while subject to demand for payment by the broker, and thus theoretically current, are generally sought to be maintained (as long as properly margined) on a long term basis. Similarly, bank loans, payable on demand, are usually collateralized by securities purchased in margin accounts by customers and may be virtually long term in substance. Investments in marketable securities may be long or short term but the factors influencing the sell or hold decision, such as alternative investment opportunities, change frequently. Some confusion as to current or non-current status could result also from the customary application of the net capital rules where concepts such as "immediate convertibility into cash," "collectible within 30 or 45 days," etc., have evolved.

Thus, for the typical brokerage concern, it is believed that appropriate description of the assets (such as distinguishing clearly between marketable and not readily marketable investments) and liabilities without arbitrary distinction between current and non-current is the most meaningful presentation. However, if the brokerage concern diversifies to a substantial degree into non-financial businesses, such a distinction may be appropriate.

Most of the items set forth in the exhibited statements of financial condition are self-explanatory and those relating to corporate form (Exhibit E) are cross-referenced to the items appearing in the Answers to Part I of the Financial Questionnaire (Exhibit B). Several items, however, require special comment, as follows:

Receivable From Brokers or Dealers. This classification includes primarily failed to deliver and securities borrowed items.

Where the brokerage concern deals through correspondents, there may be debit balances in the "omnibus" accounts of one or more of the correspondents. In such instances, if the amounts are insignificant, they may be included under this classification. If the amounts are significant, a separate caption, "Due from correspondent brokers," may be appropriate.

Customers' Partly Secured and Unsecured Accounts. The suggested financial statement presentation of customers' partly secured and unsecured accounts is to classify them as receivables due from customers. Where losses in such accounts can be reasonably anticipated, an asset valuation allowance should be established. The disclosure and classification of such an allowance in the financial statements should be in accordance with the applicable Accounting Principles Board Opinion.

Trading and Investment Accounts. Trading and investment accounts of a brokerage concern generally are of two types:

1. *Trading accounts.* Generally marketable securities (stocks, corporate bonds, United States Government securities, state and municipal bonds, commercial paper, etc., or commodities) carried in inventory and held for sale in the ordinary course of business.
2. *Investment accounts.* Investments of all types other than those carried in trading accounts (including venture capital investments in securities, oil and gas leases, and real estate) both marketable and not readily marketable.

While the general practice in the past has been to reflect marketable securities in trading accounts at market value in the interim date balance sheets of brokers who are members of national securities exchanges, securities, etc., in investment accounts have been carried at cost and, in some instances, at market. In any event, because of the historical requirement to issue only a statement of financial condition (balance sheet) in connection with the surprise examinations of members of national exchanges, very few individuals focused on the cost versus market value implications in brokerage concerns' income statements (see discussion on income statements following).

In considering the issues involved, it is appropriate to classify investment accounts into two categories: (1) marketable, and (2) not readily marketable. "Not readily marketable" investments include (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 (or the conditions of an exemption, such as Regulation A, under Section 3 (b) of such Act have been complied with); (c) securities which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities or to the company; and (d) most investments in oil, gas and real estate.

Trading and investment positions should be valued for financial statement purposes as follows:

1. Marketable securities at current market value.
2. Not readily marketable securities and other investments at fair value as determined by the brokerage concerns' management, with cost disclosed.[2]
3. The increase or decrease in unrealized appreciation or depreciation resulting from the foregoing treatment should be included in the income statement.
4. Differences between accounting and tax treatment will, in the case of corporations, require appropriate tax allocation.

The market and fair value concept recognizes that trading and investment securities and other investments, whether readily marketable or not, appreciate or depreciate as the earnings records of the companies themselves and market or other economic conditions dictate. Accordingly, the investing brokerage concern should account for its decisions to purchase, hold or sell a particular investment during the period under review. The market and fair value concept provides the most effective means of measuring the trading and investment decisions of the brokerage concern's management.

The difficulties in determining the fair value of not readily marketable investments are recognized. In this connection it is suggested that reference be made to SEC Accounting Series Release No. 118 relating to not readily marketable investments of investment companies.

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[2] Investments which meet the criteria of APB Opinion No. 18, *and* which are made for long-term *operating* purposes, should ordinarily be carried on the equity basis. Investments of this type are usually made to provide facilities or services to the brokerage concern. The emphasis here is on the long-term operating nature of this type of investment.

The brokerage concern's interest (assuming such interest is not merely contingent) in underwriting or joint accounts with others for issued securities is includable with the trading and investment account. Where parts of the joint accounts are carried by other brokerage concerns (as set forth in Question 15 of Answers to Financial Questionnaire), the interest of the brokerage concern being reported upon should be determined and classified as above with a contra liability to the carrying brokerage concern.

Many brokerage concerns acting as principal have contractual commitments, including underwriting, when issued, when distributed and delayed delivery contracts. Appropriate footnote disclosure should be made of these commitments when deemed significant and provision should be reflected in the financial statements for inherent losses, if any.

Securities sold by the brokerage concern under repurchase agreements are required to be set forth in Questions 3 and 10 of Answers to Financial Questionnaire. These securities should be reported with trading and investment accounts, at market value, in the statement of financial condition with the repurchase cost reflected as a liability.

In some instances brokerage concerns sell call options against long security positions in trading and investment accounts. If material, it is necessary to separate such securities from the regular trading and investment securities, describe them as "securities for which endorsed calls are outstanding," and value them on an individual security basis at the lower of market value or contract value of calls outstanding.

In other instances, brokerage concerns operate "conversion accounts" for put and call brokers. These accounts are hedged as far as the securities broker is concerned. If material, the long securities must be likewise separated from the regular trading and investment securities, described as "securities for which endorsed calls are outstanding and puts for like amounts are held." For purposes of valuation in the statement of financial condition, a determination must be made as to the present realizable value of the security, considering the existing relationship between the put price, the call price and the current market price (see accounting for option premiums elsewhere in this guide). Because of the complexity of these relationships they are illustrated in the table on the following page.

If "put" price is above "call" price—

	Long Put	*Short Call*	*Market*	*Realizable Value (for statement of financial condition)*
and market is:				
Above put	$100	$ 98	$101	$ 98 (Call)
Same as put	100	98	100	98 (Call)
Below put, above call	100	98	99	99 (Market)
Same as call	100	98	98	100 (Put)
Below call	100	98	97	100 (Put)

If "call" price is above "put" price—

and market is:				
Above call	$ 98	$100	$101	$100 (Call)
Same as call	98	100	100	100 (Market)
Below call, above put	98	100	99	99 (Market)
Same as put	98	100	98	98 (Put)
Below put	98	100	97	98 (Put)

Secured Demand Notes. Secured demand notes are usually found in brokerage concerns operating as corporations, although it is possible for such notes to be found in partnerships. The secured demand notes receivable have a contra on the liability side of the statement of financial condition under liabilities subordinated to claims of creditors. Where the note is payable solely from the proceeds of the collateral, care should be exercised to limit the stated value of the note to the lower of the market value of the collateral or the face amount of the note.

Memberships in Exchanges. Exchange memberships owned by the brokerage concern are generally acquired for operating purposes and should be valued at cost or at a lesser amount where there is an indication of permanent impairment in value of a material amount. Exchange memberships contributed for the use of the brokerage concern and subordinated to claims of general creditors should be carried at market value with an offsetting amount shown under liabilities subordinated to claims of general creditors.

Investment in Subsidiaries. Under certain circumstances, valid reasons may exist for omitting a subsidiary from consolidation. However, generally accepted accounting principles require that subsidiaries, when they meet certain criteria, be consolidated. Where the brokerage concern has such investments, presentation in the financial statements should be in accordance with the applicable Accounting Principles Board Opinions.

Payable to Brokers or Dealers. This classification includes primarily failed to receive and securities loaned items. Where the brokerage concern operates through correspondents the credit balances in "omnibus" accounts of correspondents may be included under this classification if the amounts are insignificant. If significant, however, such credit balances should be shown separately as "Due to correspondent brokers."

Footnotes. The fairness of financial statement presentation is dependent upon the adequacy of disclosures involving material matters. As in the case of financial statements generally, footnotes for such items as summary of accounting policies, changes in accounting principles, long-term lease obligations, maturity dates of subordinated borrowings, assets subject to lien, pension and retirement plans, contingent liabilities, depreciation policies, stock option and purchase plans, provisions under which the brokerage concern may be required to purchase its own capital stock, etc., are necessary and required for fair presentation. Such disclosures in the financial statements should be regarded as being reasonably adequate unless otherwise stated in the report. If matters which the independent auditor believes require disclosure are omitted from the financial statements, the matters should be included in his report and he should appropriately qualify his opinion.

Statement of Income

Until quite recently, substantially all brokerage concerns were privately owned and the distribution of financial information to the public generally was limited to statements of financial condition which were required by the national securities exchanges to be made available to customers. However, as brokerage concerns sold their equity securities to the public, they became subject to the disclosure rules which apply to publicly held companies in general. Such rules require the dissemination of more comprehensive financial information to stockholders including statements of income and changes in financial position. While brokers and dealers, other than those with public ownership, are not presently required to publicly disclose their results of operations and changes in financial position, we believe they should be encouraged to do so.

Prior to the advent of public ownership of brokerage concerns and the adoption in 1972 of amendments to Rule 17a-5 (SEC Release No. 9658), the independent public accountant was not generally concerned with reporting upon results of operations of such concerns. With the recent emphasis on such reporting, however, a number of accounting matters have assumed added significance. Chief among these is the question of the most informative method of asset valuation and the resultant effect on operating results.

Brokerage concerns today are involved in a number of financial activities including the investment of substantial sums of money in both short-term and long-term investments of various types. As indicated previously in this guide, we have concluded that trading and investment accounts of brokerage concerns should be valued at market or fair value for financial reporting purposes and that unrealized as well as realized gains and losses be reflected in the statement of income. The increase or decrease in net unrealized appreciation or depreciation in investment accounts included in results of operations should be disclosed if significant. The aggregate effect on reported net income (net of taxes) should also be disclosed as well as the amount per share.

The statement of income should disclose separately the principal sources of the brokerage concern's revenues such as brokerage commissions, trading profits or losses, investment profits or losses, underwriting profits or losses, fee income, dividends and interest, etc. Expenses should be reported by major types such as employee compensation and benefits, communications, occupancy and equipment, interest, floor brokerage and clearance fees, promotion, etc.

Examples of statements of income and retained earnings (corporate form), statement of income and statement of changes in partnership capital (partnership form), and the accompanying accountant's report submitted when operating results are included are shown in Exhibits F, L, D, and J, respectively.

Statement of Changes in Financial Position

The Statement of Changes in Financial Position, formerly referred to as Statement of Source and Application of Funds, is now required as a basic financial statement when financial statements purporting to present both financial position (balance sheet) and results of operations (statement of income and retained earnings) are issued. Several regulatory agencies have acted recently to require such statements in certain reports filed with them.

Examples of Statement of Changes in Financial Position (corporate and partnership forms) are submitted as Exhibits H and N, respectively.

Statement of Changes in Subordinated Liabilities

This statement, examples of which are submitted as Exhibits G and M (corporate and partnership forms), is now required to be filed with the Securities and Exchange Commission and must be covered by the opinion of the independent public accountant.

Annual Report of Income and Expense

Effective January 1, 1969, the Securities and Exchange Commission adopted Rule 17a-10 and the related Form X-17A-10. Under the provision of Rule 17a-10, every member of a national securities exchange and every broker or dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (other than members of a national securities exchange or a registered national securities association which maintains records containing the information required by Form X-17A-10 as to each of its members, and which transmits to the Commission a copy of the record as to each such member, pursuant to a plan the procedures and provisions of which have been submitted to and declared effective by the Commission) shall file a report of his income and expenses and related financial and other information for such calendar year on Form X-17A-10. The report is due to be filed not later than 90 days after the close of each calendar year and need not be certified.

The New York Stock Exchange requires its member organizations to file annual reports which meet the exemption requirements of Rule 17a-10. These reports, however, are more detailed than the report on Form X-17A-10 in that income and expenses must be further identified by functions, i.e., sales, execution, administration, research, other business, security commission income and other income.

Since the preparation of both Form X-17A-10 and the related exchange report requires considerable breakdown and classification of income and expense, the larger brokerage concerns have expanded their classification of accounts to collect certain of the information on a day-to-day basis. Smaller brokerage concerns can, of course, obtain the information by analysis of the accounts, but such analysis should be carried on periodically throughout the year rather than waiting until the year end.

Since reports pursuant to Rule 17a-10 of the Securities and Exchange Commission and comparable rules of the New York Stock Exchange do not require certification by an independent public accountant, neither the rules nor the forms are included in this guide.

Section 3

Internal Accounting Control and Procedures for Safeguarding Securities

General

Statement on Auditing Procedure No. 54, issued by the Committee on Auditing Procedure of the American Institute of Certified Public Accountants, describes accounting control as follows:

> *Accounting control* comprises the plan of organization and the procedures and records that are concerned with the safeguarding of assets and the reliability of financial records and consequently are designed to provide reasonable assurance that:
>
> a. Transactions are executed in accordance with management's general or specific authorization.
>
> b. Transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets.
>
> c. Access to assets is permitted only in accordance with management's authorization.
>
> d. The recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

The review of the accounting system, internal accounting control, and procedures for safeguarding securities required by the Audit Requirements of Form X-17A-5 recognizes the regulatory concern for safeguards over customers' property held by the broker-dealer in that the independent public accountant is required to report on any material inadequacies found to exist in the accounting system, internal accounting control and procedures for safeguarding securities.

While not unique to the industry, the importance of an effective internal audit group in the overall internal control system of a broker-dealer should be stressed. Such a group should conduct continuing tests and evaluations of the procedures and controls in effect, adherence to established policies, and make recommendations for improvement. The internal audit function should, of course, be carried out by personnel who are independent of the departments or functions subject to audit.

Procedurally, in reviewing the actual operation of the system of internal control, the reviewer should follow the documentation. Completeness in documentation, of course, does not necessarily imply satisfactory control. However, in reviewing what is done and evaluating the effectiveness of control, the principal point of reference should be the documentation.

Many activities of a broker or dealer in securities are unlike those of companies in other industries; consequently, many internal accounting controls are peculiar to this industry. Such controls are concerned primarily with the following categories of activity: receiving, delivering, pledging, borrowing, lending, transferring, and maintaining custody of securities; maintaining customers' accounts including extending credit under the regulations of the Board of Governors of the Federal Reserve System; and transactions with other brokers and dealers and organizations involved in clearing and/or settling securities transactions.

Specific Controls

The following are illustrative of some of the controls one would expect to find in operation in a brokerage concern. Excluded are those controls which have to do with the adequate separation of duties between individuals who initiate and record transactions, and the approval of transactions or journal entries by individuals who do not initiate or record transactions and journal entries; these are characteristics of all good systems of internal control.

Securities. The controls over securities should be such as to provide compliance with regulatory requirements as well as providing for physical safeguards and integrity of the records.

1. Certificate numbers should be recorded for all securities received and delivered; this is sometimes accomplished by microfilming such securities.
2. Securities received should be checked for negotiability (endorsements, signature, guarantee, etc.) and for completeness (coupons, warrants, etc.) before they are placed in the active box or vault.
3. Securities received from customers registered in the name of a third party should be accepted only upon proof of ownership.
4. Adequate investigation should be made to determine that customers delivering securities registered in a "street name" have title to such securities.
5. A limited number of responsible employees should be authorized to execute or guarantee assignments and, if the brokerage concern is a member of the New York Stock Exchange, an appropriate resolution must be filed with that Exchange.
6. Facsimile signature devices, if used, should be adequately controlled.
7. When securities are shipped against payment, a designated employee who does not handle securities or cash should follow to a conclusion the receipt of payment.
8. Adequate physical controls should be maintained over securities on hand; access to areas containing securities should be restricted to authorized employees. Access to security vaults should require the presence of two or more authorized employees.
9. Customers' fully-paid-for securities and excess margin securities, should be properly noted in the records of the brokerage concern as securities requested to be segregated.

10. The detail records pertaining to securities in transfer and those pledged as collateral to borrowings from banks should be agreed periodically (at least quarterly) with the securities record.
11. Securities on hand should be counted periodically and any differences recorded and followed to a conclusion. Reference is made to Rule 17a-13 of the Securities and Exchange Commission and to similar rules of other regulatory authorities which make periodic counts mandatory.
12. Movements of securities should be balanced daily and the responsibility for the clearance of out-of-balance positions should be assigned to specific individuals who have no other duties with respect to securities handling or accounting.
13. Security positions (and related ledger amounts) in suspense accounts should be investigated and resolved on a timely basis.

Customers' Accounts. In order to provide effective control over the opening and maintaining of customers' security and commodity accounts, various procedures are followed by brokerage concerns, some of which are required by regulatory authorities. These procedures include the following:

1. New accounts should be approved by a partner or voting stockholder-officer before or immediately following the completion of the initial transaction in the account.
2. All accounts should be in the name of the customer unless a written statement signed by the customer attesting to his ownership of an account in any other name, symbol, or number has been received.
3. Letters should be mailed to customers requesting confirmation of changes in addresses. Some brokerage concerns mail confirmation requests to the customer's last known address as well as his new address.
4. Statements should be mailed to customers periodically (at least quarterly) unless a customer has specifically requested, in writing, that the statement be held.
5. Security positions as shown on customers' periodic statements should be compared to margin and security records.

6. A signed, written authorization should be required from each customer for whom the brokerage concern carries a discretionary account. Every trade in the account should be approved by a partner or officer of the brokerage concern. An advice should be mailed to the customer on the date each trade is completed.
7. Separate ledgers should be maintained for the accounts of all employees and known relatives in order that transactions in such accounts can be reviewed more readily by an officer or partner of the brokerage concern.
8. Written approval for the opening of an account for an employee of another broker or dealer should be obtained from his employer.
9. Payment of funds or withdrawal of securities from customers' accounts should not be allowed without the written authorization of the margin department.
10. Margin records should be checked periodically by an employee who has no duties in connection therewith to determine that the minimum margin requirements of the firm are being maintained.
11. The margin department of a brokerage concern should provide a system to prevent violation of Regulation T of the Board of Governors of the Federal Reserve System and similar regulations dealing with the extension and maintenance of credit of other regulatory bodies. In that connection, procedures should be in effect to see that all necessary margin calls are made and followed up.
12. Bookkeepers and margin clerks should be rotated periodically so that they are not always servicing the same accounts.

Transactions With Other Brokers and Dealers.

1. The details of fails to receive, fails to deliver, securities loaned and securities borrowed should be agreed periodically with the securities record, and the respective amounts receivable or payable should be agreed with the related general ledger control accounts.
2. Aging schedules of fails to receive and fails to deliver transactions should be maintained on a current basis.

3. With respect to accounts carried by other brokers (omnibus accounts), the details of transactions should be agreed daily and responsibility for follow-up of any differences should be assigned.

Electronic Data Processing. Despite the high degree of reliability of the machines and the application of advanced techniques in developing computer programs, it should not be assumed that good internal control automatically carries over into an EDP system from a previously used system. While there is no reason why control should not be at least as effective in the EDP system as in any other, the changes that accompany an EDP installation may present control problems that do not exist in less sophisticated systems.

In an EDP system, as in any other system, there are four stages in the complete flow of data from origination to final recording and use. These are: data acquisition, data transmission, data processing, and data utilization. Internal controls relating to the first two stages are generally referred to as "input controls," those relating to the third stage, "processing controls," and those relating to the fourth stage, "output controls." "Security control" is another important aspect of an EDP system.

(a) *Input controls*—The purpose of input controls is to insure correctness in the initial accumulation of data and any preliminary operations that may be involved in presenting the information to the computer. Specifically, they regulate and monitor the following activities:

- The authorization of source documents.
- The handling of source documents.
- The conversion of data to machine language.

Controls with respect to these activities should be reviewed and tested in the same manner as that used for similar activities in manual systems.

(b) *Processing controls*—These controls, which are known also as programmed checks or programmed controls, are a part of the stored instructions that direct a computer's operations. To the extent that they are used, an EDP system becomes self-regulating, eliminating the need for clerical monitoring of results. This characteristic gives the computer a self-auditing capability which is superior to that of any other processing system. The purposes of processing controls are to monitor the following:

- The adequacy of the programs.
- The quantity and quality of data.
- The correctness of human intervention.

There are numerous methods used to provide processing controls. Among the more common control methods are the following:

Quantitative controls:
Record counts
Control totals
Hash totals
Sequence checks

Qualitative controls:
Coding checks
Combination checks
Check digits
Matching checks
Composition checks
Posting checks
Limit checks
Crossfooting checks
Sign checks
Labels

(c) *Output controls*—These controls provide accountability over documents prepared by the computer. They regulate the assembly and distribution of reports and provide a means of comparing results with predetermined control information. Output controls are not concerned with the accuracy of processing as such, since this is a function of system controls in the input and processing stages.

(d) *Security controls*—These controls consist of policies and work rules governing the operation of electronic data processing equipment. They are provided to protect the equipment, data, and programs from known hazards. These include: fire, power loss, humidity extremes, excessive dust, wear and tear, and other physical hazards and inadvertent or deliberate destruction or alteration by the machine operators. Measures that provide control over the console and restrict access to program tapes and data tapes should be emphasized.

Review and Tests of Internal Accounting Controls By Independent Public Accountants

The principal purposes of the examination by independent public accountants required under Rule 17a-5 are to report to the jurisdictional agencies on financial condition (presented in such detail as to facilitate computation of the net capital ratio) and on any material inadequacies found to exist in the brokerage concern's accounting system, internal accounting control and procedures for safeguarding securities.

In his review of internal controls, the independent public accountant should first obtain information as to procedures purported to be in effect and make an evaluation as to their adequacy. After obtaining the information, he must make appropriate compliance tests to satisfy himself that the procedures are being carried out.

With reference to electronic data processing, the independent public accountant should review and test the input, processing and output controls. Additionally he should review procedures to ascertain that controls over report distribution are adequate and that reports showing errors or exceptions (based on processing controls) are properly distributed to those responsible for follow-up. The independent public accountant's principal interest in the so-called "security controls" relate to those measures that govern or limit the activities of machine room employees. In the system of internal control as a whole, the importance of measures that provide control over the console and restrict access to program tapes and data tapes should be emphasized.

In compliance with generally accepted auditing standards, as well as the rules of the Securities and Exchange Commission and the principal national securities exchanges, the independent public accountant is required to review and make appropriate tests of the accounting system, internal accounting control, and procedure for safeguarding securities for the period since the prior examination date. If, based on his review and tests of compliance, no material inadequacies are found to exist with respect to any of the foregoing matters, the independent public accountant should so state in his report on internal control. If, however, material inadequacies are found to exist his report should disclose the nature of the inadequacies and the constructive action proposed to be taken or already taken by the brokerage concern. The supplementary report on internal control is now required to be filed as public information and therefore it is suggested that such report be included in Part I of Answers to Financial Questionnaire. Reference is made to Statement on Auditing Procedure No. 49, and an illustration of suggested language for such a report is presented in Exhibit C.

The evaluation of the adequacy of internal control, and the distinction between inadequacies considered to be material and those considered not material, is one of the more difficult problems the independent public accountant encounters in carrying out the audit requirements of the various regulatory agencies. A material inadequacy can be defined as a condition that would permit a person acting individually in the brokerage concern's organization to perpetrate errors or irregularities involving the accounting records, assets of the brokerage concern, and/or assets of customers that would not be detected through the internal control procedures in time to prevent material loss or misstatement of the concern's financial statements, or serious violation of rules of the regulatory agencies.

Section 4

Examinations

General

The first prerequisite for undertaking an examination (audit) of a broker or dealer in securities is to be knowledgeable of the Securities Exchange Act of 1934, particularly Rules 15c-3(1), and 17a-5.

Timing of Commencement of Examination. Certain major exchanges presently require that the examination by independent public accountants be made on a date previously unannounced to the broker or dealer. The Securities and Exchange Commission does not require that the examination be on a surprise basis. Elimination of the surprise audit requirement is currently under study.

Where the examination must be on a surprise basis, it is generally understood that it be commenced on the examination date so as to minimize the problem of controlling securities movements. However, the independent public accountant is not precluded from commencing the examination a few days prior thereto.

Audit Requirements. The Securities and Exchange Commission, as well as the principal stock exchanges and other regulatory bodies, have prescribed audit requirements (minimum) for the examination of brokers or dealers in securities by independent public accountants. It is incumbent upon the independent public accountant, however, to expand the scope of his examination if in his professional judgment such expansion is necessary in the circumstances.

The audit requirements prescribed pursuant to Rule 17a-5 of the Securities Exchange Act (which are the same as those set forth in audit requirements of the national securities exchanges) are set forth in Form X-17A-5 of the Securities and Exchange Commission. See Exhibit T.

Preliminary Considerations. Prior to undertaking the examination, the independent public accountant should make a study of the physical layout of the brokerage concern's principal office, the organization of the employees' duties and other similar factors. If the brokerage concern utilizes data processing, either on premises or through a service bureau, the independent public accountant should also make a review of the system, ascertain the extent to which the system can be utilized in the conduct of his examination, and arrange with the client to keep him promptly advised of subsequent system and program changes.

