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Comment letters on Proposed Audit and Accounting Guide "Audits of Brokers and Dealers in Securities"

American Institute of Certified Public Accountants. Stockbrokerage and Investment Banking
Committee

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Comment Letters Received.

on the Exposure Draft of 8/16/94

Audit & Accounting Guide

"Audits of Brokers and Dealers in Securities"



Paul R. Ogorzelec
Executive Vice President

November 17, 1994

Mr. Al Goll
Technical Manager
File 4340.SG
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Proposed Audit and Accounting Guide
"Audits of Brokers and Dealers in Securities"

Dear Mr. Goll:

BankAmerica Corporation appreciates the opportunity to comment on the Proposed Audit and Accounting Guide, "Audits of Brokers and Dealers in Securities" (proposed Audit Guide). As the parent of several brokers and dealers in securities, we believe the proposed Audit Guide will be an important resource for addressing accounting and financial reporting matters that are unique to these entities.

Overall, we are satisfied with the guidance in the proposed Audit Guide. However, we urge the Institute to consider the following comments, which we believe would make it more beneficial to both preparers of financial statements of broker-dealers and independent auditors.

The remainder of this letter discusses our most significant comments. Other comments and suggestions on the proposed Audit Guide are included in the Attachment to this letter.

1

VALUATION OF DERIVATIVE FINANCIAL INSTRUMENTS

Paragraph 7.15 provides a general discussion of factors to consider in pricing derivative financial instruments. However, the proposed Audit Guide does not address recently proposed methods for determining the fair value of derivative financial instruments. We recommend that the proposed Audit Guide discuss the valuation methods presented by the Group of Thirty in its July 1993 report, "Derivatives: Practices and Principles," including the mid-market valuation concept and adjustments to the mid-market valuation for expected future costs such as unearned credit spreads, close-out costs, investing and funding costs, and administrative costs.

COMBINED FINANCIAL INSTRUMENTS

Paragraph 7.17 recommends valuing combined financial instruments that are created from an arbitrage trading strategy based on the substance of the transaction (i.e., valuing the component instruments taken as a whole), rather than the form of the component parts.

We understand that the Securities and Exchange Commission (SEC) may issue disclosure requirements on combined instruments, which would require registrants to disclose information about each component of a combined instrument. Given the heightened interest in derivatives and other financial instruments, we encourage the Institute to ensure that guidance on the valuation of combined instruments is consistent with that which may be promulgated by the SEC.

DISCLOSURE ABOUT DERIVATIVE FINANCIAL INSTRUMENTS AND FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement of Financial Accounting Standards No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments", (SFAS 119) significantly impacts broker-dealers because of its expanded requirements for disclosures related to derivative financial instruments, many of which are traded or held by broker-dealers. Given the impact that SFAS 119 will have on the financial statements of broker-dealers, we recommend that the proposed Audit Guide summarize the disclosure requirements established by SFAS 119.

1

Mr. Al Goll
November 17, 1994
Page 3 of 4

REPURCHASE TRANSACTIONS

Paragraph 7.35 addresses repurchase transactions and includes a reference to Statement of Position 90-3, "Definition of the Term "Substantially the Same" for Holders of Debt Instruments, As Used in Certain Audit Guides and a Statement of Position" (SOP 90-3). The Proposed Audit and Accounting Guide, "Banks and Savings Institutions," dated August 31, 1994, provides an in-depth discussion of repurchase agreements, but supersedes SOP 90-3.

Because repurchase agreements are widely used by broker-dealers, as well as banks and savings institutions, we recommend the Institute issue a separate Statement of Position providing comprehensive guidance on accounting for repurchase and reverse repurchase agreements. A separate Statement of Position would be beneficial because it would provide a single source of information for broker-dealers and financial institutions.