Regardless of the system in use by the brokerage concern, it is desirable for the independent public accountant to meet with his client's operating personnel well in advance of the examination date and develop an operating plan which may be described as "what to do when the auditors arrive" and to arrange for proper liaison between his staff and client's staff. This will avoid confusion at the start of the examination and will insure a minimum amount of inconvenience to his client.

Review of In-House Data Processing Operations. In audits of brokerage concerns which utilize in-house computer systems, the independent public accountant must evaluate the adequacy of internal controls. Selected basic administrative control areas may be reviewed on an annual basis. Major application controls should be reviewed on a rotating basis (except that all major application areas should be reviewed in a first-time-through situation). In conducting the review of controls over data processing, the independent public accountant should concern himself with administrative, processing, and input/output controls. It is suggested that the independent public accountant refer to the American Institute of Certified Public Accountants' publication, *Auditing and EDP,* by Gordon Davis, when developing the program for this review. Many accountants will find it desirable to utilize the services of data processing specialists in this area.

Review of Data Processing Service Centers. The use of a data processing service center may to some degree improve the level of internal control due to the greater separation of responsibilities inherent in the "third party" status of the service organization. However, a service center often processes major applications such as purchase and sales, bookkeeping, margin, etc., for the brokerage concern and maintains important files at the center location. In such a case, the absence of good internal controls may be considered a material inadequacy due to the potential for interruption of the brokerage concern's day-to-day activities.

The work to be done by the independent public accountant in reviewing controls will depend on the facts and circumstances in each case. If, for example, the independent public accountant is able to audit the output of the service bureau and to satisfy himself that the brokerage concern has good controls and is able to check the daily output throughout the year, it may not be necessary to perform any further review of the processing controls in use at the service center. However, it would appear essential that the independent public accountant make inquiry as to the existence of any problems relating to system continuity or data file security due to inadequate equipment or program backup and/or poor administrative control at the service center.

If the independent public accountant determines that the controls of the brokerage concern are weak and that output cannot be checked daily, he should inquire whether the service center controls are adequate. He might choose to accept the report of the independent public accountant of the service center as to the above matters, but if not, and if the processing is considered significant in relation to the overall information processing of the brokerage concern, he should consider visiting the service center to perform the appropriate review. Again, in establishing a program for such a review, it is suggested that reference be made to the American Institute of Certified Public Accountants' publication, *Auditing and EDP,* referred to above.

Initial Control of Data Processing Operations. After the data processing records (cards, tapes, or discs) have been updated on the audit date and the usual daily reports prepared, the closing stock record should be prepared. The data going into the preparation of the closing stock record should be utilized in the customers' statement run and in the preparation of the street side runs, i.e., boxes, transfers, bank loans, correspondent brokers, etc.

Some brokerage concerns maintain a subsidiary record known as a "holders' file" which is a duplicate of the customers' position in the stock record in account sequence. This record is updated each day and provides a current record of customers' positions. The record is also usually utilized in the preparation of customers' statements. In other brokerage concerns the stock record is maintained in account sequence and sorted into security sequence when a stock record is required. If the holders' file is a subsidiary record and if such record is utilized in the preparation of customers' statements, it should be compared mechanically or electronically, under control of the independent public accountant, with the customers' positions in the stock record.

Representatives of the independent public accountant should control or obtain duplicates of cards, tapes, and discs comprising the following input data:

1. Stock record (in account or security sequence, whichever is appropriate).
2. Closing money trial balance.
3. Name and address.
4. Holders' file (if any).

The independent public accountant's representatives should also be present to observe and control, to the extent required, the preparation of the customers' statements and the listings of other accounts such as trading and investment accounts, details of fails, transfers, boxes, etc. Such presence coupled with utilization of the controlled input data in the preparation of the reports and statements will eliminate the detailed checking otherwise necessary to ascertain agreement between the customer statements, position listings, and the stock record. Control in this context could include a requirement for review or test of certain computer programs of the brokerage concern.

In those instances where the brokerage concern utilizes off-premise service centers, the foregoing procedures may be deemed unnecessary where the independent public accountant has satisfied himself as to the internal controls and the independence of ownership, management, and operation of such facilities. If the independent public accountant utilizes special audit reports generated by a service bureau, he should take whatever steps he considers necessary to assure himself that the contents of the reports are appropriate and valid.

Some independent public accountants take control of the brokerage concern's data processing departments and use their own employees in the preparation of the statements and reports utilized in their examination. Others have devised sophisticated programs of their own, including conversion programs which convert the brokerage concern's data into input data acceptable to these special programs.

Fidelity Bonds. The independent public accountant should examine the fidelity bonds of the brokerage concern under examination, should note any special conditions and compliance therewith, and should ascertain that the amount of coverage is in compliance with recommendations of regulatory bodies.

Examination of or Accountability for Securities

Physical Inspection of Securities. Securities in physical possession may fall into several classes, depending upon the stage of the transaction with the customer, the characteristics of the customer's account, and other factors. Such securities are ordinarily placed in boxes, cabinets, or other storage devices. Apart from any physical form that such devices may have today, the custom persists of referring to any given class of securities in physical possession as being identified with a particular type of "box," such as "active box," "safekeeping box," "segregation box," "name of box," etc.

Inspection of securities should include positive identification of the classes or series such as, Class A or B common stock, preferred stock, prior preference stock, "old" or "new" stock and, with reference to bonds, the interest rate and maturity date. All securities received while the count and inspection are in progress should be segregated from those under audit control, and the independent public accountant should have a record of securities which are removed from audit control to permit delivery.

Control of securities should be maintained until the inspection and count are completed and the results are compared with the records. If time does not permit such control, securities not yet compared with the records should be recounted before releasing control and such counts agreed to by appropriate personnel of the brokerage concern.

Any differences between the physical count and the records, as to either quantity or identification, should be reviewed with a responsible official of the brokerage concern who should, before control is released, concur with the differences.

The record of inspection may be in the form of listings prepared during the count or by checking the count to pre-listings which are usually obtained where electronic data processing systems are in use. If listings are prepared during the count, it is necessary to check the security count to the brokerage concern's stock record; whereas, if the pre-listing is prepared by utilizing controlled data in the preparation of the stock record, the two separate operations (listing and checking) are combined.

Securities in for Transfer, Exchange, or Redemption. The brokerage concern, particularly one which engages in a large number of transactions, probably will have a separate department or division to handle securities which are held for transfer, exchange, or redemption. The basic procedures for handling such securities, however, are the same in all brokerage concerns and do not vary materially with the size or plan of organization. Securities in this class consist of the following:

1. Securities on hand pending preparation of instructions for transfer of title, exchange, or redemption.
2. Securities on hand awaiting processing for delivery or routing to securities boxes.
3. Securities on hand which are not in negotiable form because of the absence of legal documents, such as those necessary to qualify one to act as an executor, administrator, or guard-

ian, or in some other similar capacity. These securities are frequently referred to as "legal" securities.

4. Securities delivered to local transfer agents for transfer of title, exchange, or redemption and for which window tickets or receipts are held.
5. Securities sent to out-of-town transfer agents or the corporate issuers for transfer of title, exchange, or redemption. Copies of transmittal correspondence should be available for inspection.
6. Securities receivable from other brokerage concerns which have initiated a transfer-of-title procedure. This situation occurs principally as a result of delivery to the receiving broker of a certificate or certificates for a greater number of shares than required and the receiving broker is having the excess shares transferred to the name of the sending broker.
7. Securities in process of being transferred through Central Certificate Service or any other depository service.

Securities in the first three of the foregoing groups should be counted and inspected in the same manner as the securities in any other box.

The location of the securities described in the last four of the foregoing groups should be accounted for by direct correspondence with the transfer agents, the corporate issuers, the other brokerage concern or should be examined upon return to the brokerage concern under examination.

Circumstances of internal control and/or the quality of audit evidence obtainable, may be such as to permit, as an alternative procedure, a combination of direct confirmation, inspection and control of outgoing mail on the audit date and inspection of incoming mail for several days subsequent to the audit date. Securities received in the incoming mail should be inspected at the time the mail is opened and should be traced to the record of securities sent to transfer agents. Dates appearing on stock certificates received from transfer subsequent to the audit date should be noted. Such information will be helpful to the independent public accountant in satisfying himself that the securities purported to have been delivered out for transfer were not actually on hand as of the audit date.

Securities Held by Branch Offices. Ordinarily, securities held by a branch office of the brokerage concern should be inspected in the same manner as those held at the main office, and simultaneously with the inspection at the main office. Only if such security holdings are small may it be appropriate to request that all securities on hand at the branch office at the audit date be submitted to a bank for inspection and for listing in detail in a written communication to the independent public accountant. Where this procedure is used, banks should be asked to hold securities overnight. As an alternative procedure, when the holdings are small, the branch office may be requested to mail all securities on hand to the head office of the brokerage concern in order that they may be counted and inspected by the independent public accountant.

Securities in Transit Between Offices. Description and quantities of all securities which were transmitted between offices (including correspondent brokers) during a period of several days immediately preceding the audit date should be noted and used in the reconcilement and accounting for securities in transit.

In those cases where outgoing mail on the audit date and incoming mail for several days after the audit date is controlled, securities in transit between offices may be examined and checked to the record of pre-audit-date shipments. Identification of securities by certificate number facilitates the audit of securities in transit.

If application of these procedures is impracticable, copies of receipt forms, correspondence, and any other pertinent evidence should be examined to the extent necessary to satisfy the independent public accountant that the securities were actually in transit on the audit date.

Free Shipments. In many instances, securities are shipped "free" to out-of-town brokerage concerns to avoid payment of collection charges. Requests for confirmation, prepared in sufficient detail to clearly identify the security, should be mailed to the respective brokerage concerns for all free shipments which are open at the audit date.

Other Accounts Containing Security Positions. Under the audit requirements prescribed by jurisdictional agencies "positive" confirmation requests are required to be sent with respect to all accounts containing security positions as of the audit date.

Count Differences. All differences disclosed, through the comparison of counts and confirmations, in the records of the brokerage concern should be corrected or should be considered as "differences" pending clearance.

Since many of the differences in security positions will be in the nature of offsetting items, i.e., between box and transfer, box and loans, etc., the recognition of these offsetting items is facilitated in large operations by use of a so-called "composite break sheet" such as that shown below.

Security Description	*ABC Corporation*		*Security Number 1013*
Account Number	*Stock Record*	*Count or Confirmation*	*Account Name*
99999-0-5	300	200	Active Box
99996-0-9	100	–0–	Branch Office
99997-0-7	–0–	100	Segregation Box
99995-0-9	200	300	Transfer
	600	600	

The responsibility for clearing security differences lies with the brokerage concern. At times, the independent public accountant may be requested to assist his client in researching the open items; however, subsequent adjusting entries should be initiated only by the brokerage concern under examination, and the role of the independent public accountant should be limited to controlling the open differences and satisfying himself as to the validity of subsequent adjustments.

Examination of Accounts

General. All jurisdictional agencies require that written positive confirmation requests be sent to all customers whose accounts show, as of the audit date, a balance due to or from, or a security or commodity position with, the brokerage concern. In addition to customers' accounts (including closed accounts discussed below) this requirement includes, but is not limited to, the following accounts:

- Bank balances and other deposits
- Deposits and open contractual positions with clearing corporations and associations
- Money borrowed and details of collateral
- Accounts carried for the broker or dealer by others
- Securities borrowed
- Securities loaned
- Failed to deliver
- Failed to receive
- Accounts of partners, officers, or directors
- Investment and trading accounts (confirmed with management)
- Capital accounts
- Borrowings and accounts covered by subordination agreements
- Open contractual commitments (other than unsettled "regular way" purchases and sales of securities)
- Guarantees in cases where required to protect customers' accounts guaranteed as of the audit date

In addition, the independent public accountant is required to obtain a written statement from the proprietor, partner (if a partnership), or officer (if a corporation) as to the assets, liabilities, and accountabilities, contingent or otherwise, not recorded on the books of the brokerage concern.

Compliance with requirements for obtaining written confirmation shall be deemed to have been made if such request has been mailed in an envelope by the independent public accountant, bearing his return address, and second requests are similarly mailed to those not replying to the first requests, together with such auditing procedures as may be necessary. With respect to customers' accounts closed since the last prior audit, the accountant may use either positive or negative confirmation requests. (Closed accounts for this purpose are those which, as of the audit date, reflected no money balances, open contractual commitments, or commodity or security positions and had no transactions during the period covered by the customers' statement.)

It is further provided that, with respect to periodic investment plans sponsored by member organizations of a national securities exchange whose members are exempted from Rule 15c3-1 by paragraph (b)(2) thereof, the independent public accountant examining the financial statement of the originating member organization may omit direct written confirmation of such plan accounts with customers when, in his judgment, such procedures are not necessary, if (1) the originating member organization does not receive or hold funds for such accounts, except the initial payment which is promptly transmitted to the custodian; (2) the custodian is a member organization of such national securities exchange and files certified reports complying with Rule 17a-5 in connection with which the customers' accounts are confirmed by an independent public accountant; and (3) funds and securities held by the custodian for each such customer's account are reconciled with the records of the originating member organization as of the date of the most recent audit of the custodian.

The independent public accountant should usually deliver the request for confirmation directly to the postal authorities. However, under certain circumstances he may hand deliver requests for confirmation directly to the addressee through clearing-house facilities. The addressee should be requested to acknowledge in writing the accuracy of the statement of account which accompanies the request for confirmation and to return the request directly to the independent public accountant in a self-addressed envelope which has been enclosed for the convenience of the addressee. Accounts for which no current addresses are known and which have a money balance and/or security positions should be reviewed by the independent public accountant to determine that efforts are being made to locate the customers and that the accounts are under adequate supervision and control.

Unsatisfactory replies should be followed up by, or under the direction of, the independent public accountant. As to unanswered requests, while he is required by the jurisdictional agencies to make second requests, the independent public accountant may, if deemed appropriate, make further requests. Also, the independent public accountant may find it desirable to furnish a listing of unanswered requests to the brokerage concern at the conclusion of the examination.

Since positive confirmation requests are required by regulation for 100% of the accounts, thus mandating a scope which is more comprehensive than the independent public accountant would ordinarily consider necessary for the expression of his opinion, it is appropriate to limit the application of alternative procedures relating to non-replies to those non-replies included in a selected sample. It is suggested that the sample be of sufficient size to provide satisfactory evidence to the independent public accountant as to the validity of the accounts as a whole as if confirmation had not been requested on a 100% basis. The alternate procedures to be applied may include a review of subsequent cash receipts or payments, delivery or receipt of securities, remittance advices, orders, correspondence, credit files, etc. The sampling technique does not, of course, relieve the independent public accountant of responsibility for follow-up of all significant exceptions received with respect to accounts not included in the sample.

While the examination of many of the accounts of a broker or dealer in securities does not differ materially from the examination of accounts of other types of businesses, a few special comments are presented, as follows:

Bank Balances and Other Deposits. In addition to confirming bank balances, the independent public accountant is required to reconcile balances shown by bank statements with balances recorded on the books. This requirement is deemed to be met where the reconciliation is prepared by personnel of the brokerage concern provided the independent public accountant satisfies himself with respect to the accuracy of the reconciliation. After allowing ample time for clearance of outstanding checks and transfers of funds, the independent public accountant is required to obtain from the depositories bank statements and paid checks and by appropriate audit procedures to substantiate the reconciliation as of the audit date.

Good-Faith Deposits. Generally good-faith deposits accompany bids to purchase new issues of securities. The deposit and the related commitment are normally confirmed at the same time. The brokerage concern may be acting as manager of a group making a bid for a new issue of securities and, in such cases, the other participating members usually deposit proportionate amounts of the required deposit with the managing concern. In these instances, the participants should be requested to confirm in writing the amount of their deposit as well as their participation in the commitment.

Interest Accrued on Margin Account Balances. In order to reduce the month-end work peak, interest on customer accounts is ordinarily computed, and charged to customer accounts, up to a date within a week or ten days prior to the end of the regular statement period. Interest from such date to the end of the regular statement period is then estimated and accrued on the basis of the aggregate of all interest bearing accounts. The procedures followed in making such accruals should be reviewed to ascertain the reasonableness thereof.

Customers' Accounts. The brokerage concern usually prepares the statements of customers' accounts as of the audit date and under manual systems sometimes checks these statements to the margin department records or to the stock record before releasing them to the independent public accountant. Where in-house data processing systems are in use, the independent public accountant should be present during the time the statements are being prepared and should control the statements and the cards, tapes, or discs from which the statements were prepared. If the client wishes to review the statements prior to mailing, the review should be made from a copy released to the client and arrangements should be made for proper control of any statements released to the client for purposes of correction.

Copies of the customers' statements should be retained by the independent accountant as a part of his working papers, unless the security and commodity positions and the ledger balances in customers' accounts are retained in some other form. In cases where the brokerage concern utilizes data processing equipment this other form may be tapes, discs, cards, or print-outs thereof.

Requests for confirmation of customers' accounts are usually in the form of printed data processing type cards which are enclosed with the customers' statement. Where data processing systems are in use, the confirmation cards are prepared, usually in duplicate, by use of a simple program or routine. The duplicate card comprises a master deck which is utilized for the purpose of determining the unconfirmed accounts requiring second requests.

In examinations of very small brokers or dealers, it is not uncommon for the independent public accountant to prepare, or have the brokerage concern prepare for him, written or typed requests for confirmation of customers' accounts which show the money balance and details of the security position at the audit date.

Customers' accounts containing no money balance or security position as of the audit, but which have been closed during the current month (or during the most recent quarterly period in cases where statements are furnished to customers on a quarterly basis), are generally referred to as "flat accounts." Under data processing systems, statements for these accounts are usually produced during the statement run as of the audit date and can be confirmed in the same manner as open accounts. Customer accounts closed since the previous examination by the independent public accountant may be selected for confirmation on a test basis utilizing either positive or negative form requests.

Trading and Investment Accounts. In addition to obtaining written confirmation of trading and investment accounts from management, the independent public accountant should also ascertain that the trading department position records are in agreement with, or reconcilable to, the stock record.

Capital Accounts. With respect to partnerships, the independent public accountant should examine the partnership agreement and determine, among other things, the extent, if any, to which securities or equities in partners' security or commodity accounts may be included in net capital.

With respect to corporations, the independent public accountant should examine the charter, bylaws, and minutes of meetings of the Board of Directors and any committees thereof for the period since the last examination. Minutes subsequent to the audit date and up to the date of the accountant's report should also be examined for the purpose of determining subsequent events which may have a bearing on the financial position and results of operation as of the audit date.

The independent public accountant should also ascertain that the brokerage concern has obtained counsel's opinion to the effect that the issuance of secured demand notes, debentures, subordinated notes, voting and non-voting shares of capital stock or any capital contribution by limited or general partners since the previous examination did not involve a public offering of securities within the meaning of Section 4(2) of the Securities Act of 1933 and therefore need not be registered under such Act.

Subordinated Accounts and Borrowings. The independent public accountant should examine subordination agreements and determine, preferably by direct confirmation, whether or not they have been approved by the regulatory bodies in the amounts reflected on the books. He should also determine the expiration dates of the agreements, the extent of the amounts subordinated, any limits as to those amounts, and the exact nature of the liability to the subordinating party. This information is necessary in order for him to determine the carrying value of these accounts and the effect that the liability to the subordinated lender may have under the "net capital" rules. Also, he should determine if the borrower has the right to sell or pledge the securities and the nature of the items to be returned to satisfy the subordinated debt.

Dividends Receivable or Payable. Dividends receivable in cash or securities should be analyzed and reviewed as to age and collectibility and, if material in amount, confirmation procedures should be applied. Some regulatory bodies consider age a factor when determining whether the cash or receivables are allowable in the computation of net capital.

Many brokerage concerns do not record dividends receivable or payable on stock positions "long" or "short" in trading or investment accounts until the payable date of the dividend, which can be from a few days to several weeks after the record date for the dividend. This practice may result in an understatement of assets and income, or liabilities and expense, when a dividend record date and payable date straddle the examination date. Under these circumstances the independent public accountant should review the procedures for recording dividends receivable and payable and should ascertain the materiality of any unrecorded amounts.

Exchange Memberships. The ownership of exchange memberships should be confirmed by direct correspondence with the applicable exchange. Although an exchange membership is usually registered in the name of an individual, it is ordinarily considered to be an asset of the brokerage concern if it is held by the brokerage concern under a so-called A-B-C agreement or if its use has been contributed to the brokerage concern under a subordination agreement. Also, it is not unusual for a broker or dealer to have more than one membership on a particular exchange.

Under an A-B-C agreement the member agrees that upon dissolution of the member organization or his ceasing to be a participant therein or upon his death or other contingencies, he or his legal representatives will comply with the terms of one of the following options:

(a) Retain his membership and pay to the member organization the amount necessary to purchase another membership

(b) Sell his membership and pay the proceeds over to the member organization, or

(c) Transfer his membership for a nominal consideration to a person designated by the member organization and satisfactory to the exchange.

The propriety of considering exchange memberships as assets of the brokerage concern should be ascertained by reference to partnership agreements or other applicable documents of the member organization.

Unclaimed Dividends, Coupons, and Securities. Procedures followed by the brokerage concern for recording transactions in accounts for unclaimed dividends, coupons, and securities should be reviewed. Detailed accounts maintained for unclaimed items should be agreed with related controlling accounts and particular attention given to accounts containing debit balances and/or short security positions. Charges against unclaimed items should be test checked to claims or applicable correspondence, giving particular attention to older items. Compliance with applicable state escheat laws should be reviewed.

Suspense Accounts. All suspense accounts should be analyzed to determine the nature of the items included therein, and the items should, if material, be reclassified to appropriate accounts.

Reserves and Allowances. The independent public accountant should analyze or obtain from the brokerage concern analyses of all liability and valuation reserve accounts. On a test basis he should examine documentary evidence supporting charges and credits to such accounts and indication of approval by authorized personnel. He should also ascertain the adequacy of allowances which are deductible from assets and investigate the reasonableness of reserves established for possible claims. If he believes provision for such allowances or reserves to be inadequate, he should evaluate the circumstances in relation to the type of opinion to be rendered covering the Answers to Financial Questionnaire and the financial statements.

Income, Expense, and Other Charges and Credits. The extent of the examination of income, expenses and other charges and credits is dependent upon the nature of the opinion to be expressed by the independent public accountant, the effectiveness of the system of internal control, and the degree of reliance that may be placed upon the classification of the income and expense accounts. Audits of brokers and dealers have traditionally placed primary emphasis on examination of the balance sheet, with usually only limited procedural testing being performed on the income and expense accounts. The responses (Answers) to Financial Questionnaires filed with the various regulatory authorities have been largely concerned with presentation of financial liquidity or detailed information necessary for the net capital computations. Recently, however, the income statements of brokers and dealers have received considerable attention because of the need to furnish financial information which is adequate for public investors. This presents a unique problem in that many brokers and dealers are subject to surprise examinations which rarely coincide with their fiscal year-ends. Furthermore, situations will undoubtedly occur where brokers and dealers will require their income statements to be audited retroactively so as to present comparative financial data for several prior years.

In order to render an opinion on income statements of the various fiscal years, the independent public accountant must do sufficient audit cut-off work as of the fiscal year-ends (assuming the regular audit does not coincide with the year-end) to satisfy himself as to allocation of income and expense items between years, in addition to the testing of transactions during the years. Whether the independent public accountant can satisfy himself regarding the individual fiscal year results on a retroactive basis depends upon the quality of the brokerage concern's internal controls and the accuracy of its records. Under conditions where such items as stock record differences of material amounts may have gone unresolved for extended periods, determination of income on an annual basis may be impracticable.

As in other industries, the procedures followed in auditing the income and expense accounts will depend upon their relative importance and the internal control procedures in effect. Where the independent public accountant merely renders opinions on the Answers to Financial Questionnaire of the regulatory bodies and the statement of financial condition, work on the income and expense accounts may generally be limited to procedural tests and review of internal control. The audit procedures prescribed by the Securities and Exchange Commission and the stock exchanges relate only to the balance sheet accounts, are comprehensive and cover virtually all such accounts. Although retained earnings or undistributed profit and loss are *not* specifically covered in the prescribed audit requirements, these accounts must be reviewed in order to render an opinion on the overall fairness of the statement of financial condition and the Answers to Financial Questionnaire. Without a review of income and expense accounts there can be no reasonable assurance that the assets, liabilities, and capital accounts are fairly stated.

Depending upon the nature of the particular brokerage concern, such procedural tests, quite limited in scope, might include major elements of income and expense such as: commission income, trading profit or loss, underwriting income, interest and dividends, advisory fees, employee compensation, and interest expense. It is also desirable to compare current operating results with the prior period to ascertain that the variations are logical in light of the facts and circumstances. Here the independent public accountant should consider such matters as stock market volumes, the brokerage concern's share of the market, changed business conditions such as volume of new securities offerings, changes in character of the brokerage concern's business, trend of securities prices, etc. A comprehensive discussion of this comparative data with top management will often highlight areas where added audit emphasis should be directed.

If an opinion is to be rendered on the income statement, the above procedures would, of course, still apply. In addition, however, many transactions that heretofore did not fall within the scope of the procedural tests would have to be tested by examination of supporting records or documents. Particular attention should be given to the consistent classification of items so as to obtain meaningful trend comparisons.