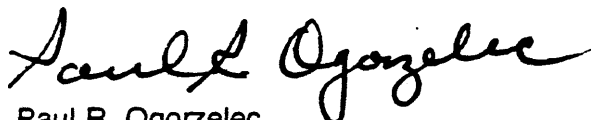
If the Institute elects not to issue a separate Statement of Position on repurchase agreements, then we recommend either including in this proposed Audit Guide an expanded discussion of repurchase agreements, or including a reference to the guidance on accounting for repurchase agreements contained in the Proposed Audit and Accounting Guide, "Banks and Savings Institutions."

Further, paragraph 7.35 uses the phrase "substantially the same" in reference to the securities exchanged in a repurchase agreement, and indicates that such transactions are generally accounted for as financing arrangements, rather than as sales of securities with gain or loss recognition. However, "substantially the same" (rather than identical) securities are exchanged only in dollar repurchase agreements. Accordingly, we recommend that the proposed Audit Guide clarify the differences between repurchase agreements and dollar repurchase agreements.

* * * * *

Please do not hesitate to contact me at (415) 624-1009, or Julie Chan at (415) 624-0430, if you would like to discuss our comments.

Sincerely,



Paul R. Ogorzelec
Executive Vice President

1

Mr. Al Goll
November 17, 1994
Page 4 of 4

cc: Mr. Lewis W. Coleman
Vice Chairman of the Board and
Chief Financial Officer
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Mr. Thomas W. Taylor
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Ernst & Young
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Mr. James H. Williams
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BANKAMERICA CORPORATION

Attachment

Proposed Audit and Accounting Guide "Audits of Brokers and Dealers in Securities" ("the proposed Audit Guide")

This Attachment provides other comments and suggestions on the proposed Audit Guide. It is an integral part of, and should be read in connection with, the accompanying letter dated November 17, 1994.

CHAPTER 1: THE SECURITIES INDUSTRY

Business versus Calendar Days

Comment 1: Various sections of the proposed Audit Guide (e.g., paragraphs 1.47, 1.49, and 2.49) address the number of days that may elapse before events related to a securities transaction must occur (e.g., delivery of securities). However, the proposed Audit Guide does not distinguish between business and calendar days.

In all cases, we recommend that the proposed Audit Guide clarify whether the time periods indicated represent business or calendar days.

Regulatory Overview

Comment 2: Paragraphs 1.40 through 1.43 provide a summary of the major regulatory bodies that have jurisdiction over the activities of broker-dealers. However, the proposed Audit Guide does not discuss instances in which the activities of a broker-dealer may be subject to regulation by the Office of the Comptroller of the Currency (OCC).

Broker-dealer subsidiaries of national bank holding companies may be subject to certain rules and regulations of the OCC if the broker-dealer subsidiary engages in transactions with the national bank subsidiary. Accordingly, we recommend that the proposed Audit Guide also include an overview of the instances in which OCC rules and regulations would apply to broker-dealers that are subsidiaries of national bank holding companies.

CHAPTER 2: BROKER-DEALER FUNCTIONS, BOOKS, AND RECORDS

Items Included in the Stock Record

Comment 3: Paragraph 2.11 discusses the items commonly included in the stock record, but does not address money market and mutual fund shares.

We recommend that the proposed Audit Guide indicate that money market and mutual fund shares are also generally recorded in a broker-dealer's stock record.

Trade Execution

Comment 4: Paragraph 2.18 discusses customer sales but does not address discretionary accounts.

Discretionary accounts are those in which a customer has granted permission to a broker-dealer to execute trades on its behalf without prior consultation. Discretionary accounts represent an internal control risk due to the need for greater management oversight for customer suitability and possible conflicts with other activities of the broker-dealer. Accordingly, we recommend that the proposed Audit Guide include a discussion of discretionary accounts.

Calculation of Aggregate Debit and Credit Items

Comment 5: Paragraph 2.162 indicates that SEC Rule 15c3-3 requires broker-dealers to maintain records of the periodic (weekly or monthly) calculations of aggregate debit and credit items and the deposits required in the special reserve bank account for the exclusive benefit of customers.

We recommend that the proposed Audit Guide clarify the instances in which weekly versus monthly calculations of these amounts are required.