Auditing for many of the income and expense items such as interest, dividends, employee compensation, occupancy, communications, promotion, and taxes is similar to other industries and need not be covered here. Tests should be made of trading and investment profit and loss and it should be ascertained on a test basis, where appropriate, that trading and investment inventories are marked-to-market and the market adjustment reflected in current earnings. Calculations of commission income should be tested and related to trading volumes and to compensation of registered representatives. Provisions for uncollectible accounts and for potential loss on aged fails, aged transfers, aged dividends receivable and security shortages should be analyzed and reflected in the proper period. Accounts reflecting losses or gains from closed out security differences should be reviewed and consideration given as to the effect of possible claims arising from closed out "long" differences (overages). Care should be exercised to determine that proper accruals are made in the appropriate period for such items as investment advisory fees, sums due to and from syndicate account managers, merger and professional fees, etc. If the accounting for securities transactions is on a "settlement date" basis, it is appropriate to accrue commission income on the unsettled trades and related expenses such as registered representatives' share of the commissions, floor brokerage, etc. Since the brokerage concern has performed all of the required services and incurred the costs of earning one-half of the "round-turn" commissions on open commodity positions, such commissions, if material, should be accrued even though they are not billed to customers until the position is closed.

If the examination is being made at a time other than at the time of the normal closing of the accounts of the brokerage concern, it is the practice to group all income and expense account balances into one figure designated as "undistributed profit and loss." As brokerage partnerships frequently have limited partners who share in the profits in addition to receiving interest on their capital contributions, care should be exercised in classifying as a liability that portion of undistributed profits which is applicable to limited partners in accordance with the terms of the partnership agreement.

Open Contractual Commitments. Contractual commitments which are usually not recorded in money liability accounts include underwriting commitments, "when issued" contracts, "delayed delivery" contracts, endorsements of puts and calls, commitments in foreign currencies, etc.

Confirmation of all commitments of the type indicated, other than endorsed puts and calls (as to which the holder is unknown), should be requested, as well as the offsetting commitments of its customers. In most instances the commitments of customers will appear in the accounts of the customers and will be confirmed at the time the accounts are confirmed. In other instances, however, information as to purchases and sales of securities on a "when issued," "delayed delivery," or "when distributed" basis may not appear in the accounts of customers or others but may be represented by tickets in an open contract file. If so, these open contracts must be confirmed in the same manner as other accounts. In some instances where a settlement date (subsequent to the audit date) has been fixed for an open contract transaction, the broker or dealer will clear the open contract file and enter the transactions on the settlement blotter for the day of settlement. These transactions are not "regular way" transactions and should be confirmed and reported as "open contractual" commitments.

Another type of contract has to do with the brokerage concern's interest in joint accounts in issued securities carried by other brokerage concerns. In many instances the interest in these positions in securities is not recorded in the financial accounts of the non-carrying member of the joint account although, if material, they should be reflected in the financial statements. Regardless of whether or not the positions are reflected in the financial accounts of the brokerage concern under examination, all details of the joint accounts should be confirmed in writing with the carrying brokers. If the brokerage concern under examination is the carrying broker, all details of the joint accounts should be confirmed with the participating brokers.

Contingent Items. Inquiry should be made as to the existence of contingent or unrecorded assets, liabilities and accountabilities, lawsuits or claims pending, accommodation endorsements, rediscounted notes, guarantees, and subsequent happenings. A representation should be obtained from an authorized representative of the brokerage concern as to unrecorded assets, liabilities, accountabilities, and any other matters which might influence the overall fairness of the financial statements.

Written statements should be obtained from outside legal counsel of the brokerage concern as to the status of lawsuits or claims pending and any other matters involving legal determination and as to the probable extent of any liability arising therefrom.

Unsettled Principal Transactions. Many brokerage concerns record transactions on a settlement date basis; however, particularly where brokers or dealers in securities maintain substantial positions in their inventory accounts, it may be necessary, where there has been a material change in the inventory value, to adjust such accounts to a trade date basis in order to present fairly the financial position and results of operation.

In cases where trades are recorded on the trade date basis, the offsetting entry on a sale of securities would be to the asset account "Receivable for securities sold for future settlement," and the offsetting entry on a purchase of securities would be to the liability account "Payable for securities purchased for future settlement." The receivable and payable accounts, including securities positions, should be confirmed, if practicable, or otherwise audited by alternative procedures. If confirmation is requested, the confirmation should identify the securities by quantity and description, trade date and settlement date, and should show the specific amount to be received or paid upon receipt or delivery, respectively, of the security.

Exclusion From Valuation of Segregated and Safekeeping Securities

Under Item B.2 of the general instructions to Form X-17A-5 the valuation of customers' securities in segregation or safekeeping need not be included in the answers. While the language indicates that the elimination is permissive, the valuations of segregated and safekeeping securities (including fully paid for securities in transfer into the name of the customer) are generally eliminated because the values have no financial significance and their elimination facilitates the interpretation of the Answers to Financial Questionnaire.

In brokerage concerns utilizing electronic data processing it is possible to develop programs which automatically eliminate from valuation the segregated and safekeeping securities. These programs are designed to cross-foot the quantities appearing in the "Seg" and "SK" columns (see example of EDP produced stock record elsewhere herein), to subtract the totals thus obtained from the quantities appearing in the "long" column (or in the "short" columns with respect to the box control accounts), and to determine the net quantities "long" and "short" which should be valued. Special program instructions may be provided to identify "over segregated" conditions, i.e., where the aggregate in segregation and safekeeping columns exceeds the position "long." (This indicates an error condition which should be corrected.) Items in process of being transferred into customer name are eliminated by special program instructions, or manually as if such securities were in segregation. This elimination is made because the securities, when returned to the brokerage concern in customer name, are generally no longer negotiable and are held for that particular customer.

In smaller brokerage concerns where the independent public accountant manually checks security counts and confirmations to copies of the brokerage concern's stock record, the elimination of segregation, safekeeping, and transfers to customers' names are performed manually. Where the independent public accountant checks his security count to copies of the stock record, the "Seg" or "SK" column may be posted opposite the customers' names simultaneously with the count check out. An example of this operation is shown on the following page.

SECURITY: X Y Z Corporation 6% Preferred

MARKET VALUE ______

SOURCE ______

LONG									
			Quantity			SK.		Value	
			Shs. or Par		Fr.	or SEG.			
Customers' Accounts:									
John Doe				200		100(1) 100(3)			
Richard Roe				500		100(2) 100(3)			
Henry Hoe				100		100(1)			
Failed to Deliver				200					
Stocks Borrowed				100					
Firm Accounts				100					
				1,200		500			

SHORT									
			Quantity			SK.		Value	
			Shs. or Par		Fr.	or SEG.			
Customers' Accounts:									
James Smith				100					
Firm Accounts				—					
Active Box				100					
Safekeeping Box				200		200(1)			
Segregation Box				100		100(2)			
Bank Loans				500					
Transfer				200		200(3)			
				1,200		500			

After the segregation and safekeeping elimination has been completed, the balance of positions to be valued "long" should be in agreement with the balance of positions to be valued "short."

Valuation of Securities

Securities regularly traded are valued at the closing prices on the audit date or, in the event that no transactions occurred on that date, at the appropriate closing bid or ask prices. Fractions are generally eliminated unless their elimination would have a material effect on net capital.

Market prices for securities actively traded are obtained from financial journals or other reliable sources and the source indicated in the working papers. Quotations may not be available for exempted securities and securities not actively traded. In such cases, the independent public accountant may obtain prices for such securities from the trading department of the brokerage concern being examined, provided he checks all material items independently with some other brokerage concern having knowledge of the particular security and, for net capital computation purposes, that such securities meet the requirements of the applicable regulatory body.

In the case of securities for which market quotations cannot be obtained, fair values would ordinarily be determined by the management. The independent public accountant does not function as an appraiser and is not expected to substitute his judgment for that of the brokerage concern's management; rather he should review all information considered by management and ascertain that the procedures followed appear to be reasonable and adequate. Since the determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures, the accountant may find it appropriate to qualify his opinion where such valuation involves material amounts.

Reference is made to Accounting Series Releases No. 113 and No. 118 of the Securities and Exchange Commission as guides for the valuation of securities and the auditing thereof.

General instruction B.5 to Form X-17A-5 requires that securities not readily marketable shall be so designated in the Answers to Financial Questionnaire. (Reference should be made to the rules and regulations of the applicable regulatory bodies for definitions of "not readily marketable.")

In brokerage concerns utilizing electronic data processing, special programs are often developed which associate pricing data with the stock record and perform the necessary computations automatically. The end result is what may be termed a "valued stock record."

In smaller brokerage concerns the security prices and source may be entered on a copy of the stock record and the necessary computations performed manually. The "valued stock record" would appear as follows:

SECURITY: X Y Z Corporation 6% Preferred

MARKET VALUE 46
SOURCE WN-1(*)

LONG						
		Quantity Shs. or Par Fr.	SK. or SEG.		Value	
Customers' Accounts:						
John Doe		200	100 100			
Richard Roe		500	100 100		13	800
Henry Hoe		100	100			
Failed to Deliver		200			9	200
Stocks Borrowed		100			4	600
Firm Accounts		100			4	600
		1,200	500		32	200

SHORT						
		Quantity Shs. or Par Fr.	SK. or SEG.		Value	
Customers' Accounts:						
James Smith		100			4	600
Firm Accounts		—				
Active Box		100			4	600
Safekeeping Box		200	200			
Segregation Box		100	100			
Bank Loans		500			23	000
Transfer		200	200			
		1,200	500		32	200

(*) Wall Street Journal
New York Stock Exchange
Closing Sale

Review and Classification of Accounts in Response to Financial Questionnaire

At this point of the examination, securities valuations "long" and "short," by security, have been balanced and preliminary classification of the questionnaire answers for most of the general ledger accounts determined. However, certain accounts, such as those with customers and brokers, must be analyzed before it can be determined where they are to be reported in the questionnaire. In general, the accounts to be analyzed are those which contain, or may contain, security or commodity transactions and where the classification of the account may depend upon the relationship of security valuations to the net debit or credit balance in the account.

In manually operated accounting systems the valuation of each security position may be posted to the audit file copies of the statements of customers and brokers, bank loan confirmation requests, etc. This procedure may be accomplished at the same time the security positions, as shown on the stock record, are compared to those shown on the file copies of the statements. When all values have been posted, the valuations are totaled separately by "long" and "short" on each file copy or listings such as those containing trading and investment accounts. The totals obtained are then compared to the appropriate totals mentioned in the following paragraph.

In turn, a summary analysis is made of the valued stock record which should show totals for each security valuation "long" and "short," summarized as follows:

Customers
Brokers
Trading and investment accounts
Other accounts
Bank and other loans
Box, transfer and transit

When complete, the summary is totaled, and the total of all valuations "long" must agree with the total of all valuations "short."

After posting of security valuations to copies of customer's statements the customer's equity in each account may be determined. Accordingly, all statements which show this information are commonly referred to as "equity statements."

In determining a customer's equity in an account, the value of securities "long" represent credits and the value of securities "short" represent debits. If the value of securities "long" exceeds the debit balance plus the value of securities "short," or if the credit balance plus the value of securities "long," exceeds the value of securities "short," such excess represents the customer's equity in the account and the account is secured. If the total of the debit balance and value of securities "short" is greater than the value of securities "long," or if the credit balance is less than the value of securities "short," the account is in deficit and is partly secured. If the account shows a debit balance and no long security values, or a short security value and no credit balance or long value, the account is unsecured.

In determining equity, all of a customer's accounts (including accounts related by bona fide written guarantees) other than regulated commodity accounts may be combined. Also, securities in negotiable form which were not valued, because held in segregation, may be considered (but need not be reported in the Answers) in determining the equity and status of an account. For example, if the equity statement discloses the account to be unsecured, but the value of negotiable securities held in segregation is equal to or greater than the deficit, the account should be classified as secured.

Although the classification of customer accounts is primarily based on the equity or deficit in the account, there is an additional classification consideration with respect to customers' cash accounts. Form X-17A-5 provides that "bona fide cash accounts" (defined as accounts having both unsettled money balances and positions in securities which are current items within the meaning of Section 4(c) of Regulation T of the Board of Governors of the Federal Reserve System) are to be classified in Question 6A regardless of whether the account liquidates to an equity or a deficit. Therefore, in order to properly classify cash accounts, a determination must be made as to whether the open transactions included in each account are current. Cash accounts which contain one or more transactions which are not current within the meaning of Section 4(c) of Regulation T must be reclassified from Question 6A to Question 6B or 6C, based on the equity or deficit in the account. As indicated elsewhere in this audit guide, the present practices of the brokerage industry provide for the maintenance of customers' accounts on a "net balance forward" basis which does not provide details of the individual open items comprising such balance in form through which open transactions can be readily aged and summarized at a given point in time for classification purposes. Accordingly, it may be time consuming and costly for the brokerage concern to comply with this classification requirement and extremely difficult for the independent accountant to ascertain that "all" transactions included in accounts which are classified as "bona fide" cash accounts are current.

The difficulty posed by the present requirements is under consideration by various regulatory agencies at this time.

After completing the analysis of customers' accounts a summary classification is prepared and may then be posted to the general ledger working trial balance. In addition, the values shown on the valued stock record covering securities in box, transfer, and transit may likewise be posted to the general ledger working trial balance.

The responses to Questions 14, 15, and 16 are not recorded in ledger accounts for money, and the security values are not included with the totals reported in the columns for "long" and "short"; accordingly, responses to these questions are prepared independently of the responses to preceding questions.

In substance, similar steps are taken in order to classify the accounts, by type, when the brokerage concern utilizes EDP equipment. There are various methods that may be utilized in order to accomplish these objectives. Such methods vary depending upon the systems and procedures in effect.

Margining of Customers' Margin Security Accounts

Margining of customers' margin security accounts is not required for purposes of completing Form X-17A-5 of the Securities and Exchange Commission or Parts I and II of the financial questionnaires of the various regulatory bodies. However, for purposes of completing Part III of the financial questionnaire of the New York Stock Exchange (which part is also required by other exchanges) margining of all customers' margin security accounts is necessary. All security accounts of a customer may be combined for the purpose of determining adequacy of margin.

Federal regulations designate the amount of credit which a brokerage concern may extend to its customers on initial purchases of securities. The exchanges, on the other hand, designate in their rules the margins which their member organizations must maintain in the margin accounts of customers. Although it is maintenance margin that the independent public accountant is primarily concerned with in his examination of the Answers to Financial Questionnaire, he should also review and test procedures for compliance with federal regulations of initial margins.

Margining of customers' margin security accounts begins with the equity statements described elsewhere in this guide. In large brokerage concerns utilizing electronic data processing equipment, margining may be performed by use of special programs which are sometimes incorporated in the equity statement programs and performed simultaneously with the preparation of the equity statement. In small manually operated brokerage concerns and in some brokerage concerns with less sophisticated data processing equipment, the margining operation can be accomplished by performing the calculations manually on the equity statement (or on a copy of the customer's statement to which security valuations have been entered from the valued stock record during the posting operation).

The following example, based on the present maintenance margin requirements of the New York Stock Exchange, illustrates a method used to determine the amount of cash required, if any, to margin an account. Such cash required (after application of current margin calls outstanding as of the audit date) must be reported in Part III of the Answers to Financial Questionnaire when reporting to the New York Stock Exchange.

Customer—John Doe:		
Ledger balance—debit		$ 6,800
Long security valuations:		
100 shs. A B C Corp. @ 75	$7,500	
200 shs. X Y Z Corp. @ 25	5,000	12,500
Short security valuation:		
100 shs. D E F Corp. @ 32		3,200
Computations		
Equity in account:		
Debit balance		6,800
Valuation of "short" securities		3,200
Total		10,000
Valuation of "long" securities		12,500
Equity		$ 2,500
Maintenance margin required:		
25% of valuation of "long" securities		$ 3,125
30% of valuation of "short" securities		960
Total		$ 4,085
Maintenance margin deficiency (cash basis) ($4,085-$2,500)		$ 1,585

If the customer corrects the maintenance margin deficiency by depositing additional securities, the valuation of such securities must be greater than the $1,585 cash deficiency shown in the above example since the additional securities are also subject to the 25% maintenance margin requirement. To determine the valuation of securities needed to correct the cash margin deficiency, the cash margin deficiency is divided by 75% which, in the above example, would result in $2,113.33.

If undermargined accounts are guaranteed and such guarantees are evidenced by approved written forms, the maintenance margin status is determined by combining the account with the account of the guarantor.

The margining of accounts contemplates that consideration be given to margin required with respect to contractual commitments such as "when issued," "when distributed," and "delayed delivery" transactions and put and call options.

Computation of Net Capital and Capital Ratio

Before completion of the examination of the Answers to Financial Questionnaire, the independent public accountant is required to verify the computation of net capital and the capital ratio of the respondent as of the audit date in accordance with the rules of the Securities and Exchange Commission or of the securities exchanges of which the respondent is a member. He is also required to review the procedures followed in making the periodic computations required under provisions of Rule 17a-3 (a)(11) of the Securities and Exchange Commission. The various net capital rules specify the maintenance of a minimum net capital and establish maximum permissible ratios of aggregate indebtedness to net capital.

Net capital is basically the net worth plus, where applicable, subordinated indebtedness of a broker or dealer less (1) assets which cannot be readily converted into cash and (2) certain percentage reductions, referred to as haircuts, in the market value of proprietary securities.

"Aggregate indebtedness" is the aggregate of certain liabilities as set forth in Rule 15c3-1 of the Securities Exchange Act of 1934 and may be defined generally as total money liabilities excluding amounts payable to general partners and excluding indebtedness (1) adequately collateralized by securities exempted from registration under the Securities Exchange Act of 1934 otherwise than by action of the Securities and Exchange Commission, (2) adequately collateralized entirely by proprietary securities, and (3) subordinated to claims of general creditors under approved agreements.

The rules, regulations, and instructions relating to the computation of net capital have been made quite extensive in an attempt to provide for the proper handling of a myriad of transactions. Since the number of situations a broker or dealer may engage in is limited to some extent only by his imagination, a standard form which may be used to insert figures to arrive at net capital does not appear to be practical. However, examples of a computation are provided in Exhibit R and in the Securities Exchange Act (1934) Release No. 8024 (which is also identified as Accounting Series Release No. 107 of the Securities and Exchange Commission). Unfortunately, there are at present numerous variations in the capital rules of the regulatory and self-regulatory bodies. It is, therefore, extremely important that the independent public accountant ascertain (a) which rule is applicable in each case, and (b) that he is familiar with the current provisions and interpretations of such rule.

Computation of Formula for Determination Of Reserve Requirement

On November 10, 1972 the Securities and Exchange Commission adopted Rule 15c3-3, under the Securities Exchange Act of 1934, which became effective January 15, 1973. The Rule provides, among other things, that a brokerage concern must compute on a weekly basis the amount, if any, of customer funds held in excess of funds deployed in specific customer related activities and, further, that such amount must be on deposit in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" at all times. The computation is made in accordance with a detailed formula which is provided in the Rule. The Rule also requires a brokerage concern to promptly obtain physical possession or control of all fully-paid securities and excess margin securities carried for the account of customers and requires him to act within designated time frames where possession or control has not been established.

The independent public accountant should review the procedures and controls of the brokerage concern relating to this Rule and perform those tests which he considers necessary to satisfy himself that the procedures and controls in effect provide reasonable assurance of compliance with the Rule.

Report to Be Rendered on SIPC Annual Assessment

The Securities and Exchange Commission, in its Release No. 9766, amended Rule 17a-5 by the addition of paragraph (b) (4), effective October 15, 1972, which requires certain exchange members, brokers and dealers to file concurrently with the report filed pursuant to Rule 17a-5, a supplemental report, in letter form, addressed to the Commission, covering the SIPC annual general assessment reconciliation or exclusion from membership forms, not previously reported on under this subparagraph (b)(4). Attached to this supplemental report shall be an independent public accountant's report which shall state that in his opinion either the assessments were determined fairly in accordance with applicable instructions and forms, or that a claim for exclusion from membership was consistent with income reported. However, if his examination did not provide the basis for issuing such a report, the accountant shall state the extent of his review. Such review shall include as a minimum, certain procedures as detailed in the amendment.

Reporting

The independent public accountant's report covering the Answers to Financial Questionnaire must meet specified Securities and Exchange Commission and stock exchange requirements (see Exhibit A). Reports on statements of financial condition and related statements of income follow the standard short form (see Exhibits D and J), as does the report when reporting only on the statement of financial condition (Exhibit P).

There may be situations where it is appropriate for the independent public accountant to qualify or disclaim an opinion. Particularly troublesome areas include material amounts of unresolved security differences, suspense accounts, unverified transfer items and unverified dividends receivable. Situations may also be encountered where operational conditions and the status of the records are such that it would be inappropriate to report on financial statements prepared on a "going concern" basis.

A violation of the applicable net capital rules as of the audit date requires footnote disclosure and may require the independent public accountant to qualify his opinion because of "going concern" considerations. However, there may be situations in which the capital deficiency is corrected prior to the issuance of the independent public accountant's report. In these circumstances footnote disclosure may be adequate.

Section 5

Commodity Transactions

General

The commodity department usually functions as an independent unit with its own purchase and sales, bookkeeping, and margin departments. The commodity general ledger reflects all real and nominal accounts relevant to commodities and carries the net balancing figure thereof as an account in the general ledger.

Transactions in commodities involve either futures contracts or spot (cash) transactions. A futures contract is an agreement to buy or sell a definite quantity of a specified commodity of a certain grade at some later time. Settlement generally is made by an offsetting futures contract, either before or during the delivery month specified in the contract; this is known as a round-turn. A spot (cash) transaction involves delivery of the commodity. Customers of brokerage concerns generally are not interested in making or accepting delivery of a commodity; instead, they wish to trade in futures contracts only.

Security brokers and dealers who also deal in commodities generally engage in at least one of several activities. The larger brokerage concerns may act in the capacity of futures commission merchants, cash commission merchants, commodity merchandisers, and country and/or terminal grain elevator operators.

The number of brokerage concerns that engage in all of these activities is relatively few as commodity trading is a highly specialized activity.

Trading in futures is the most common type of commodity transaction and, accordingly, is the kind which will be most frequently encountered in examinations of brokerage concerns. While a direct relationship with futures trading exists, cash (spot) trading occurs much less frequently. Commodity merchandising and elevator operations often are conducted through subsidiary or affiliated companies because of capital requirements and other restrictions imposed upon brokerage concerns who are also members of national securities exchanges.

Commodities traded range from grains to cocoa, cotton, eggs, metals (lead, copper, etc.), and meats (turkeys, pork bellies, etc.). Commodities are susceptible to trading on a futures basis because of their generally fungible nature (that is, a particular lot or grade of the physical commodity loses its identity when commingled with quantities of the same commodity) and volatility of price fluctuations in periods of uncertainty (wartime conditions, crop failures, pestilence, drought).

In the absence of a futures market for these commodities, food processors, millers, farmers, and other users who must carry large physical quantities of these commodities in inventory would be subject to the risk of price changes. The futures market, however, affords these users a means of price protection by enabling them to hedge the physical quantities of commodities in inventory in either their raw or finished state.

In its simplest form, hedging involves the simultaneous purchase of the physical commodity to replenish inventory and entering into a contract for the sale of the same commodity for delivery at some future date. Theoretically, as physical (spot) inventory is accumulated, futures (sales) contracts are entered into to hedge against loss due to price fluctuations. As the physical inventory of the commodity is sold, the futures trade is closed by buying-in the previous sale. Any loss incurred on the futures transaction becomes part of the cost of sales and will be offset by a profit on the inventory liquidation, or vice versa.

Through continued application of futures transactions, commodity users can avoid a large part of the potential losses caused by fluctuations in market price of the commodity.

While price protection is the basic purpose of a futures market, the speculator plays a major role in making an effective market. The speculator assumes the risk of price changes, and it is these changes in price that provide the speculator an opportunity to profit, generally by assuming a position opposite to the hedger.

The federal government participates significantly in the regulation of commodity exchanges. Through the authority conferred upon it by the Commodity Exchange Act, the United States Department of Agriculture regulates the operation of certain commodity contract markets or exchanges. Some of the more important provisions of these regulations limit the quantities of speculative futures contracts in each commodity any one person may acquire, require daily reporting of trading activity by exchange members, and restrict use of customers' funds deposited with brokers as margin on futures contracts.

Federal authority over trading activity is confined only to certain commodities—commonly referred to as regulated commodities. These commodities are, however, often the most actively traded, and accordingly, Federal regulation is quite broad in scope. Regulated commodities are generally those domestically produced farm commodities controlled by regulations of the United States Secretary of Agriculture under the Commodities Exchange Act. These include grains, soybeans, cotton, butter, eggs, potatoes, etc. Commodities not covered by this legislation are classified as non-regulated commodities.

In a few instances, brokerage concerns also may be subject to the United States Public Warehouse Act governing the operation of public storage facilities. These situations are generally confined to concerns operating grain elevators.

In addition to federal government regulations, brokerage concerns must conform to the requirements of the various contract markets or exchanges and associated clearing organizations of which they are members. These self-policing organizations are similar in nature to security exchanges in that they maintain and provide a market place for buyers and sellers and establish standards for orderly trading. Moreover, initial and maintenance margin requirements have been established for each commodity. Unlike security exchanges, however, commodity exchanges have set maximum daily price fluctuations for certain commodities.

Rules and regulations of the various exchanges require minimum initial margin deposits depending upon the commodity bought or sold. While the brokerage concern may establish its own requirements depending upon the financial ability of a particular customer, they must not be less than the minimums set by the exchanges. Margin rates differ for each commodity and for the purpose for which a futures trade is made, that is, hedging or speculating. In periods of high volume of activity, when excessive speculation prevails, the exchanges increase initial margin requirements. However, margin rates are subject to reduction or restoration to their previous level when conditions warrant a change.

In addition to initial margin requirements, maintenance margin requirements have also been prescribed by the exchanges. Any impairment of the initial margin deposit due to price fluctuation below the maintenance margin level set by the exchange must be met by margin calls to customers. In most cases, the call must be sufficient to restore the margin to the maintenance level which is usually lower than the initial margin, while for certain commodities the call must be sufficient to restore the margin to the original margin deposit. Obviously, if the call is not met within a reasonable number of days, the customer's open futures position must be liquidated to an extent that would bring his account back to a status of margin conformity.

Execution of orders for future commodity trades by brokerage concerns is somewhat similar to the handling of stock or bond orders. However, a brokerage concern, other than a brokerage concern which places its commodity transactions through a correspondent broker, actually deals with a clearing organization when it buys and sells futures contracts for the account of its customers. According to commodity exchanges rules, the clearing organization substitutes for the other broker that is a party to the transaction. As a result, offsetting transactions entered into by the same broker are immediately balanced against one another by the clearing organization.

Accounting for a future commodity contract transaction differs from that for a security transaction. While a confirmation of the trade is submitted to the customer showing the pertinent price, quantity, and commodity data, no monetary entry is made in the customer's ledger. The customer's account reflects only the margin deposit and the open contract in the commodity traded.

The commodity exchange usually establishes at the close of business each day a settlement price to which all contracts are to be adjusted, that is, marked-to-the-market. Each day, all open contracts are listed, together with the quantity, contract price, and settlement price. The net difference (gain or loss) is determined, after considering the nature of the individual variations, and is settled in cash with the clearing organization each day. The brokerage concern records the amount of the daily settlements in contract difference accounts from which gains and losses are transferred to the customers' accounts when roundturns have been completed.

Standing margins are established by the clearing organization and are used as collateral to guarantee a brokerage concern's commitments. The amount of margin is based upon the position in each commodity. The cash generally is deposited by the clearing organization in a bank account designated by the brokerage concern, and evidence of these deposits in the form of margin certificates is delivered by the bank to the member organization.

The foregoing procedures apply basically to all futures commodities trades, regulated as well as nonregulated. Futures contracts in regulated commodities, however, impose additional accounting requirements. All funds deposited by customers and all funds accruing to customers as a result of trades or contracts must be separately accounted for and deposited in separate bank accounts appropriately designated as customers' funds segregated under the Commodity Exchange Act or invested in qualified securities. Such investments are limited to obligations of the United States, general obligations of any State or of any political subdivision, or obligations fully guaranteed as to principal and interest by the United States, and the securities must be deposited in an escrow account with a bank. Income derived from these securities accrues to the brokerage concern. The amount of money and securities which must be deposited in segregated accounts in order to comply with the requirements of the Commodity Exchange Act must be computed as of the close of the market each business day.

In determining customers' funds to be segregated, a deficit in the account of one customer cannot be offset against another customers' equity. Separate accounts must be kept for customers trading in both regulated and nonregulated commodities as the

Commodity Exchange Act prohibits commingling of funds and transferring between customers' accounts except on specific written authorization of the customer. The Commodity Exchange Act does not regulate margin requirements on futures trades; these are regulated by the various exchanges. However, the Commodity Exchange Act specifies that customers' funds deposited in accounts designated as regulated commodity accounts may be used only to margin customers' regulated commodity positions.

Many brokerage concerns, particularly those located outside the exchange cities, do not deal directly with the commodity exchanges but place their commodity transactions through correspondent brokers. In such instances, the accounts of the brokerage concern may not contain a contract difference account since the offset to purchases and sales of futures commodity transactions will be in the account with the correspondent broker.

Examination of Commodity Department

In many respects, audit procedures applicable to commodity accounts do not differ materially from those relating to security accounts. The basic procedures of confirmation, balancing of positions, margining, inspection of documents, and account classification must be carried out. In addition, the independent public accountant should review the procedures for complying with the Commodity Exchange Act segregation requirements and, as of the audit date, check the calculation of such requirements and ascertain that sufficient funds are appropriately segregated.

Independent public accountants conducting examinations of financial statements of brokers and dealers doing business in commodities should obtain a copy of the Commodity Exchange Act and the regulations thereunder issued by the Secretary of Agriculture. (This material may be obtained from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.)

It is important that the independent public accountant have a clear understanding of the following areas which are somewhat peculiar to the Commodity Department.

Clearing Organization for Settlement of Future Commodity Contracts. A brokerage concern ordinarily will be a member of the clearing organization which is affiliated with any commodity exchange through which the concern, as a member, executes transactions. Daily settlement reports (recapitulation sheets) based upon receipts rendered by member brokerage concerns are prepared by the organization. The net amount payable or receivable is settled by a check or draft forwarded with the daily report. The daily settlement report also shows the amount of original margin deposits controlled by the clearing organization as protection against defaults on contracts.

The positions open with the clearing organizations, the amounts receivable or payable on settlements and the aggregate amounts of original margins should be confirmed by submitting to each clearing organization a copy of the clearing sheet as of the audit date together with a request for certification of the details shown therein. The independent public accountant should review subsequent clearing sheets for a selected number of days after the audit date for open trades, as of the audit date, which may have been cancelled thereafter.

Spot (Cash) Commodities in Physical Possession. Spot (cash) commodities ordinarily are represented by warehouse receipts or bills of lading, although some commodities such as gold, silver, or platinum may be in physical possession of the brokerage concern. The documentary evidences of ownership of such commodities may be in possession of the brokerage concern or they may have been deposited with a lender with whom such evidences of ownership are pledged as collateral.

The independent public accountant should inspect all warehouse receipts and bills of lading which are in the physical possession of the brokerage concern and should trace into the records any entries relating to such documents which may be in transit between offices of the brokerage concern at the audit date. Direct confirmation in writing should be obtained from the warehouses where the amounts involved are significant and from lenders as to any such documents that may have been pledged as collateral to loans.

The counting or weighing of commodities in physical possession should be observed by the independent public accountant, and he should take whatever steps are deemed necessary in the circumstances to satisfy himself concerning the types and grades of commodities.

Accounts Carried by Other Brokers and Dealers in Commodities. If a brokerage concern trades in commodities for which transactions are executed on a commodity exchange of which the concern is not a member, it probably maintains open accounts with other brokerage concerns who are members of that exchange. Such accounts are usually referred to as carrying brokers accounts and as of a given date, like other commodities accounts, show a debit or credit money balance and commodity positions either "long" or "short."

Brokerage concerns with which such accounts are maintained should be requested to forward directly to the independent public accountant a statement of the account as of the audit date, showing the cash balance and the commodity positions "long" or "short." These statements should be compared with the records of the brokerage concern under audit. The independent public accountant may, if he desires, mail a statement of the account to the carrying broker, requesting confirmation of the balance and position, to facilitate the reconcilement of the account.

Customers' Commodity Accounts. Customers' commodity accounts fall into two general classes: accounts with spot (cash) commodities positions and those with open futures contracts.

Written requests for confirmation of the balances and positions in these accounts as of the audit date should be mailed directly to customers in a manner similar to that followed for customers' securities accounts.

Accrued Commodity Commissions Receivable and Payable. These represent commissions due from customers or due other brokers on uncompleted "round-turns" (open "long" and "short" positions). These amounts should be tested by reference to the brokerage concern's commission schedule.

Commodity Suspense Accounts—Regulated and Non-Regulated. The balances herein represent checks payable to, or drafts receivable from, various clearing organizations on account of "variation margin" (last day point fluctuation—difference between prior day's settling price or contract prices during the day and last day settling price—on net "long" or "short" positions). This account should be analyzed, the net balance broadened to reflect drafts receivable and payable, and the amounts agreed to certified copies of clearing sheets.

Commodity Exchange Fees. These represent fees due from the exchange members' customers on uncompleted round-turns (open "long" and "short" positions) and due to various clearing organizations upon execution of trades thereon. This account should be analyzed, the net balance broadened into fees receivable and payable, reconciled to copies of statements filed with clearing organizations, and subsequent payments traced to the cash journal.

Commodity Brokerage Payable. This represents brokerage due to member organizations of other exchanges with respect to trades executed by them on the floor of the exchange for the account of the brokerage concern under examination. This account should be examined by comparing the bills for the current month with payments subsequent thereto to determine adequacy of accrual.

Balancing Commodity Positions

Commodity positions are balanced in the same way as security positions, i.e., separately by customers, partners, trading accounts of the brokerage concern, and other brokers' positions "long" and "short" are posted from certified copies of clearing sheets, statements from correspondent brokers, etc. Frequently this is accomplished by preparation of a schedule in commodity sequence which includes each futures commodity contract by month of contract maturity together with extended contract values and market values and resultant gain or loss. This schedule is termed a point balance schedule. The gains and losses shown should be in agreement with the contract difference accounts.

Valuation of Commodity Contracts

Commodity contracts should be extended at both contract and market value (settling price at audit date as per certified copies of recapitulation sheets) and the resulting gains or losses computed. If the brokerage concern deals directly with the commodity exchange, the difference between the net clearing house positions extended at contract and market should agree with the amount shown by the contract difference account and will balance the net gains or losses determined for offsetting contracts of customers, partners, etc. Also, since this operation automatically proves the balances in the contract difference accounts in the general ledger, it will eliminate the necessity for test-checking extensions of contract and market values.

Margining of Customers' Commodity Accounts

As with security accounts of customers, margining of customers' commodity accounts is not required for purposes of completing Form X-17A-5 of the Securities and Exchange Commission or Parts I and II of the financial questionnaires of the various regulatory bodies. However, for purposes of completing Part III of the financial questionnaire of the New York Stock Exchange (which part is also required with respect to other exchanges), margining of customers' commodity accounts is necessary.

Computing margins in customers' commodity accounts is performed in much the same way as computing margins in customers' security accounts, i.e., by testing the equity in the account with the margin required by the commodity exchanges for the various types of commodities carried in the account.

The independent public accountant, before undertaking the margining of commodity accounts, should obtain the following:

1. Latest bulletin on maintenance margin issued by the Securities Industry Association.
2. List of outstanding margin calls.
3. List of trade accounts, including accounts with credit lines granted.
4. List of proprietary accounts.

Customers' accounts with margin deficiencies should be reviewed for subsequent transactions to determine whether outstanding margin calls, if any, have been satisfied.

Section 6

Option (Put and Call) Transactions

General

Options for the purchase or sale of securities, commonly referred to as "puts" and "calls," include variations thereof which are known as "straddles," "spreads," "strips" and "straps." In each case, the option constitutes a contract which confers upon the buyer the privilege of buying (i.e., "calling" for) or selling (i.e., "putting" to) a certain security. In each instance the privilege may or may not be exercised, at the option of the buyer. The various securities options may be distinguished as follows:

1. A "put" is an option to sell a certain number of shares of a specified security issue at a fixed price on or before a fixed date to the seller thereof.
2. A "call" is an option to buy a certain number of shares of a specified security issue at a fixed price on or before a fixed date from the seller thereof.
3. A "straddle" is a combination of one "put" and one "call," identical with respect to security issue, number of shares, exercise price and expiration date.

4. A "spread" is a combination of one "put" and one "call" covering the identical security issue, number of shares and expiration date. The exercise price for the "put" is customarily slightly below the current market price, while the exercise price for the "call" is customarily above the current market price at the time the option contract is created.
5. A "strip" consists of two "puts" and one "call" for the same security.
6. A "strap" consists of two "calls" and one "put" for the same security.

"Put" and "call" options are normally written on a standardized contract form adopted by members of the Put and Call Brokers and Dealers Association, Inc. In the normal course of events, an individual desiring to purchase an option will contact his broker or dealer and request a market quotation on the cost of such an option. The broker or dealer will ordinarily contact an active put and call broker or dealer, who will in turn contact an individual who has previously expressed an interest in selling options of the type required. Assuming that mutually satisfactory terms can be arranged, the option contract will be written, endorsed (guaranteed) and delivered to the purchaser. Most put and call brokers and dealers are thus typically engaged as middlemen or finders, without obligation to the option holder.

Options are customarily written only on the most active security issues listed on national securities exchanges. However, there is nothing to prevent two individuals from entering into an option contract covering less active securities, including over-the-counter securities. By the same token, option contracts may be written at any price and for any duration, but are most frequently written "at the market," i.e., at the current market price at the time of entering into the contract, for periods of 30 days, 60 days, 90 days or six months (actually six months and ten days, thereby permitting the option holder to sell the option and realize long-term capital gain). During the existence of the option, the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights and stock dividends or splits.

All forms of options may be referred to in the financial community as "papers."

Examination of Option Department

Option positions are usually carried in customer or proprietary accounts of the brokerage concern along with and in the same manner as securities; i.e., purchased options are carried as "long" and sold options are carried as "short." The description of the option, however, includes the quantity, the contract price and the date of expiration. Confirmation of option positions of customers is accomplished therefore simultaneously with confirmation of customers' accounts.

Purchased Options. Purchased options, which are carried as "long" in the accounts of the brokerage concern under examination, are evidenced by endorsed "papers" on hand in the "box" or are set forth in the account of the correspondent broker through which the brokerage concern placed its option order. Therefore, the "papers" are examined, confirmed and balanced in the same manner as securities.

Sold Options. Sold options are carried as "short" in the accounts of the brokerage concern under examination. If the brokerage concern placed its option order through a correspondent, it can be confirmed in the same manner as a security. If the brokerage concern under examination endorses its customers' options and delivers them to the purchasers, either directly or through put and call brokers, the "papers" are said to be "out on the street" and the identity of the purchaser is usually unknown. In such instances confirmation is not possible but since, of necessity, the endorsing organization must maintain a record of endorsed "papers" the sold options are verified by checking them to this record. The customer side of the endorsed option is confirmed in the same manner as a security and should be balanced against the record of endorsed "papers."

The confirmation of both purchased and sold options should include quantities, contract prices and dates of expiration.

Margining of Customers' Option Positions

The purchaser of a securities option must make full cash payment in an amount equal to the option cost (premium) in the time prescribed by Regulation T of the Board of Governors of the Federal Reserve System. Purchased options (options which are "long") have no loan value and thus must be ignored when margining customers' accounts.

The seller of a securities option must deposit in his margin account an amount equal to the maintenance margin which would be required if the specific option were exercised. Thus, under New York Stock Exchange rules, a sale of a "put" would ordinarily result in a margin requirement of 25% of the contract price, assuming sale "at the market." Similarly, a sale of a call would ordinarily result in a margin requirement of 30% of the contract price, assuming sale "at the market." Following the date the option contract is written the margin requirement would be increased or decreased to reflect unrealized gain or loss. An exception to the above occurs whenever (a) the "short" call option is offset by adequately margined "long" stock or (b) the "short" put option is offset by adequately margined "short" stock, in which case no margin is required on the option contract. A further exception relates to the straddle; in this instance, margin is required on the "put" or the "call," whichever is greater, but not on both options.

In margining sold options each option is considered separately. Thus, in the case of a series of options for a particular customer, the excess of equity in one or more options cannot be used to reduce the deficit in other options.

The margin required on options should be entered on the customer's equity statement to determine any under-margined condition in the account as a whole. In cases where the sold options relate to existing positions in the customer's account, the market value of an existing "long" position cannot exceed the contract price of an applied call and an existing "short" position must be valued at the higher of the market value or the contract value of the applied put.

Accounting For Option Premiums

As a general rule, an option premium represents compensation to the seller for the risk he has assumed or, in a hedged situation, for the interest cost (actual or imputed) of carrying the related security position. In either event, it is appropriate to amortize the premium to income over the life of the option in order to achieve a proper matching of cost and revenue.

Conversion Accounts

The demand for call options by option buyers usually exceeds that for put options. Sellers of options, however, generally prefer to sell straddles. To cope with this imbalance of supply and demand, certain New York Stock Exchange member organizations operate option conversion accounts. Under this arrangement, the option dealer buys a straddle and sells the call portion. He then takes the remaining put and gives it, free of charge, to the member organization. In return, the member organization agrees to sell the option dealer another call, generally containing the same contract price as the put. The option dealer can then resell this call option to another buyer. The member organization simultaneously purchases the related security in the market to hedge the call. At this point, the member organization is "long" a put, "short" a call and "long" the related security. (It should be noted that the foregoing can operate in reverse if the demand for puts in a given security exceeds the demand for calls; however, this occurs less frequently.)

After the conversion, the member organization is in a fully hedged position; if the market value of the optioned stock increases, the purchaser of the option will call the stock. If the market value declines, the purchaser of the call option will not exercise his right and the member organization will exercise its put option.

The market value of the security positions in the conversion account must be shown separately in Question 10 of Part I of the Answers to Financial Questionnaire. Also, a separate schedule of such securities should be included in Part II. The Part II schedule must contain a separate column for the value of the securities *at the option price* (since this is a straddle, "put" and "call" prices are the same) and this value should also be parenthetically disclosed in Question 10 of Part I. These securities must be reflected in the statement of financial condition at the option price rather than at market value as this represents the realizable value of these securities to the brokerage concern. In addition, if such positions are material, separate disclosure must be made with appropriate description, i.e., "securities for which endorsed calls are outstanding and puts for like amounts are held."

It should be noted that similar situations can occur without a conversion arrangement, by market action. A brokerage concern can buy a security, buy a put and sell a call in unrelated transactions. Such situations should be treated basically the same as conversion situations for purposes of the Answers to Financial Questionnaire. However, in these instances, the contract prices of the puts and calls could be different; if so, the value of the security to be parenthetically disclosed in the Answers to Financial Questionnaire would be the *lower* of the put price or the call price. It is important to note, however, that for purposes of the statement of financial condition, such value may be too conservative. A determination must be made as to the present realizable value of the security, considering the existing relationship among the put price, the call price and the current market price. (See illustrations of such determinations elsewhere in this guide.)

Preface to Exhibits

The regulatory agencies which require brokerage concerns to issue their statement of financial condition to customers do not require that they be in comparative form. However, if comparative statements are issued, the comparison should be to the last audited statement of financial condition distributed to customers.

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form X-17A-5

Information Required of Certain Members, Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

SEC FILE NUMBER

FOR SEC USE

WORK LOCATION	DATE OF REPORT	DOCUMENT SEQ. NO.	

NAME OF REGISTRANT *(If individual, state last, first, middle name)*

STANDARD STOCKBROKERAGE CO., INC.

I.R.S. Employer Identification or Social Security No.

00-0000000

NAME UNDER WHICH BUSINESS IS CONDUCTED (If different)

ADDRESS OF PRINCIPAL PLACE OF BUSINESS

Number and Street	City	State	ZIP Code
1 Main Street	New York	New York	10004

THE ATTACHED REPORT reflects the financial condition of the above registrant as of: *(Date)*

December 31, 19X2

INDEPENDENT PUBLIC ACCOUNTANT whose Opinion is contained in this Report
Name *(If individual, state last, first, middle name)*

Accounting Firm

I.R.S. Employer Identification or Social Security No.

99-9999999

Address Number and Street	City	State	ZIP Code
2 Main Street	New York	New York	10004

Check one—

- [X] Certified Public Accountant
- [ ] Public Accountant
- [ ] Accountant not resident in United States or any of its possessions

FOR SEC USE

THIS REPORT CONSISTS OF (Check below)

- [X] Part I—Financial Information
- [X] Part II—Supporting Schedules Filed under a separate confidential cover.
- [X] Accountant's Certificate

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U. S. GOVERNMENT PRINTING OFFICE : 1969 O - 361-013

EXHIBIT A

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire

To the Board of Directors (1),
Standard Stockbrokerage Co., Inc.:

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2. Our examination was made in accordance with generally accepted auditing standards and with the audit requirements prescribed by (jurisdictional agency), and accordingly included a review of the accounting system, the internal accounting control and procedures for safeguarding securities and such tests thereof for the period since the prior examination date, December 31, 19X1, and of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the Answers to Financial Questionnaire, securities and investments not readily marketable amounting to $8,610,685 (21.7% of Stockholders' Equity) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the Answers to Financial Questionnaire of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the accompanying Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. at December 31, 19X2 present fairly the information required, in the form prescribed by the (jurisdictional agency (2)), in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The supplementary information included in Part II (2) has been subjected to the same auditing procedures and, in our opinion, includes all information required to be reported therein.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Board of Directors (1),
Standard Stockbrokerage Co., Inc.:

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2. Our examination was made in accordance with generally accepted auditing standards and with the audit requirements prescribed by (jurisdictional agency), and accordingly included a review of the accounting system, the internal accounting control and procedures for safeguarding securities and such tests thereof for the period since the prior examination date, December 31, 19X1, and of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. at December 31, 19X2, present fairly the information required in the form prescribed by the (jurisdictional agency (2)), in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. The supplementary information included in Part II (2) has been subjected to the same auditing procedures and, in our opinion, includes all information required to be reported therein.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report on Examination of Answers to Financial Questionnaire, continued

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

For a partnership the report is addressed:

To the Partners,
Standard Stockbrokerage Co.:

(2) Brokers or dealers in securities are subject to the regulatory requirements of a number of organizations, depending on the extent of their business activities. It is essential that the accountant inquire as to what reports the broker must file with such organizations and become familiar with their specific reporting requirements, if any.

Certain stock exchanges require additional supplementary information to be submitted, including information which is not readily subject to examination in accordance with generally accepted auditing standards. Such information should be noted as "unaudited" and the opinion paragraph should be appropriately modified as follows:

> Our examination also included the supplementary information contained in the accompanying Parts II and III, except that the information required in Part II schedule .... relating to accounts in which voting stockholders have an interest, and schedule ...., relating to amounts authorized or proposed to be distributed or withdrawn within the next six months, and in Part III schedule .... relating to financial obligations of stockholders was furnished to us by the stockholders of Standard Stockbrokerage Co., Inc. We do not express an opinion on Part II schedules .... or on Part III schedule .... as our examination did not extend to the affairs of the individual stockholders. Otherwise, in our opinion, Parts II and III present fairly the information shown therein.

EXHIBIT B

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire
As of December 31, 19X2
PART I

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	1	**Bank Balances and Other Deposits:**						
A-1		Cash on hand	$ 10,000					
A-1		Cash in banks:						
		Subject to immediate withdrawal	2,413,709					
A-2		Segregated under the Commodity Exchange Act	5,000					
A-3		Contributions to security clearing organizations (cash and respondent's exempted securities)	740,000			$ 10,000		
A-3		Good faith deposit related to contractual commitment	5,000					
	2	**Money Borrowed, and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured by or Containing Customers' Collateral** (including $2,000,000 market value of securities owned by the respondent):						
L-1		A. Money borrowed:						
		1. From banks and trust companies		$20,000,000		30,000,000		
		B. Accounts carried by other banking or brokerage houses:						
		2. Commodities accounts:						
(b) A-4		a. Regulated commodities futures accounts:						

		ii. Accounts liquidating to a deficit	31,546				$3,855
		b. Nonregulated commodities futures accounts:					
(b) A-4		*ii.* Account liquidating to a deficit	6,992				4,049
	3	**Money Borrowed and Accounts Carried for Respondent by Other Banking or Brokerage Houses, Secured Entirely by Collateral Owned by Respondent or its Officers and Directors, or by Securities Covered by "Satisfactory Subordination Agreements":**					
L-1		A. Money borrowed:					
		1. From banks and trust companies		9,000,000		15,000,000	
	4	**Other Open Items With Brokers and Dealers:**					
A-4		A. Securities borrowed	1,420,500		$ 1,723,455		
		B. Securities failed to deliver:†					
A-4		1. Outstanding less than 30 days	21,315,716		21,285,731		
A-4		2. Outstanding 30 through 39 days	1,645,053		1,618,445		
A-4		3. Outstanding 40 through 49 days	226,547		224,500		
A-4		4. Outstanding 50 through 59 days	127,618		123,592		
A-4		5. Outstanding 60 days or longer	110,182		86,325		
		C. Securities loaned:					
L-2		1. Customers' securities		2,174,850		2,028,547	
		D. Securities failed to receive:†					
		1. For customers:					
L-2		a. Outstanding less than 30 days		11,300,225		11,250,328	
L-2		b. Outstanding 30 days or longer		3,185,423		3,027,433	
		3. For accounts reportable under Question 10:					
L-2		a. Outstanding less than 30 days		7,820,425		7,784,638	
		b. Outstanding 30 days or longer		1,548,320		1,470,528	
A-4		E. Settlement balances with clearing organizations	600,000		1,000,000	425,000	

The accompanying notes are an integral part of this financial statement.

†Information regarding age of fails may be presented in a footnote.