Tax Information Reporting

Comment 6: We recommend that the proposed Audit Guide provide an expanded discussion of tax information reporting by reordering paragraph 2.166 to a new paragraph numbered 2.167, and inserting the following new paragraph to replace the former paragraph 2.166:

The IRS also matches Forms 1099-INT, OID, and DIV against a payee's Form 1040. If there is a discrepancy, the IRS will send four notices to the payee to resolve the discrepancy. If the payee does not respond, the IRS will notify the payor of this fact. The payor is then required to notify the payee that it has received such a notice and advise the payee to immediately resolve the problem with the IRS. The payor is also required to notify the payee that it must commence mandatory backup withholding on the 31st day after receipt of the IRS notice and can only terminate withholding when it receives a "stop notice" from the IRS (either directly from the IRS or a copy of a "stop notice" sent by the IRS to the payee). Failure to withhold will result in a tax liability for the payor.

CHAPTER 3: REGULATORY CONSIDERATIONS

Quarterly Securities Counts

Comment 7: Paragraphs 3.52 through 3.55 discuss SEC Rule 17a-13, which requires broker-dealers to conduct a securities count at least once in each calendar quarter.

We recommend that the proposed Audit Guide clarify that SEC Rule 17a-13 states that no security shall be examined, counted, verified, or compared less than two months or more than four months after a prior examination, count, verification, or comparison.

CHAPTER 4: FINANCIAL STATEMENT PRESENTATION AND CLASSIFICATION

Typographical Error

Comment 8: The second bullet point in paragraph 4.52 begins with "sing.." which appears to be a typographical error.

CHAPTER 7: ACCOUNTING STANDARDS

Fair Value of Financial Instruments

Comment 9: Paragraph 7.14 addresses the use of matrix pricing as a method to determine the valuation of a financial instrument.

We recommend that the proposed Audit Guide include inventory aging and turnover as additional factors to consider in the valuation, because a slow moving financial

instrument or illiquid position may have a lower fair value than a matrix or other type of pricing model would indicate. Furthermore, we recommend that the proposed Audit Guide state that matrix or other mathematically modelled pricing is, at best, an indication of fair value and does not have the same reliability as actual dealer bids or reported sales.

Securities Borrowed and Loaned

Comment 10: Paragraph 7.33 indicates that as the market value of borrowed or loaned securities fluctuates, the contract amount (cash deposit) may be adjusted.

We recommend that the proposed Audit Guide clarify that the contract amount refers to the margin on deposit with the party lending the securities and that adjustment of the contract amount results when the securities lender makes a margin call on the borrower.

OTHER MATTERS

No Action Letters and Blue Sky Laws

Comment 13: A "No Action Letter" is issued to a broker-dealer by the staff of the SEC in response to a request filed by the broker-dealer describing a proposed business activity that may or may not conform to SEC rules and regulations. In a "No Action Letter," the SEC staff indicates that, based on the facts presented by the broker-dealer, the SEC staff will recommend no action be taken against the broker-dealer for engaging in the proposed activity. A "No Action Letter" does not have the force of law; however, it represents an interpretation of the SEC staff that may be applied in a situation where the broker-dealer is engaging in an activity not addressed by existing SEC rules and regulations.

Blue Sky laws are state laws governing the activities of broker-dealers. A broker-dealer must comply with the Blue Sky laws in each state in which it does business. Due to the importance of complying with all applicable rules, regulations, and laws, we recommend that the proposed Audit Guide include a discussion of "No Action Letters" and Blue Sky laws.

1

Impact of SEC Rule 15c6-1 on Settlement Period and Procedures

Comment 14: SEC Rule 15c6-1, effective June 1, 1995, will establish a standard settlement period of three business days for most financial instruments. This represents a reduction in the allowable settlement period for many financial instruments that currently settle in more than three business days. Accordingly, broker-dealers will have to adjust their internal procedures to enable them to process securities settlements in three business days.

We recommend that the following paragraphs in the proposed Audit Guide reflect the impact of Rule 15c6-1.