Continued

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	5	**Valuations of Securities and Spot (Cash) Commodities in Box, Transfer, Depositories and Transit:**						
		A. Negotiable securities in box, transfer, depositories and in transit between offices of respondent				$58,612,500		
		B. Spot (cash) commodities represented by warehouse receipts or bills of lading in box and in transit between offices of respondent				200,000		
	6	**Customers' Security Accounts:**						
		A. Bona fide cash accounts:						
A-5		1. Accounts with debit balances	$ 9,011,380		$ 8,960,875	117,309		
L-3		2. Accounts with credit balances		$2,088,967	20,567	2,065,842		
		B. Secured accounts:						
		1. Accounts with debit balances:						
(c) A-5, A-6		a. Joint account in which the respondent has a 50% interest†	58,808		60,510			
L-3		Deposit as margin on the above joint account		5,000				
A-5		b. Other	40,411,167		56,571,175	857,543		

L-3		2. Accounts with credit balances		6,254,915	45,435	4,345,187	
		C. Partly secured accounts:					
A-5		1. Accounts with debit balances	18,076		7,200	876	
L-3		2. Accounts with credit balances		1,538		1,784	
A-5		D. Unsecured accounts	18,731			1,527	
L-3		E. Accounts with credit balances having open contractual commitments		27,834	30,152		
L-3		F. Accounts with free credit balances		3,797,711			
		G. Fully paid securities not segregated (Note 2)			5,602,409		
	7	**Customers' Commodity Accounts:**					
		A. Accounts with open futures contracts liquidating to an equity:					
(b) L-3		1. Regulated commodities		24,408			$3,855
(b) L-3		2. Nonregulated commodities		4,900			2,849
		B. Accounts with open futures contracts liquidating to a deficit:					
(b) A-5		1. Regulated commodities		1,090			1,200
		C. Accounts with spot (cash) commodity positions:					
		2. Not hedged:					
		a. Secured			125,000		
(b) A-5		b. Partly secured	100,000		75,000		
	8	**Accounts of Officers and Directors:**					
		A. Officers					
A-5		1. Secured accounts with debit balances	51,206		74,008		
L-3		2. Accounts with free credit balances		90,060			
		3. Fully paid securities not segregated			123,040		

The accompanying notes are an integral part of this financial statement.

†Ledger balance has been adjusted to reflect respondent's interest at market valuation.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance Debit	Ledger Balance Credit	Security Valuation Long	Security Valuation Short	Future Commodity Contracts Losses	Future Commodity Contracts Gains
	10†	**Trading and Investment Accounts of Respondent (Note 1):**						
		A. Securities accounts:						
		1. Marketable securities at market quotations:						
A-6		a. Exempted securities	$ 1,008,060		$ 1,008,060			
A-6/L-4		b. Other securities	17,749,443		19,612,172	$1,862,729		
A-8		2. Not readily marketable—at estimated fair value (cost, $7,880,000)	8,110,685		8,110,685			
A-8		C. Other:						
		1. Investments in real estate, cattle, and oil and gas drilling funds not readily marketable, at estimated fair value (cost, $505,000)	500,000					
	11	**Capital Accounts:**						
		C. Corporation:						
		1. Capital stock:						
L-12		a. $5 cumulative preferred stock of $100 par value per share; redeemable at $105 per share plus accrued dividends. Authorized 100,000 shares; issued and outstanding 50,000 shares		$ 5,000,000				

L-13		b. Common stock without par value. Authorized 2,500,000 shares; issued 1,500,000 shares (Note 5)		6,289,000	
L-14		2. Additional paid-in capital		2,200,000	
L-15		3. Retained earnings		27,438,172	
		4. Treasury stock:			
L-16		a. Common stock—200,000 shares, at cost	1,200,000		
	12	**Subordinated Accounts and Borrowings (Note 4):**			
		B. Other subordinated borrowings:			
A-9/L-9		1. Securities borrowed under subordination agreements			6,281,725
L-9		2. Cash		400,000	
L-10		3. Pursuant to secured demand note collateral agreements		3,215,773	
A-13/L-11		4. Exchange memberships contributed for the use of the Company (market value $375,000)			

The accompanying notes are an integral part of this financial statement.

†Ledger balances may be combined with respect to all security accounts and also with respect to all spot (cash) commodity accounts.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number		Ledger Balance		Security Valuation		Future Commodity Contracts	
			Debit	Credit	Long	Short	Losses	Gains
	13†	**Other Accounts, etc.:**						
A-15		Accrued interest receivable on securities in trading and investment accounts	$ 20,000					
A-15		Accrued interest receivable on customers' secured accounts	67,809					
A-15		Deposit as margin on joint account with other broker (see Question 15)	15,000					
(d) A-6		Respondent's interest in unrealized appreciation in joint trading accounts carried by others	10,613					
A-15		Advances to employees	10,000					
A-15		Dividends receivable:						
		Outstanding under 30 days	65,350			$ 111,000		
		Outstanding 30 days or longer	3,300			1,875		
L-8		Dividends payable and unclaimed		$ 254,875	$ 15,750			
A-15		Securities shipped on open account	87,815					
A-15/L-8		Floor brokerage and similar commissions receivable and payable	52,187	545,125				
A-15		Miscellaneous accounts receivable	301,998					

—	Investments in subsidiaries, at cost plus equity in undistributed earnings (Note 1)	2,425,763					
A-10	Secured demand notes	3,215,773		6,387,235			
A-12	Exchange memberships at cost (market value $2,000,000)	2,100,000					
A-14/L-7	Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization of $1,225,249 and present value of future lease rental payments (Note 1)	2,881,769	2,000,000				
L-6	Accrued bank loan interest payable		420,000				
L-6	Accrued producers commissions payable		478,027				
L-8	Taxes withheld from employees		36,272				
L-6	Accounts payable and accrued expenses		262,913				
	Federal and State income taxes:						
L-5	Currently payable		1,076,473				
	Deferred to future periods (Note 3)		1,200,000				
L-5	Allowance for customers' accounts doubtful of collection		10,500				
A-5	Security difference account (Note 7)			14,100	12,500		
	Totals	$118,152,796	$118,152,796	$139,187,146	$139,187,146	$7,904	$7,904

The accompanying notes are an integral part of this financial statement.

†Immaterial balances in ledger accounts may be combined under appropriate captions, such as "Miscellaneous receivables" or "Miscellaneous payables."

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Question Number	
14	**Contractual Commitments That Are Not Recorded in a Ledger Account For Money:**
	A. Respondent:

Security Description	Purchased		Sold		Net Position			Unrealized Profit	Percentage Allowable in Lieu of 70% in Computation of Net Capital	Related Good Faith Deposit
	Amount	Cost	Amount	Proceeds	Amount Long (Short)	Contract Value	Market Value			
1. "When issued" transactions:										
Delaware (State of) 5% various maturities	$375,000	$373,350	$375,000	$375,000				$1,650		
Portsmouth (City of), Virginia 6% various maturities	$300,000	306,000	$275,000	284,625	$25,000	$25,000	$25,875	4,500	100%	
2. Underwriting participations:										
XYZ Electronics Corporation common Class A Shs.	4,000	48,500	3,400	41,225	600	7,275	7,500	225		

Oakland (Port of), California: 5½% various maturities	$250,000	250,000	$250,000	252,500				2,500		$5,000
Respondent's interest in unsold bonds in underwriting account					$50,000	50,000	50,500	500	100%	
3. "Delayed delivery" transactions: LSD Corp. 8⅞% due 9/30/X7 *Note*: These bonds are "long" in trading and investment account reported in answer to Question 10; delivered January 15, 19X3			$ 10,000	10,000	($10,000)	(10,000)	(10,000)		100%	

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Cross Reference to Grouping in the Statement of Financial Condition	Question Number	
(d)	**15**	**Participations of Respondent in Joint Trading and Investment Accounts Carried by Others That Are Not Recorded in a Ledger Account for Money:** A. The respondent has a 50% interest in a joint trading account carried by others. At December 31, 19X2 the account had a debit balance of \$154,574 and was "long" securities having a market value of \$175,800. The respondent has deposited \$15,000 as margin on this joint account. This deposit is reported in the answer to Question 13.
	16	**Unrecorded Assets, Liabilities and Accountabilities:** A. Drafts with securities attached amounting to \$1,000,000 have been deposited for collection for which immediate credit has been received. These drafts are collateralized by customers' securities.

Notes to Answers to Financial Questionnaire:

(1) Accounting policies followed by the respondent:

Securities transactions (and related commission revenue and expense) are recorded on a settlement data basis,* generally the fifth business day following the transaction date.

The respondent records as purchases lease transactions with a subsidiary. Accordingly, the property rights received and the obligation for future payments of rent have been recorded in the accounts at their respective present values based upon an assumed interest rate of 5%.

*An alternative method is discussed elsewhere in this guide.

Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the Board of Directors.

All subsidiaries are either wholly or majority owned. Investments in subsidiaries (not consolidated in these Answers) are carried at cost plus equity in undistributed earnings. Such companies are engaged primarily in leasing, investment advisory and venture capital endeavors.

Depreciation is provided on a straight-line basis using an estimate useful life of 10 years. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the life of the lease.

(2) The market value of fully paid securities not segregated for the account of customers is comprised of the long securities in accounts reported in answer to Question 6F, as well as the long securities in accounts with no debit money balance or short security positions and also includes securities for which instructions to segregate have been issued but which have not been accomplished.

(3) Deferred income taxes amounting to $1,200,000 are applicable to unrealized appreciation of securities owned by the respondent.

(4) Borrowings subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from **5%** to **6%** and expiring as follows:

	Borrowings Under Subordination Agreements				
Expiration Date	Cash	Securities	Exchange Memberships	Liabilities Pursuant to Secured Demand Note Collateral Agreements	Total
October 19X3		$4,000,000			$ 4,000,000
March 19X4		1,000,000			1,000,000
March 19X6		1,281,725			1,281,725
December 19X4	$400,000				400,000
August 19X8				$3,215,773	3,215,773
January 19X6			$375,000		375,000
	$400,000	$6,281,725	$375,000	$3,215,773	$10,272,498

Continued

STANDARD STOCKBROKERAGE CO., INC.
Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART I, continued

Notes to Answers to Financial Questionnaire, continued:

(5) During 19X2, the stockholders approved adoption of a qualified stock option plan covering 100,000 shares of common stock. Options may be granted during the period to June, 19X7, at 100% of the market value at the date of grant and are exercisable wihin five years from date of grant. No options have been granted under this plan.

(6) The respondent has several pension plans covering substantially all of its employees. Prior service cost of $3,000,000 is being amortized over periods ranging from 25 to 40 years. The respondent's policy is to fund pension cost accrued.

(7) The security difference account is made up of 2 long differences and 3 short differences disclosed by physical count on December 31, 19X2, at which time there were positions in approximately 7,500 securities. Short security differences amounting to $42,000 were liquidated between (date of last filing) and December 31, 19X2.

(8) The respondent leases its main office and 11 sales offices under noncancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

(9) Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000 respectively. The Company's net capital ratio was 1.79 to 1. The net capital rules may effectively restrict the payment of cash dividends.**

**Various regulatory agencies including stock exchanges may impose additional capital requirements.

Explanation of certain cross references to Statement of Financial Condition:

(a) A: Asset captions; L: Liability and Stockholders' Equity captions.

(b) The amounts of equities and deficits in commodity accounts should be shown in the statement of financial condition in lieu of the ledger balances.

(c) One-half of ledger balance and one-half of security valuation included in trading accounts for purposes of the statement of financial condition.

(d) One-half of debit balance and one-half of security valuation included in trading accounts and one-half of debit balance included in accounts payable and accrued expenses for purposes of the statement of financial condition.

STANDARD STOCKBROKERAGE CO., INC.

Supplementary Information Relating to Answers to Financial Questionnaire

Pursuant to (indicate jurisdictional agency and regulation)

As of December 31, 19X2

PART II

(Confidential)

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire
As of December 31, 19X2

PART II

Index of supporting schedules:

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules:
Question 6B.1.a.—Customers' secured accounts:
Joint account:

Security Description	Shares or Principal Amounts	Market Price	Security Valuation Long
ABC Corporation	500 shs	$18.00	$ 9,000
DEF Corporation	1,010 shs	$51.00	51,510
			$60,510
Respondent's participation, 50%			$30,255

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:
Question 6C.—Customers' partly secured accounts:

Security Description	Ledger Balance Dr. (Cr.)	Shares or Principal Amount	Market Price	Market Valuation Long	Market Valuation Short
Account #1:	$18,076				
EGM Co., Inc.		219 shs	$4.00		$ 876
BAB Corporation 6% 10/31/X6		$8,000	90.00	$7,200	
Account #2:	(1,538)				
IJK Corp.		446 shs	4.00		$1,784

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 7—Customers' commodity futures contracts:

	Open Contracts		Approximate Market Value
	Commodity	Quantity Long	Long
February	Silver	3	$25,000
April	Silver	6	50,000
June	Silver	5	42,000
August	Silver	1	8,000
November	Plywood	4	24,000
August	Broilers	1	7,000
November	Broilers	2	13,000
July	Eggs	1	6,000
April	Hogs	4	25,000
			$200,000

EXHIBIT B, cont'd

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 7C.2.b.—Customer's partly secured account:

Commodity Description	Ledger Balance Dr. (Cr.)	Quantity	Market Valuation Long
Account #1:	$100,000		
February Silver		3	$25,000
April Silver		6	50,000
			$75,000

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.A.1.a.—Trading and investment accounts of respondent, security accounts, exempted securities:

Security Description	Principal Amount	Market Price	Security Valuation Long	Percentage Charge	Accrued Interest Receivable
Obligations of the U.S. Government:					
U.S. Treasury Bonds 6% 11/30/X3	$ 90,000	$100.00	$ 90,000	0%	$ 500
U.S. Treasury Bonds 6½% 7/31/X4	400,000	100.00	400,000	0%	1,500
State and municipal obligations:					
New York State 5% 3/31/X3	20,000	90.30	18,060	0%	250
Illinois State 5½% 8/31/X6	220,000	90.91	200,000	0%	750
New York State 4% 9/30/X9	400,000	75.00	300,000	0%	1,000
			$1,008,060		$4,000

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities:

Security Description	Principal Amount	Market Price	Security Valuation Long	Percentage Charge	Accrued Interest Receivable
Corporate bonds:					
AAA Corporation 6% 4/30/X3	$ 500,000	$ 98.00	$ 490,000	5%	$ 975
AAB Corporation 5¾% 6/30/X3	400,000	96.00	384,000	5%	1,000
AAC Corporation 5% 1/31/X3	126,000	100.00	126,000	5%	25
BAA Corporation 6½% 5/31/X6	350,000	94.00	329,000	6%	800
BAB Corporation 6% 10/31/X6	70,000	90.00	63,000	10%	150
BAC Corporation 5% 2/28/X6	10,000	80.00	8,000	20%	50

LSD Corp. 8⅞% 9/30/X7	1,000,000	100.00	1,000,000*	5%	3,000
DAA Corporation 7% 3/31/X4	500,000	97.50	487,500	5%	825
DAB Co., Inc. 7½% 4/30/X8	300,000	92.75	278,250	7%	700
DAC Incorporated 6% 6/30/X5	400,000	82.50	330,000	7%	1,200
DAD Company, Inc. 5% 11/30/X8	600,000	77.25	463,500	23%	300
DAE Corporation 7¼% 7/31/X3	650,000	105.75	687,375	5%	2,175
DAF Incorporated 6⅝% 10/31/X5	850,000	94.75	805,375	5%	1,500
DAG Incorporated 7% 8/31/X6	700,000	90.00	630,000	10%	1,700
DAH Corporation 8⅛% 7/31/X7	500,000	110.00	550,000	5%	850
DAI Co., Inc. Conv. 7% 3/31/X4	268,000	100.00	268,000	20%	750
			$6,900,000		$16,000

* Includes $10,000 market value of LSD Corp. 8⅞% due 19X7 for which no capital charge is taken and which is offset by delayed delivery transaction, delivered January 15, 19X3, reported in answer to Question 14.A.3.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:
Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities, continued:

Security Description	Shares Long (Short)	Market Price	Security Valuation Long	Aggregate Contract Price	Percentage Charge
Positions related to short calls:					
EAA Co., Inc.	3,000	$105.00	$315,000		
Call on EAA Co.,Inc. @ 100 Exp. 4/8/X3	(3,000)			$300,000	30%

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10A.1.b.—Trading and investment accounts of respondent, securities accounts, other securities, continued:

Security Description	Shares	Market Price	Security Valuation Long	Security Valuation Short
Corporate stocks and warrants:				
FAA Corporation	50,000	$15.750	$ 787,500	
FAB Co., Inc.	13,000	18.250	237,250	
FAC Incorporated	11,400	35.375		$ 403,275
FAD Company	12,450	57.000	709,650	
FAE Company	37,000	20.750	767,750	
FAF Corporation	15,000	44.000	660,000	
FAG Co., Inc.	25,000	31.250	781,250	
FAH Incorporated	10,000	60.500	605,000	
FAI Incorporated	30,019	30.000		900,570
FAJ Co., Inc.	10,400	48.000	499,200	
FAK Corporation	12,300	35.750	439,725	
FAL Corp.	11,400	28.625	326,325	
FAM Corp.	10,000	92.375	923,750	
FAN Corp.	12,500	43.250		540,625
FAO Co., Inc.	589	31.000		18,259
FAP Incorporated	30,000	22.000	660,000	
FAQ Corporation	22,800	35.375	806,550	
FAR Corporation	32,600	21.750	709,050	
FAS Inc.	92,300	9.000	830,700	
FAT Co., Inc.	45,600	13.500	615,600	
FAU Corporation	8,500	59.000	501,500	
FAV Inc.	15,750	50.000	787,500	
WTS. FAW Corp.	22,000	30.000	660,000	
WTS. FAY Co., Inc.	51,936	2.000	103,872	
			$12,412,172	$ 1,862,729

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10A.2.—Trading and investment accounts of respondent, securities accounts, securities not readily marketable—at estimated fair value:

Security Description	Shares	Amount
XYZ Corporation	1,000	$ 550,000
WVU Corporation	2,000	700,000
TSR Corporation	1,500	610,550
QPO Co., Inc.	3,000	650,135
NML Company	7,500	400,000
KJI Inc.	4,000	675,000
HGF Co., Inc.	10,000	575,000
EDC Corp.	6,000	575,000
BAZ Corporation	1,350	475,000
YXW Corporation	8,000	350,000
VUT Co., Inc.	20,000	350,000
SRQ Inc.	17,000	475,000
PON Inc.	12,000	525,000
MLK Company	5,000	450,000
JIH Company	7,500	450,000
GFE Corp.	3,000	300,000
		$8,110,685

Note: If deemed appropriate the method of arriving at fair value may be disclosed.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, *continued*

(a) Supporting schedules, continued:

Question 10C.—Trading and investment accounts of respondent, other:

Investments in real estate, cattle and oil and gas drilling funds, at estimated fair value:

Description	Amount
KAA Cattle	$100,000
KAB Real Estate	150,000
KAC Oil and Gas	250,000
	$500,000

Note: If deemed appropriate the method of arriving at fair value may be disclosed.

STANDARD STOCKBROKERAGE CO., INC.

Supplementary Information Relating to Answers to Financial Questionnaire, continued

As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.—Trading and investment accounts of respondent, summary of security valuations by percentage charge:

Percentage Charge		Long	Short	Capital Charge	Accrued Interest Receivable
0%	Exempted securities	$1,008,060			$ 4,000
5%	Corporate bonds	$4,530,250		$226,012*	$10,350
6%	Corporate bonds	329,000		19,740	800
7%	Corporate bonds	608,250		42,578	1,900
10%	Corporate bonds	693,000		69,300	1,850
20%	Corporate bonds	276,000		55,200	800
23%	Corporate bonds	463,500		106,605	300
		$6,900,000		$519,435	$16,000

*Excludes capital charge relating to $10,000 market value of LSD Corp. 8⅜% due 19X7 offset by delayed delivery transaction, delivered January 15, 19X3, reported in answer to Question 14.A.3.

Continued

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 10.—Trading and investment accounts of respondent, summary of security valuations by percentage charge:

Percentage Charge		Long	Short	Capital Charge	Accrued Interest Receivable
30%	Corporate security positions related to short calls	$ 300,000**		$ 90,000	
30%	Corporate stocks and warrants	$12,412,172	$1,862,729	$ 4,282,470	
100%	Securities not readily marketable	$ 8,110,685		$ 8,110,685	
100%	Other investments, at estimated fair value	$ 500,000		$ 500,000	
		$29,230,917	$1,862,729	$13,502,590	$20,000

** Value at the lower of market value or contract value of related option.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:

Question 12B.1.—Subordinated accounts and borrowings, securities borrowed under subordination agreements:

Name of Lender and Security Description	Shares or Principal Amount	Market Price	Security Valuation Long	Maturity Date of Agreement
Francis N. Stern*				October 19X3
GAA Corp. 8% 7/31/X9	$ 500,000	$110.000	$ 550,000	
GAB Corp. 6% 4/15/X8	$ 500,000	98.000	490,000	
			1,040,000	
Robert Wine*				October 19X3
GAC Corp.	22,000 shs	30.000	660,000	
GAD Corp., Inc.	10,000 shs	50.000	500,000	
			1,160,000	
Charles Trent**				October 19X3
GAE Corp. 6% 6/30/X9	$ 400,000	82.500	330,000	
GAF Corp. 7½% 5/31/X8	$ 400,000	105.000	420,000	
			750,000	
Frederick Sands**				October 19X3
GAG Incorporated	20,000 shs	25.000	500,000	
GAH Co., Inc.	5,500 shs	100.000	550,000	
			1,050,000	
Arthur Banker**				March 19X4
GAI Corp. 5¾% 6/30/X9	$1,000,000	100.000	1,000,000	
Alan Labor*				March 19X6
GAJ Co., Inc.	37,000 shs	20.750	767,750	
James Kent*				March 19X6
GAK Incorporated	20,559 shs	25.000	513,975	
			$6,281,725	

* Voting stockholder
** Non-voting stockholder

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2

PART II, continued

(a) Supporting schedules, continued:

Question 12B.2.—Subordinated accounts and borrowings, cash borrowings:

Name of Lender	Ledger Balance	Maturity Date of Agreement
A. Jones***	$400,000	December, 19X4

*** Officer of respondent.

STANDARD STOCKBROKERAGE CO., INC.
Supplementary Information Relating to Answers to Financial Questionnaire, continued
As of December 31, 19X2
PART II, continued

(a) Supporting schedules, continued:

Question 12B.3.—Subordinated accounts and borrowings pursuant to secured demand note collateral agreements:

Name of Lender and Security Description	Shares or Principal Amount	Market Price	Market Value	Ledger Balance	Maturity Date of Agreement
B. Doe*				$1,000,000	August 19X8
HAA Corp., 6%, 6/30/X8	$400,000	$110.00	$ 440,999		
HAB Corp., Inc.	22,000 shs	30.00	660,000		
HAC Corporation	20,000	10.00	200,000		
HAD Co., Inc.	32,600	21.75	709,050		
			2,009,050		
C. Jones**				1,000,000	August 19X8
HAE Corp.	37,000	20.75	767,750		
HAF Co., Inc.	10,000	60.50	605,000		
HAG Corp., 6⅝%, 10/31/X5	$850,000	94.75	805,375		
			2,178,125		
D. Smith***				750,000	August 19X8
New York State, 4%, 8/31/X9	600,000	75.00	450,000		
HAH Corporation	10,400 shs	48.00	499,200		
HAI Co., Inc.	12,500	43.25	540,625		
			1,489,825		
E. Brown*				465,773	August 19X8
HAJ Company	142,047	5.00	710,235		
			$6,387,235	$3,215,773	

* Voting stockholder
** Non-voting stockholder
*** Officer of respondent

EXHIBIT C

Independent Public Accountant's Supplementary Report on Internal Accounting Control

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.

We have examined the Answers to Financial Questionnaire of Standard Stockbrokerage Co., Inc. as of December 31, 19X2, and have issued our report thereon dated February 15, 19X3. As part of our examination, we reviewed and tested the system of internal accounting control (including the accounting system, the procedures for safeguarding securities, and the practices and procedures employed quarterly in counting or accounting for securities and resolving securities differences) to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and by Rule 17a-5 under the Securities Exchange Act of 1934. Rule 17a-5 contemplates that the scope of the review and tests should be sufficient to provide reasonable assurance that any material weakness existing at the date of our examination would be disclosed. Under these standards and that Rule the purposes of such evaluation are to establish a basis for reliance thereon in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to provide a basis for reporting material weaknesses in internal accounting control.

The objective of internal accounting control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management. However, for the purposes of this report under Rule 17a-5, the cost-benefit relationship has been disregarded in determining weaknesses to be reported.*

There are inherent limitations that should be recognized in considering the potential effectiveness of any system of internal accounting

* This sentence makes it clear that the independent accountant is not permitted, in reporting on internal control under Rule 17a-5, to use the option indicated in paragraph 25 of SAP No. 49 which states in part: "In some cases the auditor may conclude that for certain weaknesses corrective action by management is not practicable in the circumstances and he may decide to exclude such weaknesses from his report."

Independent Public Accountant's Supplementary Report on Internal Accounting Control, continued

control. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management with respect either to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions, and that the degree of compliance with the procedures may deteriorate.

Our study and evaluation of the system of internal accounting control for the (period) ended December 31, 19X2, which was made for the purposes set forth in the first paragraph above and would not necessarily disclose all weaknesses in the system which may have existed during the period under review, disclosed (certain) (no) weaknesses that we believe to be material. Such weaknesses, with an indication of (the) (any) corrective action taken or proposed, were as follows:

Accounting Firm

New York, New York
February 15, 19X3

(1) For a partnership the report is addressed:

To the Partners,
Standard Stockbrokerage Co.:

EXHIBIT D

Independent Public Accountant's Report On Examination of Corporate Financial Statements

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income and retained earnings, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (22% of Stockholders' Equity as of December 31, 19X2 and 26% as of December 31, 19X1) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the financial statements of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

Independent Public Accountant's Report On Examination of Corporate Financial Statements, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income and retained earnings, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Financial Condition

EXHIBIT E

December 31, 19X2 and 19X1

Cross Reference	Assets	19X2	19X2	19X1	19X1
A-1	Cash		$ 2,657,472		$ 2,382,472
2	Cash segregated under Commodity Exchange Act		5,000		10,000
3	Deposits with clearing organizations and others		745,000		700,000
4	Receivable from brokers and dealers (Note 12)		25,476,250		24,476,250
5	Receivable from customers* (Note 13)		49,628,723		44,877,050
6 & 7	Securities owned† (Note 1):				
	At market value:				
	Obligations of the U. S. Government	$ 490,000		$ 624,763	
	State and municipal obligations	518,060		575,490	
	Corporate bonds	6,900,000		6,638,213	
	Stocks	11,930,327		10,091,806	
	Warrants	900,000		748,115	
		20,738,387		18,678,387	
8	Securities not readily marketable, at estimated fair value; (cost, $8,000,000)	8,230,685		8,230,685	
			28,969,072		26,909,072
8	Other investments not readily marketable, at estimated fair value; (cost, $525,000)		500,000		500,000
9	Securities borrowed under subordination agreements, at market value		6,281,725		5,181,725
10	Secured demand notes collateralized by marketable securities		3,215,773		3,215,773
12	Memberships in exchanges:				
	Owned by the Company, at cost (market value: 19X2, $2,000,000; 19X1, $2,200,000)		2,100,000		2,100,000
13	Contributed for the use of the Company, at market value		375,000		400,000
14	Furniture, equipment and leasehold improvements, at cost, net of accumulated depreciation and amortization: 19X2, $1,425,249; 19X1, $840,249 (Note 1)		4,881,769		4,353,769
15	Other assets		723,459		640,123
			$125,559,243		$115,746,234

Continued

EXHIBIT E, cont'd

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Financial Condition, continued
December 31, 19X2 and 19X1

Cross Reference	Liabilities and Stockholders' Equity	19X2		19X1	
L-1	Short-term bank loans (Note 2)		$ 29,000,000		$ 29,800,000
2	Payable to brokers and dealers (Note 12)		26,029,243		24,964,043
3	Payable to customers (including $3,887,771 (19X2) and $2,921,000 (19X1) of free credit balances)		12,288,629		10,486,956
4	Market value of securities sold, but not yet purchased		1,862,729		1,962,729
5	Accrued income taxes, including taxes deferred to future periods: 19X2, $1,200,000, 19X1, $775,000 (Note 3)		2,276,473		2,478,329
6	Accounts payable and accrued expenses†		1,238,227		534,650
7	Notes payable (Note 4)		2,000,000		2,250,000
8	Other liabilities		836,272		671,790
			75,531,573		73,148,497
	Liabilities subordinated to claims of general creditors (Note 5):				
9	Market value of securities and cash of $400,000	$ 6,681,725		$ 5,581,725	
10	Pursuant to secured demand note collateral agreements	3,215,773		3,215,773	
11	Market value of exchange memberships contributed for the use of the Company	375,000	10,272,498	400,000	9,197,498

	Minority interest in consolidated subsidiary		28,000		26,000
	Commitments and contingent liabilities (Note 9)				
	Stockholders' equity (Note 6 and 8):				
12	$5 cumulative preferred stock of $100 par value per share; redeemable at $105 per share plus accrued dividends. Authorized 100,000 shares; issued and outstanding 50,000 shares	5,000,000		5,000,000	
13	Common stock without par value. Authorized 2,500,000 shares; issued 1,500,000 shares	6,289,000		6,289,000	
14	Additional paid-in capital	2,200,000		2,200,000	
15	Retained earnings (Note 10)	27,438,172		21,083,239	
		40,927,172		34,572,239	
16	Less, Common stock in treasury, 19X2, 199,100 shares; 19X1, 199,000 shares, at cost	1,200,000	39,727,172	1,198,000	33,374,239
			$125,559,243		$115,746,234

The accompanying notes are an integral part of this financial statement.

*Valuation reserves should be shown parenthetically, if material.
†Includes adjustment for joint trading accounts—see explanation of cross reference (c), in Exhibit B, Part I.
Cross references are to account balances as shown in Answers to Financial Questionnaire.

EXHIBIT F

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES
Consolidated Statement of Income and Retained Earnings
For the years ended December 31, 19X2 and 19X1*

	19X2		19X1	
Revenues:				
Commissions**		$42,282,211		$41,235,718
Net dealer inventory and investment gains (losses)†		1,606,778		(326,004)
Investment banking		1,789,000		1,397,466
Interest and dividends		1,242,823		1,001,975
Rent		200,000		150,000
Other		200,000		188,882
		47,320,812		43,648,037
Expenses:				
Employee compensation and benefits (Note 7)	$10,289,128		$9,374,627	
Commissions and floor brokerage	9,128,491		8,767,241	
Communications	8,551,000		7,737,126	
Interest	896,482		823,910	
Taxes, other than income taxes	27,777		21,588	
Other operating expenses	3,421,001	32,313,879	3,723,868	30,448,360
Income before taxes on income and minority interest in net income of consolidated subsidiary		15,006,933		13,199,677
Taxes on income, including amounts deferred to future periods; 19X2, $425,000; 19X1, $100,000 (Note 3)		8,400,000		7,300,000
Income before minority interest in net income of consolidated subsidiary		6,606,933		5,899,677

Minority interest in net income of consolidated subsidiary	2,000	1,000
Net income	6,604,933	5,898,677
Retained earnings at beginning of year	21,083,239	15,434,562
	27,688,172	21,333,239
Less, Dividends on preferred stock	250,000	250,000
Retained earnings at end of year (Note 10)	$27,438,172	$21,083,239
Earnings per share of common stock (Note 11)	$4.89	$4.34

The accompanying notes are an integral part of this financial statement.

*Currently, examinations may be at dates other than year end, resulting in varying periods of income determination. In such circumstances, comparative statements may not be desirable.

**The composition of commission revenues (e.g., listed securities, over-the-counter securities, etc.) may be disclosed if deemed appropriate.

†The amount of the change in unrealized gains and losses attributable to marketable securities which have been valued at market quotations as well as securities and investments not readily marketable which have been valued at fair value by management should be disclosed, if material.

EXHIBIT G

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Consolidated Statement of Changes in Subordinated Liabilities

For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Subordinated liabilities at beginning of year	$ 9,197,498	$8,937,498
Increase in market value of securities borrowed under subordination agreements	1,100,000	300,000
	10,297,498	9,237,498
Decrease in market value of exchange memberships contributed for the use of the Company	25,000	40,000
Subordinated liabilities at end of year	$10,272,498	$9,197,498

The accompanying notes are an integral part of this financial statement.

EXHIBIT H

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Consolidated Statement of Changes in Financial Position

For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Funds provided by:		
Net income	$6,604,933	$5,898,677
Charges to net income not requiring funds:		
Depreciation and amortization	585,000	560,000
Deferred income taxes	425,000	100,000
Funds provided by operations	7,614,933	6,558,677
Increase (decrease) in net payable to brokers and dealers	65,200	(1,600,000)
	$7,680,133	$4,958,677
Funds applied to:		
Increase (decrease) in cash and deposits with clearing organizations and others	$ 315,000	$ (75,000)
Increase in net receivable from customers	2,950,000	2,480,000
Increase in net securities owned	2,160,000	550,000
Purchase of office equipment	1,113,000	700,000
Decrease in short-term bank loans (and repurchase agreements, if applicable)	800,000	1,000,000
Payment of dividends	250,000	250,000
Liquidation of securities differences	42,000	10,000
Acquisition of treasury stock	2,000	
Other changes, net	48,133	43,677
	$7,680,133	$4,958,677

The accompanying notes are an integral part of this financial statement.

EXHIBIT I

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

1. Accounting policies followed by the companies:

   Securities transactions (and related commission revenue and expense) are recorded on a settlement date basis,* generally the fifth business day following the transaction date.

   The consolidated financial statements include the accounts of the Company, all wholly-owned subsidiaries and one subsidiary which is 80% owned. Such subsidiaries are engaged primarily in leasing, investment advisory and venture capital endeavors.

   Depreciation is provided on a straight-line basis using an estimated useful life of 10 to 15 years. Leasehold improvements are amortized over the lesser of the economic useful life of the improvement or the life of the lease.

   Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the Board of Directors.

2. Short-term bank loans at December 31, 19X2 are fully collateralized by marketable securities valued at $29,000,000. Such collateral includes securities owned by the Company or borrowed under subordination agreements having a market value of $17,000,000.

3. Deferred income taxes amounting to $1,200,000 and $1,100,000 for 19X2 and 19X1, respectively, are applicable to unrealized appreciation of securities owned by the Company.

4. Notes payable bear interest of 5½% and are payable in semiannual installments of $250,000 through July 1, 19X6. Leased property with a net book value of $2,500,000 has been pledged to secure the notes.

5. Liabilities subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from 5% to 6% and expiring as follows:

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* An alternative method is discussed elsewhere in this guide.

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, continued

Expiration Date	Borrowings Under Subordination Agreements: Cash	Securities	Exchange Memberships	Liabilities Pursuant to Secured Demand Note Collateral Agreements	Total
October 19X3		$4,000,000			$ 4,000,000
March 19X4		1,000,000			1,000,000
March 19X6		1,281,725			1,281,725
December 19X4	$400,000				400,000
August 19X8				$3,215,773	3,215,773
January 19X6			$375,000		375,000
	$400,000	$6,281,725	$375,000	$3,215,773	$10,272,498

6. During 19X2, stockholders approved adoption of a qualified stock option plan covering 100,000 shares of common stock. Options may be granted during the period to June, 19X7 at 100% of the market value at the date of grant and are exercisable within five years from date of grant. No options have been granted under this plan.

7. The Company and its subsidiaries have several pension plans covering substantially all of their employees. The total pension expense was $125,000 and $108,000 in 19X2 and 19X1, respectively. Prior service cost of $3,000,000 is being amortized over periods ranging from 25 to 40 years. The Company's policy is to fund pension cost accrued.

8. During the year the Company acquired 100 shares of capital stock for $2,000. There were no other changes in capital stock or additional paid-in capital during the year.

9. The Company leases its main office and 11 sales offices under non-cancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

10. Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the

STANDARD STOCKBROKERAGE CO., INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements, continued

related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000 respectively. The Company's net capital ratio was 1.79 to 1. The net capital rules may effectively restrict the payment of cash dividends.*

11. Earnings per share of common stock was calculated based on the average number of shares outstanding during the year.

12. The components of receivable from and payable to brokers and dealers are as follows:

	19X2	19X1
	(In thousands)	
Securities failed to deliver:		
Outstanding less than 30 days	$21,316	$21,000
Outstanding more than 30 days	2,109	2,256
	23,425	23,256
Deposits paid for securities borrowed	1,420	1,020
Other	631	200
Total receivable from brokers and dealers	$25,476	$24,476
Securities failed to receive:		
Outstanding less than 30 days	$19,120	$17,889
Outstanding more than 30 days	4,734	5,225
	23,854	23,114
Deposits received for securities loaned	2,175	1,850
Total payable to brokers and dealers	$26,029	$24,964

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

13. Accounts receivable from customers include amounts due on uncompleted transactions and margin balances. Securities owned by customers and held as collateral for these receivables are not reflected in the financial statements.

*Various regulatory agencies including stock exchanges may impose additional capital requirements.

EXHIBIT J

Independent Public Accountant's Report On Examination of Partnership Financial Statements

To the Partners,
Standard Stockbrokerage Co.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income, changes in partnership capital, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (19.3% of Partnership Capital as of December 31, 19X2 and 24.3% as of December 31, 19X1) have been valued at fair value as determined by the partners. We have reviewed the procedures applied by the partners in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the financial statements of the valuation of securities and investments determined by the partners as described in the preceding paragraph, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

Independent Public Accountant's Report On Examination of Partnership Financial Statements, continued

An example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material is as follows:

To the Partners,
Standard Stockbrokerage Co.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co. and Subsidiaries as of December 31, 19X2 and December 31, 19X1, and the related consolidated statements of income, changes in partnership capital, changes in subordinated liabilities and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the consolidated financial position of Standard Stockbrokerage Co. and Subsidiaries at December 31, 19X2 and 19X1 and the results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

EXHIBIT K

STANDARD STOCKBROKERAGE CO., AND SUBSIDIARIES

Consolidated Statement of Financial Condition

December 31, 19X2 and 19X1

(on following pages)

EXHIBIT K

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Financial Condition
December 31, 19X2 and 19X1

Assets	19X2		19X1	
Cash		$ 2,657,472		$ 2,382,472
Cash segregated under Commodity Exchange Act		5,000		10,000
Deposits with clearing organizations and others		745,000		700,000
Receivable from brokers and dealers (Note 8)		25,476,250		24,476,250
Receivable from customers* (Note 9)		49,628,723		44,877,050
Securities owned (Note 1):				
At market value:				
Obligations of the U.S. Government	$ 490,000		$ 624,763	
State and municipal obligations	518,060		575,490	
Corporate bonds	6,900,000		6,638,213	
Stocks	11,930,327		10,091,806	
Warrants	900,000		748,115	
	20,738,387		18,678,387	
Securities not readily marketable, at estimated fair value (cost, $8,000,000)	8,230,685		8,230,685	
		28,969,072		26,909,072
Other investments not readily marketable, at estimated fair value (cost, $525,000)		500,000		500,000
Securities owned by individual partners contributed to or considered as partnership capital, at market value		3,215,773		3,215,773
Securities borrowed under subordination agreements, at market value		6,281,725		5,181,725
Memberships in exchanges:				
Owned by the Company, at cost (market value: 19X2, $2,000,000; 19X1, $2,200,000)		2,100,000		2,100,000
Contributed for the use of the Company, at market value		375,000		400,000

Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, net of accumulated depreciation and amortization: 19X2, $1,425,249, 19X1, $840,249 (Note 1)		4,881,769		4,353,769
Other assets		723,459		640,123
		$125,559,243		$115,746,234
Liabilities and Partnership Capital		**19X2**		**19X1**
Short-term bank loans (Note 2)		$29,000,000		$29,800,000
Payable to brokers and dealers (Note 8)		26,029,243		24,964,043
Payable to customers (including $3,887,771 (19X2) and $2,921,000 (19X1) of free credit balances)		12,288,629		10,486,956
Market value of securities sold but not yet purchased		1,862,729		1,962,729
Accounts payable and accrued expenses		1,238,227		2,826,508
Notes payable (Note 3)		2,000,000		2,250,000
Other liabilities		836,272		1,533,788
Minority interest in consolidated subsidiary		28,000		26,000
		73,283,100		73,850,024
Commitments and contingent liabilities (Note 6)				
Liabilities subordinated to claims of general creditors (Note 4):				
Market value of securities, and cash of $400,000	$ 6,681,725		$ 5,581,725	
Market value of exchange memberships contributed for the use of the Company	375,000	7,056,725	400,000	5,981,725
Partnership capital (Notes 1, 5 and 7)		45,219,418		35,914,485
		$125,559,243		$115,746,234

The accompanying notes are an integral part of this financial statement.

*Valuations reserves should be shown parenthetically, if material.

EXHIBIT L

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Income
For the years ended December 31, 19X2 and 19X1

	19X2		19X1	
Revenues:				
Commissions*		$42,282,211		$41,235,718
Net dealer inventory and investment gains (losses)**		1,606,778		(326,004)
Investment banking		1,789,000		1,397,466
Interest and dividends		1,242,823		1,001,975
Rent		200,000		150,000
Other		200,000		188,882
		47,320,812		43,648,037
Expenses:				
Partner and employee compensation	$10,289,128		$9,374,627	
Commissions and floor brokerage	9,128,491		8,767,241	
Communications	8,551,000		7,737,126	
Interest	896,482		823,910	
Miscellaneous taxes	27,777		21,588	
Other operating expenses	3,421,001	32,313,879	3,723,868	30,448,360
Income before minority interest in net income of consolidated subsidiary		15,006,933		13,199,677
Minority interest in net income of consolidated subsidiary		2,000		1,000
Net income		$15,004,933		$13,198,677

The accompanying notes are an integral part of this financial statement.

*The composition of commission revenues (e.g., listed securities, over-the-counter securities) may be disclosed if deemed appropriate.

**The amount of the change in unrealized gains and losses attributable to marketable securities as well as securities and investments not readily marketable valued at fair value by the partners should be disclosed, if material.

Statement of Changes in Partnership Capital
For the years ended December 31, 19X2 and 19X1

		19X2	19X1
Partnership capital at beginning of year		$35,914,485	$30,515,808
Additions during the year:			
Additional capital contributions including $1,100,000 in market value of securities	$5,500,000		
Increase in equities in partners' individual accounts	300,000	5,800,000	200,000
		41,714,485	30,715,808
Withdrawals during the year		11,500,000	8,000,000
		30,214,485	22,715,808
Net income		15,004,933	13,198,677
Partnership capital at end of year (Notes 1, 5 and 7)		$45,219,418	$35,914,485

The accompanying notes are an integral part of this financial statement.

EXHIBIT M

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Consolidated Statement of Changes In Subordinated Liabilities
For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Subordinated liabilities at beginning of year	$5,981,725	$5,721,725
Increase in market value of securities borrowed under subordination agreements	1,100,000	300,000
	7,081,725	6,021,725
Decrease in market value of exchange memberships contributed for the use of the Company	25,000	40,000
Subordinated liabilities at end of year	$7,056,725	$5,981,725

The accompanying notes are an integral part of this financial statement.

EXHIBIT N

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES

Consolidated Statement of Changes In Financial Position

For the years ended December 31, 19X2 and 19X1

	19X2	19X1
Funds provided by:		
Net income	$15,004,933	$13,198,677
Charges to net income not requiring funds:		
Depreciation and amortization	585,000	560,000
Funds provided by operations	15,589,933	13,758,677
Increase (decrease) in net payable to brokers and dealers	65,200	(1,600,000)
Additions to partnership capital	5,800,000	200,000
	$21,455,133	$12,358,677
Funds applied to:		
Increase (decrease) in cash and deposits with clearing organizations and others	$ 315,000	$ (75,000)
Increase in net receivable from customers	2,950,000	2,480,000
Increase in net securities owned	2,160,000	550,000
Purchase of office equipment	1,113,000	700,000
Decrease in short-term bank loans (and repurchase agreements, if applicable)	800,000	1,000,000
Liquidation of securities differences	42,000	10,000
Capital withdrawals	11,500,000	8,000,000
Other changes, net	2,575,133	(306,323)
	$21,455,133	$12,358,677

The accompanying notes are an integral part of this financial statement.

EXHIBIT O

STANDARD STOCKBROKERAGE CO. AND SUBSIDIARIES
Notes to Consolidated Financial Statements

1. Accounting policies followed by the companies:

Securities transactions (and related commission revenue and expense if applicable) are recorded on a settlement date basis,* generally the fifth business day following the transaction date.

The consolidated financial statements include the accounts of the Company, all wholly owned subsidiaries, and one subsidiary which is 80% owned. Such subsidiaries are engaged primarily in leasing, investment advisory and venture capital endeavors.

Depreciation is provided on a straight-line basis, using an estimated useful life of 10 to 15 years. Leasehold improvements are amortized over the shorter of the economic useful life of the improvement or the life of the lease.

Securities and investments not readily marketable include: (a) securities for which there is no market on a securities exchange or no independent publicly quoted market; (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933; and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company. The estimated fair value of such securities and investments has been determined by the partners.

Federal income taxes have not been provided as each partner is individually liable for his own tax payments; however, it is currently anticipated that $3,500,000 will be withdrawn by the partners in the coming year to meet their current federal income tax liabilities and for other purposes.**

2. Short-term bank loans at December 31, 19X2 are fully collateralized by marketable securities. Such collateral includes securities owned by the Company or borrowed under subordination agreements having a market value of $17,000,000.

3. Notes payable bear interest of 5½% and are payable in semiannual instalments of $250,000 through July 1, 19X6. Leased property with a net book value of $2,500,000 has been pledged to secure the notes.

4. Borrowings subordinated to the claims of general creditors have been contributed under agreements requiring interest payments ranging from 5% to 6% and expiring as follows:

Expiration Date	Cash	Securities	Exchange Memberships	Total
October 19X3		$4,000,000		$4,000,000
March 19X4		1,000,000		1,000,000
March 19X6		1,281,725		1,281,725
December 19X4	$400,000			400,000
January 19X6			$375,000	375,000
	$400,000	$6,281,725	$375,000	$7,056,725

5. Included in partnership capital at December 31, 19X2 are equities in partners' individual accounts aggregating $3,215,773 which are considered as capital in accordance with the partnership agreement. Subject to the approval of various regulatory agencies, these amounts may be withdrawn.

6. The Company leases its main office and 11 sales offices under non-cancellable leases expiring between 19X7 and 19X9. The annual aggregate rental approximates $750,000.

7. Pursuant to the net capital provisions of Rule 15c3-1 of the Securities Exchange Act of 1934, the Company is required to maintain a minimum net capital, as defined under such provisions. Net capital and the related net capital ratio may fluctuate on a daily basis. At December 31, 19X2, the Company had net capital and net capital requirements of approximately $29,160,000 and $2,600,000, respectively. The Company's net capital ratio was 1.79 to 1.***

8. The components of receivable from and payable to brokers and dealers are as follows:

	19X2	19X1
	(In thousands)	
Securities failed to deliver:		
Outstanding less than 30 days	$21,316	$21,000
Outstanding more than 30 days	2,109	2,256
	23,425	23,256
Deposits paid for securities borrowed	1,420	1,020
Other	631	200
Total receivable from brokers and dealers	$25,476	$24,476
Securities failed to receive:		
Outstanding less than 30 days	$19,120	$17,889
Outstanding more than 30 days	4,734	5,225
	23,854	23,114
Deposits received for securities loaned	2,175	1,850
Total payable to brokers and dealers	$26,029	$24,964

"Fails" represent the contract value of securities which have not been received or delivered by settlement date.

9. Accounts receivable from customers include amounts due on uncompleted transactions and margin balances. Securities owned by customers and held as collateral for these receivables are not reflected in the financial statements.

* An alternative method is discussed elsewhere in this guide.

** Under certain conditions, it may be appropriate to record anticipated withdrawals as a liability.

*** Various regulatory agencies including stock exchanges may impose additional capital requirements.

Independent Public Accountant's Report On the Statement of Financial Condition Only

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 1 to the financial statements, securities and investments not readily marketable amounting to $8,730,685 (22% of Stockholders' Equity as of December 31, 19X2 and 26% as of December 31, 19X1) have been valued at fair value as determined by the Board of Directors. We have reviewed the procedures applied by the Directors in valuing such securities and investments and have inspected underlying documentation; while in the circumstances the procedures appear to be reasonable and the documentation appropriate, determination of fair value involves subjective judgment which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the effect on the statement of financial condition of the valuation of securities and investments determined by the Board of Directors as described in the preceding paragraph, the accompanying consolidated statement of financial condition presents fairly the financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.
For a partnership the report is addressed:
To the Partners,
Standard Stockbrokerage Co.:

Independent Public Accountant's Report On the Statement of Financial Condition Only, continued

Example of an unqualified opinion which would be appropriate when not readily marketable securities and investments are not material and the independent public accountant is reporting only on the statement of financial condition:

To the Board of Directors(1),
Standard Stockbrokerage Co., Inc.:

We have examined the consolidated statement of financial condition of Standard Stockbrokerage Co., Inc. and Subsidiaries as of December 31, 19X2 and December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statement of financial condition presents fairly the consolidated financial position of Standard Stockbrokerage Co., Inc. and Subsidiaries at December 31, 19X2 and 19X1, in conformity with generally accepted accounting principles applied on a consistent basis.

Accounting Firm

New York, New York
February 15, 19X3

(1) Under certain circumstances, it may be appropriate to address the audit report to the stockholders as well.
For a partnership the report is addressed:
To the Partners,
Standard Stockbrokerage Co.:

EXHIBIT Q

Representation Letter

February 15, 19X3

Accounting Firm
Gentlemen:

We are writing at your request to confirm our understanding that the examination which you have made was directed to the expression of an opinion on the consolidated statement of financial condition (financial statements) of Standard Stockbrokerage Co. Inc. and Subsidiaries and the examination of Answers to Financial Questionnaire as of (for the period ended) December 31, 19X2, and that your auditing procedures, including your tests of our accounting records, were limited to those which you considered necessary in the circumstances on the basis of generally accepted auditing standards approved and adopted by the American Institute of Certified Public Accountants or required by the (applicable stock exchange, e.g., New York) and the Securities and Exchange Commission.