- Paragraph 1.46 indicates that Regulation T generally requires cash payment by the customer for the purchase of securities within seven business days of the transaction. We recommend that paragraph 1.46 address the impact that SEC Rule 15c6-1 will have on the Regulation T rules for cash settlement of securities transactions.
- Paragraph 2.16 addresses the current standardized (regular way) settlement period for various financial instruments. A footnote to the chart in paragraph 2.16 indicates that, effective June 1, 1995, SEC Rule 15c6-1 establishes three business days as the standard settlement time frame for broker-dealer trades. However, the chart indicates that the current standard settlement period for government securities, futures and commodities, listed options (CBOE), money market instruments, and currency contracts--spot is less than three business days. We recommend that the proposed Audit Guide clarify that SEC Rule 15c6-1 reduces the allowable settlement period for those financial instruments that currently settle in more than three business days; however, it does not extend the settlement period for those instruments that currently settle in less than three business days.
- Paragraph 3.19 indicates that the time at which instructions may be issued to the cashing section to release securities from possession or control on sales of securities by customers is not earlier than the close of business on the third business day before the settlement date. We recommend that the proposed Audit Guide address how the shortened settlement period under Rule 15c6-1 will impact these "release from possession or control procedures."



Chemical Bank
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Joseph L. Sclafani
Senior Vice President
and Controller

November 9, 1994

Mr. Al Goll
Technical Manager, Accounting Standards Division
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New York, NY 10036-8775

**Subject: Proposed Audit and Accounting Guide, "Audits of Brokers and Dealers
in Securities"**

Dear Mr. Goll:

Chemical Banking Corporation appreciates the opportunity to respond to the proposed audit and accounting guide, "Audits of Brokers and Dealers in Securities" (the "proposed guide"). We agree with the accounting guidance and reporting guidance provided in the proposed guide. The contents of the document and the efforts of its authors are laudable. We have only a few minor comments, which follow as an attachment.

Sincerely,

A handwritten signature in cursive script, appearing to read "Joseph L. Sclafani".

Attachment

2

Attachment - Minor Comments

The organization of the proposed guide presumes a certain sophistication and familiarity with its contents from its readers due to its length. For example, in order to locate information provided relative to underwriting, a reader must refer to pages 29, 83, 85, 139, 140, and 183. We found the proposed audit guide for banks, which continues to be organized by product, to be more user friendly. In that guide, a reader picks a topic, and information on accounting, tax, auditing and regulatory concerns is presented in a single chapter. In addition, the proposed bank guide's footnotes cross-referencing upcoming pronouncements that would affect the guidance in the guide are quite useful.

We would suggest inclusion of the Statement of Financial Accounting Standards No. 119, "Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments" in the discussion of reporting requirements and in the sample financial statements. We also would suggest inclusion of reference to, or discussion of, any pending or final pronouncement on: risks and uncertainties; consolidation policies and procedures; offsetting of certain repurchase and reverse repurchase agreement; and impairment of long-lived assets.

On page 99, in Note 4 of the sample financial statements, deposits received for securities loaned are listed as a component of receivable from broker-dealer in the amount of \$7,756 and \$7,395, respectively. If this relates to securities loaned, it would not appear to be appropriate to present a receivable--only a payable. If this relates to securities borrowed, it would have been included already in Securities Borrowed on the balance sheet.

There is a typographical error in the second bullet in paragraph 4.52 ("sing.Interest" instead of "Interest").

On page 43, the section entitled "Dividends and Interest" makes no mention of interest, only dividends.

It would be an added aid to readers if the following terms were to be included in the glossary: Blue Sky laws; Chinese Wall; DVP; SVP; COD; IPO; OCC; LOANET; SMV; LMV; and PVP.

David H. Sidwell
Senior Vice President
and Controller

November 16, 1994

Morgan Guaranty
Trust Company of
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Tel: 212 648-9095

Re: Proposed Audit and Accounting Guide, "Audits of Brokers and Dealers in Securities"

Dear Mr. Goll:

We appreciate the opportunity to offer our views on the above-mentioned Audit and Accounting Guide (the Guide), which would supersede the 1985 Broker-Dealer Audit Guide. Overall, we believe that the Guide meets the AICPA's objective of assisting accounting practitioners and auditors in preparing and auditing the financial statements of broker-dealers. This letter sets forth our general comments on the Guide.