Also at your request, to supplement information obtained by you from the books and records of the Company and from other sources, we advise you that to the best of our knowledge and belief the Company and its subsidiaries at December 31, 19X2 had:

(1) Satisfactory title to all recorded assets.

(2) No assets pledged or assigned as security for liabilities, performance of contracts, etc., except as disclosed in the financial statements or notes thereto. (See Questions 2 and 3, Exhibit B)

(3) No material unrecorded assets or contingent assets (such as claims relating to buy-ins, unfulfilled contracts, etc., whose value depends on fulfillment of conditions regarded as uncertain).

(4) No securities or investments not readily marketable owned by the Company or borrowed under subordination agreements except as disclosed in the financial statements or notes thereto.

It is understood that the term "securities and investments not readily marketable" shall include, but not be limited to, (a) securities except "exempted securities," for which there is no market on a securities exchange or independent publicly quoted market, (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 (or the conditions of an exemption such as Regulation A, under Section 3(B) of such Act have been complied with, i.e., "restricted stock," and (c) securities and investments which cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities and investments or to the company, i.e., "control stock."

(5) All exchange memberships recorded on the books.

(6) No participations in joint accounts carried by others except as reflected in the financial statements or notes thereto. (See Question 15, Exhibit B)

(7) No capital stock repurchase agreements and no capital stock reserved for options, warrants, conversions, or other requirements (cor-

poration only) except as disclosed in the financial statements or notes thereto. (See Note 5, Exhibit I)

(8) No material unrecorded liabilities or contingent liabilities (endorsements or guarantees, lawsuits, additional taxes for prior years, repurchase agreements, etc.), other than as disclosed in the financial statements.

(9) No open contractual commitments other than those appearing on the memo books and records (for when distributed and delayed delivery contracts, underwritings and when issued contracts, endorsements of puts and calls, and commitments in foreign currencies and spot (cash) commodity contracts).

(10) Charged off all property, furniture, fixtures, equipment, and leasehold improvements sold, destroyed, abandoned or considered to be obsolete or of no further use.

(11) No holder of voting stock having a proprietary interest in any account classified solely as that of a customer in Answers to Financial Questionnaire.

(12) No borrowings or claims which were unconditionally subordinated to all claims of general creditors pursuant to a written agreement except as disclosed in the financial statements or notes thereto. (See Question 12, Exhibit B)

(13) Established a reserve for security differences that is adequate to cover any anticipated losses in connection with the short securities that may have to be covered and/or claims arising from the liquidation of long securities.

Further, we advise you that, to the best of our knowledge and belief, all accounting and financial records and related data of the Company have been made available to you and as far as we know none of them were withheld from you; no shortages or other irregularities have been discovered that have not been disclosed to you; and no events have occurred nor have any matters been discovered since December 31, 19X2 which would require adjustments to or disclosure in the financial statements. We agree with the adjusting journal entries which are not recorded on the books but which are given effect to in the financial statements.

Very truly yours,

.... Company

.... Chief Executive Officer

.... Chief Accounting Officer

NOTE: Where separate representations are not provided by the Company, the independent public accountant should also obtain in this letter representations as to the accuracy of items not covered by his opinion, such as future capital withdrawals, financial obligations of partners, etc. In addition, appropriate representations should be obtained with respect to the minutes of the corporation or the partnership agreement of the partnership and the appropriateness of agreements providing for the inclusion of partners' individual accounts as partnership property in the financial statements and for the purpose of computing net capital.

EXHIBIT R

STANDARD STOCKBROKERAGE CO., INC.
Computation of Aggregate Indebtedness and Net Capital in Accordance with Rule 15c3-1 Under the Securities Exchange Act of 1934
As of December 31, 19X2

(Note: The computation under the various exchange rules differ from this example. Further, the SEC announced on December 5, 1972, in Securities Exchange Act Release No. 9891, a proposal to substantially revise Rule 15c3-1.)

Questionnaire Reference			
	Aggregate Indebtedness:		
2.A.1.	Money borrowed, secured by or containing customers' securities as collateral		$20,000,000
4.C.1.	Money payable against customers' securities in securities loaned accounts		2,174,850
4.D.1.a. & b.	Money payable against securities failed to receive on account of customers' transactions		14,485,648
	Credit Balances in Customers' Accounts:		
6.A.2.	Cash accounts	$ 2,088,967	
6.B.1.A	Margin deposit on joint account	5,000	
6.B.2.	Secured accounts	6,254,915	
6.C.2.	Partly secured accounts	1,538	
6.E.	Accounts with credit balances having open contractual commitments	27,834	
6.F.	Accounts with free credit balances	3,797,711	
			12,175,965
7.A.2.	Equities in customers' nonregulated commodity accounts with open futures contracts		2,051
8.A.2.	Officers' accounts with free credit balances		90,060
13.	Dividends payable and unclaimed		254,875
13.	Floor brokerage and similar commissions payable		545,125

13.	Accrued bank loan interest payable		420,000
13.	Accrued producers' commissions payable		478,027
13.	Taxes withheld from employees		36,272
13.	Accounts payable and accrued expenses		262,913
13.	Federal income taxes currently payable		1,076,473
	Total aggregate indebtedness		$52,002,259
	Net Capital:		
	Credit Items:		
11.C.1.a.	Preferred stock	$ 5,000,000	
11.C.1.b.	Common stock	6,289,000	
11.C.2.	Additional paid-in capital	2,200,000	
11.C.3.	Retained earnings	27,438,172	
	Add—Deferred tax provision on unrealized appreciation of marketable securities	1,200,000	
		42,127,172	
	Less—Treasury stock	1,200,000	$40,927,172
12.B.1.	Market value of securities borrowed under subordination agreements		6,281,725
12.B.2.	Cash borrowings under subordination agreements		400,000
12.B.3.	Secured demand notes covered by subordination agreements		3,215,773
12.B.4.	Market value of exchange memberships contributed for the use by the Company under subordination agreements		375,000
13.	Allowance for customers' accounts doubtful of collection		10,500
	Total credit items		51,210,170

Continued

STANDARD STOCKBROKERAGE CO., INC.
Computation of Aggregate Indebtedness and Net Capital in Accordance with Rule 15c3-1 Under the Securities Exchange Act of 1934
As of December 31, 19X2
continued

Questionnaire Reference			
	Net Capital, Continued:		
	Debit Items:		
1.	Good faith deposit related to contractual commitment		$ 5,000
2.B.	Deficits in customers' commodities accounts carried by other brokers		30,634
4.B.	Contract value of securities failed to deliver:		
	Outstanding 40 through 49 days (10% of $226,547)	$ 22,655	
	Outstanding 50 through 59 days (20% of $127,618)	25,524	
	Outstanding 60 days or longer (30% of $110,182)	33,054	
			81,233
6.B.1a.	Percentage charge (30%) on respondent's interest in market value of securities long in joint accounts		9,077
6.C.	Deficits in customers' partly secured accounts		11,998
6.D.	Customers' unsecured accounts		20,258
7.B. & C.2.b.	Deficits in customers' commodity accounts		25,110
Part II. Q7	Percentage charge (1½%) on market value of long future contracts in each commodity carried for customers		3,000
Part II. Q10	Percentage charge on market value of securities in firm trading and investment accounts		13,502,590
12.B.1.	Percentage charge on securities borrowed under subordination agreements (30%)		1,884,517
12.B.4.	Market value of exchange memberships contributed for the use of the Company under subordination agreements		375,000

13.	Accrued interest receivable on securities in trading and investment accounts		20,000*
13.	Advances to employees		10,000
13.	Dividends receivable		181,525
13.	Securities shipped on open account		87,815
13.	Floor brokerage and similar commissions receivable		52,187
13.	Miscellaneous accounts receivable		301,998
13.	Investment in subsidiaries		2,425,763
13.	Exchange memberships		2,100,000
13.	Furniture, equipment, leasehold improvements and rights under lease agreements, at cost, less accumulated depreciation and amortization	2,881,769	
	Less—Capitalized lease obligation	2,000,000	
			881,769
13.	Unresolved short security differences		12,500
14.A.2.	Percentage charge on underwriting positions	2,250	
	Less—Unrealized profits thereon	225	2,025
15.A.	Percentage charge (30%) on respondent's interest in joint accounts carried by others		26,370
	Total debit items		22,050,369
	Net capital		$29,159,801
	Capital Requirements:		
	5% of aggregate indebtedness ($52,002,259)		$ 2,600,113
	Net Capital in Excess of Requirements		26,559,688
	Net capital as above		$29,159,801
	Ratio of Aggregate Indebtedness to Net Capital		1.79 to 1

*This item will be subjected to the same haircut as the related securities rather than a 100% charge if details are furnished with the particular securities in Part II schedules supporting the answers to Question 10.

EXHIBIT S

Abbreviated Financial Statements of Subsidiaries
Statement of Financial Condition
December 31, 19X2

Cross Reference to Grouping in the Statement of Financial Condition		Leasing Subsidiary, Inc. (100% owned)	Investment Advisory Co., Inc. (100% owned)	Venture Capital Co., Inc. (80% owned)	Total
A-1	Cash	$ 200,000	$ 13,763	$ 20,000	$ 233,763
A-8	Restricted securities, at estimated fair value (cost, $120,000)			120,000	120,000
A-15	Accounts receivable		100,000		100,000
A-14	Leased property, at cost, less accumulated depreciation	4,000,000*			4,000,000
	Total assets	$4,200,000	$113,763	$140,000	$4,453,763
L-7	Notes payable	$2,000,000			$2,000,000
	Stockholders' equity	2,200,000	$113,763	$140,000**	2,453,763
		$4,200,000	$113,763	$140,000	$4,453,763

*Part of this property is leased to Standard Stockbrokerage Co., Inc.
**Includes minority interest of $28,000.

Statement of Income
For the year ended December 31, 19X2

Revenue	$ 200,000	$160,000	$ 40,000	$ 400,000
Expenses	99,000	105,000	20,000	224,000
Income before taxes on income	101,000	55,000	20,000	176,000
Taxes on income	50,000	25,000	10,000	85,000
Net income	$ 51,000	$ 30,000	$ 10,000	$ 91,000

These statements are included for reference purposes only, and are not to be included as part of financial statements.

Audit Requirements Prescribed on Form X-17A-5

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. It shall include all procedures necessary under the circumstances to substantiate the assets and liabilities and securities and commodities positions as of the date of the responses to the financial questionnaire and to permit the expression of an opinion by the independent public accountant as to the financial condition of the respondent at that date. Based upon such audit, the accountant shall comment upon any material inadequacies found to exist in: (*a*) the accounting system; (*b*) the internal accounting control; (*c*) procedures for safeguarding securities; (*d*) the practices and procedures employed in complying with Rule 17a-13 and in the resolution of securities differences; and shall indicate any corrective action taken or proposed.

The scope of the audit shall include the following procedures, but nothing herein shall be construed as limiting the audit or permitting the omission of any additional audit procedure which an independent public accountant would deem necessary under the circumstances. As of the audit date the independent public accountant shall:

(1) Compare ledger accounts with the trial balances obtained from the general and private ledgers and prove the aggregates of subsidiary ledgers with their respective controlling accounts.

(2) Account for by physical examination and comparison with the books and records: all securities, including those held in segregation and safekeeping; material amounts of currency and tax stamps; warehouse receipts; and other assets on hand, in vault, in box or otherwise in physical possession. Control shall be maintained over such assets during the course of the physical examination and comparison.

(3) Verify securities in transfer and in transit between offices of respondent.

(4) Balance positions in all securities and spot and future commodities as shown by the books and records at the audit date.

Audit Requirements Prescribed on Form X-17A-5, continued

(5) Reconcile balances shown by bank statements with cash accounts. After giving ample time for clearance of outstanding checks and transfers of funds, the independent public accountant shall obtain from depositaries bank statements and canceled checks of the accounts and by appropriate audit procedures substantiate the reconciliation as of the audit date.

(6) Obtain written confirmation with respect to the following (see note):

(a) Bank balances and other deposits.

(b) Open contractual positions and deposits of funds with clearing corporations and associations.

(c) Money borrowed and detail of collateral.

(d) Accounts, securities, commodities, and commitments carried for the respondent by others.

(e) Details of:

(i) Securities borrowed

(ii) Securities loaned

(iii) Securities failed to deliver

(iv) Securities failed to receive

(v) Contractual commitments (see General Instruction B.11).

(f) Customers', partners', officers', directors', and respondent's accounts. Confirmation of these accounts may be in the form of a written acknowledgment of the accuracy of the statement of money balances, securities and/or commodities positions, and open contractual commitments (other than uncleared "regular way" purchases and sales of securities) accompanying the first request for confirmation mailed by the independent public accountant. Customers' accounts without balances, positions or commitments, and accounts closed since the last prior audit shall be confirmed on a test basis.

(g) Borrowings and accounts covered by "satisfactory subordination agreements."

(h) Guarantees in cases where required to protect accounts guaranteed as of audit date.

(i) All other accounts which in the opinion of the independent public accountant should be confirmed.

Audit Requirements Prescribed on Form X-17A-5, continued

NOTE: Compliance with requirements for obtaining written confirmation with respect to the above accounts shall be deemed to have been made if requests for confirmation have been mailed by the independent public accountant in an envelope bearing his own return address and second requests are similarly mailed to those not replying to the first requests, together with such auditing procedures as may be necessary; provided, however, that with respect to customers' accounts closed since the last prior audit the accountant may use either positive or negative confirmation requests; and it is further provided that with respect to periodic investment plans sponsored by member firms of a national securities exchange, whose members are exempted from Rule 15c3-1 by paragraph (*b*)(2) thereof, the independent public accountant examining the financial statements of the originating member firm may omit direct written confirmation of such plan accounts with customers when, in his judgment, such procedures are not necessary, if (1) the originating member firm does not receive or hold securities belonging to such plan accounts and does not receive or hold funds for such accounts, except the initial payment which is promptly transmitted to the custodian; (2) the custodian is a member firm of such national securities exchange and files certified reports complying with Rule 17a-5 in connection with which the customers' accounts are confirmed by an independent public accountant; and (3) funds and securities held by the custodian for each such customer's account are reconciled with the records of the originating member firm as of the date of the most recent audit of the custodian.

(7) Obtain a written statement from the proprietor, partner (if a partnership) or officer (if a corporation) as to the assets, liabilities, and accountabilities, contingent or otherwise, not recorded on the books of the respondent.

(8) Verify the computation of the ratio of aggregate indebtedness to net capital at the audit date and review the procedures followed in making the periodic computations required under the provisions of Rule 17a-3(*a*)(11).

(9) Review the practices and procedures employed for the making of the securities examinations, counts, verifications, comparisons, and the recordation of differences required by Rule 17a-13, and the methods employed in the resolution of the differences uncovered.

NOTE: Provisions of Rule 17a-5 require that the reports of certain brokers and dealers be audited by a certified public accountant or public accountant who shall be in fact independent. With respect to qualifications of accountants, accountant's certificate, opinions to be expressed, and exceptions, please refer to Rule 17a-5.

NOTE: Important additional audit and reporting requirements are imposed by Release Nos. 9658 and 9766 under the Securities Exchange Act of 1934. Reference should be made to such releases for specific requirements.

Glossary

A.D.R. Abbreviation for American Depository Receipt.

Account executive. *See* Registered representative.

Active box. A position on the Stock Record (Street Side) indicating securities located in the Cashier's Department which are normally available to the brokerage concern for its general use.

Adequately collateralized. Indebtedness shall be deemed to be "adequately collateralized" when the difference between the amount of the indebtedness and the market value of the collateral is sufficient to make the loan acceptable as a fully secured loan to banks regularly making comparable loans to brokers or dealers in the community.

Aggregate indebtedness. The total of certain liabilities of a broker-dealer which are set forth in Rule 15c3-1 of the Securities and Exchange Commission. A broker-dealer shall not permit his aggregate indebtedness to exceed a specified percentage of this net worth as defined in this same rule.

Allied member. Any general partner or qualified voting stockholder of a member organization who is not himself a member of a stock exchange.

American depository receipt (A.D.R.). A certificate issued by an American bank that serves as evidence of ownership of original foreign shares. These certificates are transferable and can be traded. The original foreign stock certificates are deposited with a foreign branch or correspondent bank of the issuing American bank.

AMEX. The popular name for the American Stock Exchange.

Arbitrage. The act of buying a security in one market and selling it in another. Also buying a security subject to exchange, conversion or reorganization and selling the security or securities to be received upon completion of the exchange, conversion, or reorganization.

Asked. A potential seller's lowest acceptable price for a security.

Back office. The administrative area of a brokerage office which contains the bookkeeping, margin, P&S, cashiers', and dividend departments.

Bad delivery. A delivery of securities that does not fulfill the requirements for delivery.

Balance order. The net balance instructions, issued by a clearing corporation, to receive or deliver securities. The instructions set forth all the information needed by the member firm to clear its transactions on a given settlement date.

Best efforts. Refers to an agreement by an underwriter to buy from the issuing corporation only those securities which it is able to sell to the public.

Bid. The highest declared price a buyer is willing to pay for a security at a particular time.

Big Board. The popular name for the New York Stock Exchange.

Blotter. A record of original entry. A book or individual units used as a record of original entry to record transactions as they occur. Covers purchases, sales, cash receipts and disbursements, and securities received and delivered.

Board room. Popular name for the area in a brokerage concern's office where customers can watch security prices and activity and enter orders for the purchase and sale of securities.

Books closed. The cutoff time that determines stockholders of record for a prescribed period. Any entries affecting the registration or ownership of securities for dividend disbursements or proxy purposes must be made before this time.

Borrowed. The act of borrowing a security for delivery. The equivalent value in money is usually deposited with the lender.

Box. A "short" position in the Stock Record representing securities on hand in the possession of the brokerage concern. A place where securities are kept such as a vault, file cabinet, or other place so used. Boxes are also identified as Safekeeping Box, Segregation Box, Name of Box, Active Box, etc.

Box count. An actual count of the securities in the box either in connection with an audit or with periodic checking.

Broker loans. Money borrowed by brokers from banks.

Brokers transfer account. An account kept by the transfer clerk of a brokerage concern giving details of securities transferred for the account of other brokers. The occasion for this arises when delivery is made by transfer (TAD—transfer as directed) instead of by delivery of the actual certificates.

Bulk segregation. Securities (usually constituting excess collateral in margin accounts) which are filed in alphabetical order in special boxes in the vault but which are not specifically identified with the owners. Collateral records are maintained by the brokerage concern to indicate the owners and the securities are usually in the name of the brokerage concern.

Buy-in. The procedure followed by a broker desiring to settle a buy contract which is past due. He may file with a stock exchange or the National Association of Security Dealers, Inc., as appropriate, a notice termed a "Buy-in," a copy of which is also served on the broker from whom the securities were to be received. If the securities are not delivered, the stock or bond may be bought in for cash for the account of the broker who is to receive the securities. The difference in price between the "Buy-in" and the contract price is adjusted by check from one broker to another.

Buying power. The equity remaining in a margin account after providing for the margining of existing securities in the account in accordance with federal and "House" margin requirements.

Cage. The term given to the area of the brokerage concern's office in which is located the cashier, stock clerk, loan clerk, transfer clerk, blotter clerk, and others having as a part of their duties the receiving and delivering of securities.

Call (margin). A request for a margin customer to put up additional collateral (cash or securities). Usually a written request.

Call loan. A loan which has no definite maturity or rate of interest. The loan may be "called" by the lender or paid off by the borrower at any time.

Call option. A contract which entitles the holder to buy (call) entirely at his option, a specified number of shares of a particular stock at a specified price at any time until the stated expiration date of the contract. Such an option (which is always for a round lot amount and which is transferable) is bought in the expectation of a price rise above the contract price. If the price rise occurs, the purchaser will exercise the option. If the rise does not occur, he will let the option expire and will lose only the cost of the option. During the existence of the option, the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights, and stock dividends or splits.

Cash account. A customer account with a brokerage concern in which purchases and sales of securities are handled on a strictly cash basis. No credit or margin is allowed.

Cash sale. A sale on which the trade and settlement dates are the same. The selling broker must be able to make delivery of the security sold on the trade date. The customer who is selling usually receives a discounted price on the sale for this special service.

Cash transaction. A transaction which is expected to clear within the time prescribed by Regulation T of the Board of Governors of the Federal Reserve System.

Cashier's department. A division of the Operations Department of a brokerage concern that handles securities and money that are received or delivered by the brokerage concern. (*See* Cage.)

Central Certificate Service (C.C.S.). A subsidiary of the Stock Clearing Corporation of the New York Stock Exchange and a depositary for eligible securities to facilitate clearances between member organizations without the necessity of receiving or delivering actual certificates.

Churning. The process of unnecessary purchases and sales in customers' accounts for the purpose of generating commissions.

Clearance. The act of clearing securities between buyers and sellers. Receipt or delivery of securities against payment.

Clearing house. Term given to the central location for matching security transactions of members to enable the determination of minimum quantities to be received or delivered.

Clearing member. A brokerage concern entitled to use the services of the clearing corporation.

Clearing organization. Usually a brokerage concern which clears the transaction of another brokerage concern. (*See* Correspondent.)

Commodity hold out. Commodity transactions on the brokerage concern's records but not reported on the clearing house sheets.

Commodity spreading. Implies open purchase ("long") and sale ("short") contracts in the same commodity or in different commodities.

Comparison. A formal notice that details the terms of the contract between brokerage concerns who are parties to non-exchange trades. If the details of the trade are correct, the comparison is stamped (acknowledged) and returned; if they are incorrect, the broker indicates the difference(s) and returns the comparison. (*See* D.K.)

Compliance department. The department in a brokerage concern that enforces adherence to policies established by the brokerage concern, plus all rules and regulations fixed by the various regulatory agencies.

Confirmation. A confirmation sets forth the terms of a contract between a brokerage concern and its customer for the purchase or sale of securities. Details shown on a confirmation are: trade date, settlement date, number of shares or par value of bonds, security description, contract price, commission, account number and type of account, customer's name and address, and any other information required.

Contract difference. The difference between the contract and the market values of commodities.

Contract sheet. A listing of compared and uncompared transactions sent to each member firm by a stock clearing corporation.

Conversion account. An account carried by a New York Stock Exchange member who endorses put and call options for a put and call dealer under a completely hedged condition.

Correspondent. One of the parties to an agreement between two brokerage concerns that performs services for the other, such as the execution and the clearance of trades. A New York City brokerage concern (a clearing member) is usually the correspondent for an out-of-town brokerage concern (often a non-member).

Cover value. The amount necessary to buy-in a "short" security position at the current market value.

Credit department. Another name for Margin Department.

Current market value. Generally, as used in connection with margin trading, means the closing price of a security as of the preceding business day.

CUSIP (number). A means of uniformly describing and identifying specific security issues. Developed by the Committee on Uniform Security Identification Procedure.

Customers' man. A salesman or registered representative.

D.A.P. Abbreviation for delivery against payment. Also referred to as C.O.D. (cash on delivery), P.O.D. (payment on delivery), and D.V.P. (delivery versus payment).

D.K. Abbreviation for Don't Know. An expression used by a brokerage concern to indicate that a certain transaction which another brokerage concern is attempting to confirm or compare is unknown to them. When mutual understanding is reached the transaction is properly compared or cancelled.

Day loan. A loan made for one day only for the convenience of the brokerage concern. Generally on an unsecured basis.

Dealer. A person or firm acting as a principal rather than as an agent in the purchase and sale of securities.

Definitive certificates. Actual and permanent certificates of bonds or stock given in exchange for temporary receipts. These temporary receipts are usually issued at the time of a new offering before the engraved certificates are available.

Delayed delivery. A transaction the delivery of which is longer than the usual regular way transaction. (*See* Sellers' option.)

Directed sale. Sale by the manager of a syndicate to a customer (usually an institution) of a syndicate member.

Discretionary account. An account over which a broker or some other person has been given discretion by the customer as to purchases and sales of securities, including the kind of securities, the time when and the prices to be paid or received. The discretion may be complete or limited.

Distribution. The sale of a large block of securities to the investing public.

Divided liability. Liability in a syndicate or underwriting which is fixed or definite in amount. (*See* Undivided liability.)

Dividend department. A division of the Operations Department that is charged with the collection of dividends and the crediting of these dividends to the accounts of customers.

Due bill. A document passed between brokerage concerns stating that dividends, rights to subscribe, stock dividends, etc., are the property of the holder of the due bill.

Equity. The net worth in a margin account, computed by subtracting the total of the "short" security values and the debit balance from the total of the "long" security values and the credit balance. If the result is a net credit the account is said to liquidate to an equity.

Equity securities. Term applied to common stocks or to debentures or preferred stock which are convertible into common stocks.

Equity statement (runs). Statements showing details of an account together with security valuations.

Ex-clearing house. Transactions which are not settled through the clearing house.

Ex-dividend. A synonym for "without dividend." The buyer of a stock selling ex-dividend does not receive the recently declared dividend. Open buy and sell stop orders, and sell stop limit orders in a stock on the ex-dividend date are ordinarily reduced by the value of the particular dividend. In the case of open stop limit orders to sell, both the stop price and the limit price are reduced. Every dividend is payable on a fixed date to all shareholders recorded on the books of the disbursing company as of a previous date of record. For example, a dividend may be declared as payable to holders of record on the books of the disbursing company on a given Friday. Since five business days are allowed for delivery of the security "regular way" in transactions on the Stock Exchange, the exchange would declare the stock "ex-dividend" as of the opening of the market on the preceding Monday. This means that anyone buying the stock on and after Monday would not be entitled to the dividend.

Ex-rights. Same as for ex-dividend. The buyer of stock selling ex-rights is not entitled to the rights distribution.

Ex-warrants. On occasion stock or bonds have warrants attached entitling the holder to subscribe to additional shares within specified periods of time and at specified prices. When these warrants are detached the security is traded "ex-warrants."

Exchange tickets. The tickets (usually data processing cards) in a clearing corporation format, prepared by a brokerage concern for each transaction made on an exchange. These tickets list all pertinent details of the trade and are sent with a daily summary listing to the clearing corporation for comparison and confirmation.

Execution report. A confirmation notice of the completion of a trade that is sent from the floor of an exchange (for listed securities) or trading desk (for over-the-counter securities) back to the point of origin of the order.

Exempt securities. Securities exempted from registration under the Securities Exchange Act of 1934, otherwise than by action of the Securities and Exchange Commission.

Extension. Permission to extend credit beyond the time prescribed by Regulation T of the Board of Governors of the Federal Reserve System.

Fails. Uncompleted security transactions between two brokerage concerns. (*See* Fail to deliver *and* Fail to receive.)

Fail to deliver. Securities which the selling brokerage concern has not delivered to the purchasing brokerage concern at the settlement or clearance date.

Fail to receive. Securities which the purchasing brokerage concern has not yet received from the selling brokerage concern at the settlement or clearance date.

Firm account. An account consisting of securities in which the brokerage concern has taken a position for investment purposes, is making a market (principal wholesaler) or has an interest with another party (joint account).

Firm commitment. Refers to the agreement of an underwriter to buy the entire issue of a security from the issuing corporation at a specified price.

Firm price. The price at which a security can be bought or sold in the over-the-counter market for such period of time as the seller may specify.

Flat. A method of trading in certain kinds of bonds. Usually used in trading income bonds which do not pay interest unless it has been earned and declared payable, or bonds on which the issuing corporation has defaulted in the payment of interest. When bonds are traded "flat" the seller is not entitled to receive in addition to the price of the bond the interest that has accumulated since the date of the last interest payment. The seller of a bond that is traded "flat" must deliver the bond with all unpaid coupons attached or a due bill authorizing the buyer to collect any payments of interest that may be made by the issuing corporation in the future.

Flat statement. A statement with no money or security balance.

Floor. The popular name for the area where securities are bought or sold on an exchange.

Floor broker. Member of exchange who executes transactions on the exchange for the account of his own organization or for the account of other member organizations.

Floor brokerage. The commission charged by one broker to another broker for executions of transactions on exchanges.

Floor clerk. An employee of a brokerage concern who maintains liaison between the order room and the floor broker.

Floor report. A report of an executed trade given to the floor clerk by the floor broker which contains the number of shares, the price, and the other broker on the trade.

Free securities. Securities which are fully paid for.

Free shipment. Shipments of securities usually to out-of-town brokerage concerns without draft attached in order to avoid payment of collection charges.

Fully paid accounts. Customer accounts in which the contract price to purchase securities has been paid. These securities should be "locked-up" in the segregation or safekeeping box.

Futures contract. Contracts for purchase or sale of commodities at some time in the future.

G.T.C. Abbreviation for "Good 'Til Cancelled." Also called an "open order." When this term appears on an order to buy or sell a security it means that the order is to remain in effect until it is either executed or cancelled.

Give-up. Type of order which is given by a customer to a member firm on whose books the customer does not have an account.

Good delivery. Certain basic qualifications must be met before a security sold may be delivered. The security must be in proper form to comply with the contract of sale and to transfer title by delivery to the purchaser.

Good faith deposit. Deposit to guarantee performance. Usually with respect to new issues of securities.

Group account. A syndicate or joint account.

Haircut. Deductions from "net worth" of certain specified percentages of the market value of securities and future commodity contracts "long" and "short" in the capital and proprietary accounts of a broker or dealer, and in the accounts of partners. These deductions are solely for the purpose of computing "net capital" and are not entered on the books.

Holder of record. The party listed as the registered owner on the transfer records of a corporation.

Holders' file. A subsidiary file (punched cards, discs or tapes) in account sequence showing securities owned or carried in such accounts.

House account. An account used by a brokerage concern to maintain a trading and/or investment position in a security for itself or its officers or partners. Also a name given to a customer's account to which no registered representative has been assigned.

House rules. Rules promulgated by the brokerage concern. Usually refers to the maintenance margin required by the brokerage concern which is over and above requirements of governing bodies.

Hypothecation agreement. An agreement signed by a customer that permits his broker to use securities in the customer's margin account as collateral for loans made to the broker.

In-box sheet. Sheet on which is listed items going into the box.

In-house. Within the brokerage concern itself.

Initial margin. The amount of money or its equivalent specified by the Board of Governors of the Federal Reserve System that a customer must deposit with his broker when the customer buys a security on margin.

International arbitrage. Same as arbitrage except markets are in different countries.

Investment banker. One who underwrites securities on an initial or secondary basis. This often involves private placements where the investment banker may act as both a broker and/or dealer.

Joint account. An account in which two or more persons have an interest.

Legal list. A list of securities in which insurance companies, banks, and fiduciaries are permitted by law to invest.

Legal transfer. A stock certificate having an assignment executed by an executor, administrator, trustee, guardian, etc., and requiring certain legal documents indicating the authority of the party assigning the securities.

Limit order. Also called a "limited order" or "limited price order." An order to buy or sell a security at a price specified by the customer or at a better price if such price can be obtained.

Listed security. A security which is traded on an exchange.

Loan consent. An agreement signed by a customer that permits the brokerage concern to lend securities in a margin account to other brokers.

Loan value. The value at which a security is accepted for margin. This value is usually less than or at a discount from current market value.

Loaned. Opposite of borrowed. The act of lending a security usually for delivery against a "short" sale. The equivalent value in money is usually deposited by the borrower.

Lock-up. The act of placing securities in safekeeping or segregation.

Long. Denotes ownership of securities. Due to.

Long and short record. *See* Stock record.

Maintenance margin. The amount of equity required to be maintained in a margin account in accordance with exchange regulations or house rules.

Margin. The equity in an account. The requirements as to the amount of margin vary between initial margin and maintenance margin and also according to the type of collateral used in computing the equity.

Margin call. A request for additional margin.

Margin department. A division of the "Operating Department." Its function is to keep an up-to-date record of each customer's purchases and sales of securities and to watch carefully margin transactions in a customer's margin account.

Margin transaction. A transaction on which the brokerage concern advances credit to the customer for a portion of the purchase price.

Mark-to-the-market. A procedure whereby a brokerage concern has the right to demand that the price of a past due or open contract be adjusted to current market values by the advancement of additional funds.

Mark-up. Refers to the difference between what a dealer has paid for a security and the price at which he offers the security to another person.

Market maker. A broker-dealer concern that stands ready to buy or sell a particular security in the over-the-counter market at prices which the concern has quoted.

Market price. Usually means the last reported price at which a security has been sold.

Master file. A file which contains the official account numbers and descriptions of securities or customers' names and addresses.

Maximum loan value. Refers to the percentage of the purchase price of a security which the broker may lend to a customer who is buying a security on margin.

Member corporation. A brokerage concern that is organized as a corporation and that has at least one director-holder of voting stock who is a member of an organized stock exchange.

Member firm. A brokerage concern that is organized as a partnership and that has at least one general partner who is a member of an organized stock exchange.

Mixed account. An account which contains both "long" and "short" securities.

NASDAQ. An electronic quotation system for over-the-counter market sponsored by the National Association of Securities Dealers, Inc.

Name-of securities. Securities registered in the name of customers of the brokerage concern.

National Association of Securities Dealers, Inc. (N.A.S.D.). Also referred to as N.A.S.D. An association of broker-dealers who do business in the over-the-counter market. The Association supervises and regulates the trading conduct of its members.

Net capital. Net worth of a brokerage concern less certain items such as exchange memberships, carrying value of securities which are not readily marketable, "haircuts" on marketable securities in proprietary accounts, furniture and equipment, etc., as defined in the net capital rules.

New issue. A security that is sold by an issuing corporation for the first time.

Non-regulated commodity. A commodity not regulated by the Commodity Exchange Act.

Odd lot. A quantity of securities which is less than the trading unit. Usually a quantity less than an even one hundred shares.

Odd-lot broker. A broker who executes odd lot transactions for other brokers. Such brokers buy or sell round lots on the exchange to cover the odd lot transactions.

Odd-lot differential. The fraction which is added to or deducted from the round lot price by the odd-lot broker.

Off-board. Means trading in unlisted securities in the over-the-counter market. Also used to describe transactions in listed securities not executed on a stock exchange.

Offer. The lowest price at which a seller is willing to sell a security.

Omnibus account. An open account carried by another brokerage concern (a margin account) as distinguished from a similar account where transactions are cleared on an individual basis (a cash account).

Operations department. The name associated with the overall clerical functions of a brokerage concern. Sometimes referred to as the "back office."

Optional dividend. A dividend that is payable in either stock or cash at the option of the holder of record.

Order department. A division of the Operations Department that receives customers' orders and transmits them either to the floor of a stock exchange or the trading department for execution. The Order Department also receives notices of executed trades and transmits such notices to the purchase and sales department and to the registered representatives.

Order room. Another name for the Order Department.

Out-of-box sheet. A sheet on which is listed securities removed from the box.

Over delivery. Delivering a greater amount of securities than called for; the surplus amount being returned by transferring it to the name of the delivering brokerage concern.

Over-the-counter (O.T.C.). A market for securities made up of brokerage concerns who may or may not be members of a securities exchange. Over-the-counter is mainly a market made over the telephone. Thousands of companies have insufficient shares outstanding, stockholders, or earnings to warrant application for listing on a stock exchange. Securities of these and other companies are traded in the over-the-counter market between brokerage concerns who act either as principals or as brokers for customers. The over-the-counter market is the principal market for United States Government bonds and municipal securities.

Over-the-window. The direct delivery of securities between two brokerage concerns, excluding the clearing-house facilities. Delivery is made by hand to the receive window of the broker and is said to be "over-the-window."

P. & S. department. Abbreviation for Purchase and Sales Department.

Pair off. Sometimes it occurs that two brokerage concerns each owe one another the same number of shares of the same security. Instead of actually receiving the security and delivering it back again they will "pair off" the transaction by giving or receiving a check for the difference in price, or by exchanging checks for the full amount of each side of the transaction.

Papers. A term sometimes given to put and call options.

Payable date. The date on which a dividend is payable to holders of record as of some previous date.

Pink sheets. A listing of over-the-counter securities published on pink paper by the National Quotation Bureau. It shows the most recent bid and asked prices for the securities listed, as well as the broker-dealers making a market in those securities. While pink paper is used for stock quotations the definition also applies to listings of bond quotations, etc., which are printed on papers of different color.

Point. When used in connection with the purchase or sale of stocks, means a rise or decline of $1.00 per share. When used in connection with the purchase or sale of bonds means a rise or decline of $10.00 per $1,000 principal amount.

Point balance run. A listing of each future commodities contract by month of contract on which the extended contract value and market value are indicated, together with the resulting gain or loss.

Position. This term is used in referring to the securities "long" or "short" in an account or in the stock record.

Position record. *See* Stock record.

Post. A booth or trading location on the floor of a stock exchange at which securities assigned to that location are traded.

Price-earnings ratio (P.E.). The market value of a stock divided by its earnings per share.

Primary distribution. The original offering to investors of securities that have never before been issued.

Principal. A dealer who buys or sells securities for his own account acts as a "principal." Also, a customer is the "principal" of the broker who executes his order.

Private placement. The direct sale of a block of securities, either a new issue or a secondary issue, to a single investor or group of investors. This is usually accomplished through an investment banker.

Proprietary accounts. This term includes capital accounts of partners or sole proprietor, investment and trading accounts, participation in joint accounts, accounts of partners which are covered by approved agreements providing for the inclusion of equities therein as partnership property, and borrowings covered by subordination agreements approved by regulatory bodies.

Proxy department. A division of the Operations Department that helps corporations communicate with their stockholders in cases where stock certificates are in street name.

Proxy statement. A document containing specified information that must be sent to stockholders at the time they are asked to sign proxies for a meeting of stockholders.

Purchase and Sales department. A division of the Operations Department that is concerned with the preparation of customers' confirmations of security transactions and the comparison of such transactions with other brokerage concerns.

Put option. A contract which entitles the holder to sell (put), entirely at his option, a specified number of shares of a particular security at a specified price anytime until the stated expiration date of the contract. Such an option (which is always for a round lot amount and which is transferable), is bought with the expectation of a price decline below the contract price. If the price decline occurs, the purchaser will exercise the option. If the decline does not occur, he will let the option expire and will lose only the cost of the option. During the existence of the option the exercise price and number of shares is adjusted on the ex-date for cash dividends, rights, and stock dividends or splits.

Puts and calls. Options to sell (put) or buy (call) securities within a specified period of time at specified prices. *See* Put option and Call option, Straddle, Strip, and Strap.

Quote. The price of a security. It may be the price of the last sale made on an exchange or the current bid and asked price.

Receive and deliver department. A division of the Operations Department responsible for the physical receipt and/or delivery of incoming and outgoing securities. Often it is also responsible for the daily balancing of cash entries made by the various operations departments.

Record date. The date on which the stockholder's name must be registered on the books of a company in order to receive a declared dividend or, among other things, to vote on company affairs.

Registered owner. The owner of a security whose name is recorded on the face of the certificate and on the books of the issuing corporation or its agent.

Registered representative. Name given to a salesman in a brokerage concern. Salesmen are registered with the exchange of which the brokerage concern is a member.

Registrar. Usually a trust company or bank charged with the responsibility of preventing the issuance of more stock than that authorized by the issuing company.

Regular-way delivery. Unless otherwise specified, securities (other than government's) are to be delivered to the buying brokerage concern by the selling brokerage concern and payment made on the fifth business day after the transaction. Regular-way delivery for government bonds is the business day following the transaction.

Regulated commodity. Commodity which is regulated by the Commodity Exchange Act.

Regulation T. The name for Federal Reserve Board's regulation governing the amount of credit that brokers and dealers may extend to customers who buy securities.

Regulation U. The name for Federal Reserve Board's regulation governing the amount of credit that banks may extend to customers who borrow money to buy securities on margin.

Reorganization department. A division of the Operations Department that processes securities involving corporate reorganizations, mergers, consolidations, subscriptions and the exchange of convertible securities into common stocks.

Repurchase agreement. An agreement whereby the seller of securities agrees to repurchase the securities within a specified time at a specified price.

Restricted account. Means that a broker may not buy securities for a particular customer for a specified period of time unless the customer has on deposit enough money in his account to pay for the securities before his orders are executed.

Reverse split. Opposite of stock split.

Rights. The privilege offered by a corporation to its stockholders to subscribe to certain securities at an advantageous price.

Round lot. A unit of trading or a multiple thereof. On the New York Stock Exchange the unit of trading is generally 100 shares in stocks and $1,000 par value in bonds.

Round turn. A purchase and a subsequent sale or a sale and subsequent purchase of a future commodity contract.

S.C.A. Abbreviation for subsequent coupons attached.

Safekeeping. A position on the Stock Record (Street Side) indicating securities that have been fully paid for by customers and are being held by the brokerage concern under custody arrangements. These securities are generally in the name of the customer.

Safekeeping box. Box in which fully paid for securities of customers are kept.

Scrip. A certificate issued to stockholders of a corporation which may be exchanged for fractional shares of stock or the equivalent in cash by a fixed date. Scrip is usually issued in connection with a stock dividend or a stock split.

Seat. The popular name for a membership on a stock exchange.

Secondary distribution. The sale of a large block of securities (other than an initial issue of a corporation). It is usually the holdings of a large individual stockholder or an estate that are being liquidated.

Secondary offering. An offering of large blocks of listed securities outside of the exchange on which they are listed.

Securities and Exchange Commission (S.E.C.). An agency established by Congress to administer Federal securities laws.

Securities borrowed. *See* Borrowed.

Securities bought but not received. A liability account used by brokerage concerns which act principally as underwriters or dealers to record purchases as of the trade date rather than the settlement date.

Securities Investor Protection Corporation (S.I.P.C.). A corporation established for the purpose of protecting customers of broker-dealers in financial difficulty.

Securities loaned. *See* Loaned.

Securities not readily marketable. This term refers to (a) securities, except exempted securities, for which there is no market on a securities exchange or no independent publicly quoted market, (b) securities which cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 (or the conditions of an exemption such as Regulation A under Section 3(b) of such Act have been complied with, and (c) securities which cannot be offered or sold because of other arrangements, restrictions or conditions applicable to the securities or the brokerage concern.

Securities sold but not delivered. An asset account used by brokerage concerns which act principally as underwriters or dealers to record sales of securities as of the trade date rather than the settlement date.

Segregation. A position on the Stock Record (Street Side) indicating customers' fully paid for or excess margin securities which are subject to the customers' instructions and which have been set aside. These securities are generally in the name of the brokerage concern. (*See* Bulk segregation.)

Segregation box. Box in which are kept segregated securities.

Sell out. Action taken by a broker to liquidate an account or transaction for failure to maintain proper margin or make timely payment.

Sellers' option. Transaction which by agreement is to be settled at a date later than the usual regular way transaction.

Selling against the box. This is similar to a "short sale" except that the seller already owns the stock being sold but keeps possession of it and so has to borrow the equivalent stock with which to make delivery to the purchaser.

Selling group. A group of brokerage concerns which have formed a joint account for the sale of securities. Usually in connection with an underwriting.

Service bureau. A data processing center which processes transactions of brokerage concerns. These centers are located away from the brokerage concern's office.

Settlement date. The date on which security transactions are to be settled by the delivery or receipt of securities and the receipt or payment of cash.

Settlement price. The price at which a security or commodity is to be settled. Used primarily in connection with clearing house operations.

Short. A Stock Record position (Street Side) which represents location (such as box, transfer, etc.) or due from (such as failed to receive, owed to the brokerage concern by a customer on account of a short sale, etc.).

Short against box. *See* Selling against the box.

Short covering. Refers to the purchase of securities so that stock previously borrowed to make delivery on a "short" sale may be returned.

Short sale. A sale of securities by a customer which requires the borrowing of equivalent securities to make delivery to the purchaser.

Signature guaranteed. In order that a registered security may be a good delivery on the exchange or a good transfer the signature of the registered owner must be properly guaranteed. The guarantee of a stock exchange firm or a bank is usually considered sufficient guarantee.

Special offering. The sale of a large block of securities on the floor of the stock exchange. The sale is made in accordance with special procedures worked out by officials of the exchange.

Specialist. A broker who is a member of an exchange and who operates on the floor of the exchange to execute transactions and to maintain an orderly market in certain specified securities.

Split. The action of increasing the number of outstanding shares of stock of a company so as to decrease the market price and afford a greater distribution of the shares, i.e., two shares for each share held will have the effect of reducing the price of the shares by one half.

Spot commodity. A contract for the future delivery of a commodity. In these cases the commodity is evidenced by a warehouse receipt.

Spread. A combination of a "put" and "call" option at different prices; one below and the other above the current market price. Also refers to the difference between the bid and ask prices of a security.

Stock Clearing Corporation (S.C.C.). A subsidiary of the New York Stock Exchange which acts as a central agency for security deliveries and money payments between member firms of the exchange.

Stock dividend. A dividend payable in stock of the issuing corporation.

Stock power. A legal document used in lieu of the assignment section of a stock certificate. It cannot be used on a bond certificate.

Stock record. The record of individual securities on which both the "long" and "short" positions are shown; the total of the "long" positions and the total of the "short" positions being in balance.

Stock record department. A division of the Operations Department that keeps up-to-date records of all securities positions.

Stock split. A method used by corporations to increase the number of shares of its stock outstanding but without changing each stockholder's interest in the corporation. Usually accomplished by reducing the par value, or stated value, of the stock.

Stockholder of record. A stockholder whose name is registered on the books of the issuing corporation.

Stop order. Also called a stop loss order. An order used by a customer to protect a paper profit in a security or to keep down a possible loss in a security. The stop order becomes a market order when the price of the security reaches, or sells through, the price specified by the customer.

Straddle. A combination of one put and one call, identical with respect to the security issue, number of shares, exercise price and expiration date.

Strap. A combination of two calls and one put for the same security issue.

Street. A term of reference for brokerage and other financial business concerns.

Street item. A transaction or account between brokers (e.g., "failed to receive," "failed to deliver," "stock loaned," and "stock borrowed").

Street name. Securities held in the name of a brokerage concern instead of in customers' names are said to be carried in "street name."

Strip. A combination of two puts and one call for the same security issue.

Subscription. The offer to purchase a certain offering, as a certain number of shares of the stipulated stock or principal amount of bonds for a stipulated amount of money. Such offer is not binding unless accepted by the proper authorized representatives of the issuing corporation.

Subordinated account. An account which is subordinated to the claims of general creditors of the brokerage concern.

Substitution. The act of withdrawing securities from a bank loan and substituting other securities of approximate equal value.

Suspense account. An account used to record securities and/or monies that cannot be immediately identified and cleared; reclamations, D.K. items, bad deliveries, etc.

Syndicate. A group of brokerage concerns who together underwrite and distribute new issues of securities or large blocks of an outstanding issue.

T.A.D. An abbreviation of transfer as directed.

Take-off. Sometimes referred to as a "Daily Activity List." A daily record showing the net changes in each security. A separate record is prepared for each security and the information is used to post (update) the Stock Record. Also a record of the "long" and "short" positions in a security on the record date which is used by the dividend department to make the appropriate dividend entries.

Tax stamp. A rubber stamp facsimile (in some instances a documentary stamp) affixed to a certificate to indicate that all applicable transfer taxes for the item have been paid.

Ticker. An instrument that prints the price at which a security has been traded on an exchange within minutes after the trade is executed.

Time loan. A loan having a definite date of maturity and a specified rate of interest for the entire period.

Trade. A term that indicates the consummation of a security transaction, either a purchase or a sale.

Trade date. The date a security transaction is actually executed.

Trader. An employee of a brokerage concern who executes orders in the over-the-counter market for customers. Also means a person who buys or sells securities for his own account for short-term profit.

Trading post. Another name for Post.

Trading unit. The unit by which the security is traded on the exchange. Usually 100 shares of stock or $1,000 principal amount of bonds (round lot).

Transfer. Usually refers to the act of changing the ownership of registered securities on the books of the issuing corporation.

Transfer agent. A transfer agent keeps a record of the name of each registered shareholder, his or her address, the number of shares owned and sees that certificates presented to his office for transfer are properly cancelled and new certificates issued in the name of the transferee.

Transfer department. A division of the Operations Department that matches, processes and controls securities being transferred.

Two-dollar broker. A name given to a member of an exchange who executes orders for other brokers on that exchange.

Underwriting. The act of distributing a new issue of securities or a large block of issued securities, i.e., a secondary offering.

Undivided liability. An arrangement whereby each member of an underwriting syndicate is liable for his proportionate share of unsold securities in the underwriting account regardless of the number of securities which he has previously sold.

Unit record. A term applied to a data processing system which utilizes only punch cards.

Unlisted security. A security which is not listed on an exchange.

Value date. Same as settlement date.

Valued stock record. The stock record at examination date with each security position other than those in segregation and safekeeping are assigned a price. Active quantities within the position are valued at the assigned price.

Variation margin. A term used in commodity operations. Refers to last day point fluctuation—difference between prior days settling price and last day settling price—on net positions "long" and "short."

Warrants. Rights to purchase additional securities. Usually affixed to the certificate at the time securities are originally issued. Also refer to document evidencing rights, i.e., a warrant for 125 rights.

When distributed. Refers to the distribution of new securities. Transactions are sometimes entered into on a "when distributed" basis before the distribution takes place.

When issued. A short form of "when, as and if issued." The term indicates a conditional transaction in a security authorized for issuance but not yet actually issued. All "when issued" transactions are on an "if" basis to be settled if and when the actual security is issued and the exchange or National Association of Security Dealers rules that the transactions are to be settled.

Window. A term applied to a place in the office of a brokerage concern where securities are actually received or delivered.

Window ticket. A term applied to a document given to the brokerage house by a transfer agent as a receipt. Also applies to a transfer document originating with the brokerage concern (broker originated window ticket).

Wire house. A brokerage concern that has a network of communications (telephone or teletype) that link the main office to branch offices and offices of correspondent brokerage concerns.

Wire room. Another name for the order room.

Yield. The return on investment that an investor will receive from dividends or interest. This is expressed as a percentage of the current market price of the security, or, if the investor already owns the security, of the price he paid. The return on stocks is figured by dividing the total dividends paid in the past calendar year by the price of the stock. The return on bonds is figured by dividing the interest by the price of the bond.