Paragraphs 7.17 through 7.19 of the Guide indicate that combined financial instruments, which are created from components of an arbitrage trading strategy, may be recorded based on the overall effect of the transactions rather than as separate instruments. The illustration indicates that "a combined financial instrument created by selling short a government security and borrowing the security under a reverse repurchase agreement with a term approaching the maturity of the underlying government security would create contractual cash flows that may measure the value of the combined financial instrument." The proposed guidance states, "it may be more appropriate to reflect the ultimate cash flow gain or loss on an amortized basis over the term of the combined financial instrument instead of valuing the government security at market and the repurchase agreement at cost." We suggest that the guidance on amortization be clarified to indicate that the method of revenue recognition be consistent with the economics of the transaction and reflect management's intent to hold the combined financial instruments. In the event that the transaction is unwound before maturity, any unamortized balance or excess gain or loss should be adjusted in the current period. We also recommend that the example provided in the Guide be revised to reflect an arbitrage transaction, as defined in the glossary.

With respect to the discussion of trade date versus settlement date accounting in paragraphs 7.20 through 7.30, we note that the proposed guidance to record delayed delivery transactions off-balance sheet until settlement reflects a change in accounting from the 1985 Broker-Dealer Audit Guide. At the present time, there is diversity in industry practice regarding the accounting for delayed delivery transactions, particularly among banks with broker-dealer subsidiaries. Accordingly, we believe that changing the current accounting guidance to settlement date accounting is not warranted at this time. We believe this issue should be deliberated by the FASB where due process, including determination of the impact and

3

Mr. Al Goll, AICPA
November 16, 1994 - Page 2

implications of changing this accounting, can be accomplished prior to implementation and an appropriate effective date could be established.

Additional suggestions on the Guide are outlined in the Attachment. As requested, we have referenced our remarks to the related paragraph numbers. For your convenience, our recommendations for modification to the existing text have been underscored. We would be pleased to discuss any of the items in greater detail if you have any questions or comments.

Sincerely,

David H. Schell

Attachment

Chapter 1

Paragraph 1.28 - The second sentence should be expanded to read, "Members of an exchange are required to execute buy and sell orders in listed securities that are not Rule 19c-3 eligible through that exchange during Exchange hours. Rule 19c-3 includes those equity securities that were listed and registered on an Exchange on or after April 26, 1979."

Paragraph 1.30 - The penultimate sentence should read "In the United States equity and corporate markets, settlement generally occurs five business days after trade date." This change is suggested because the government market represents a significant portion of the U.S. securities market and settles the next day.

Paragraph 1.35 - The Pacific Securities Depository Trust Company no longer exists. The Mortgage-Backed Securities Corporation (MBSCC) maintains open TBA commitments for members. Net settlement is done on a book entry basis at PTC or at the Fed through the broker-dealer's clearing bank. Both MBSCC and PTC are owned by their participants.

Paragraph 1.43 - The third sentence should state that "most broker-dealers registered with the SEC are required to be members of SIPC. As the sentence currently reads an auditor may infer that this membership is voluntary.

Chapter 2

Paragraph 2.2 - In the last sentence, "continuous net settlement (CNS)" should be changed to "National Securities Clearing Corporation (NSCC)," which is the entity that uses the CNS process.

Paragraph 2.10 - The examples of short positions should include "a custody account at a bank," one of the more common locations.

Paragraph 2.13 - The fourth sentence states that Rule 17a-3 requires broker-dealers to maintain memorandums for every purchase and sale of securities for its own account. This should be expanded to include customers of the broker-dealer as well. The last sentence in this paragraph should read "prescribed periods" since there are different retention periods for different records.

Paragraph 2.32 - The second sentence should read, "The periods of seven business days and thirty-five calendar days may be extended for one or more limited periods by applying to the broker-dealer's examining authority." (not as it states "a national securities exchange or to the NASD"). This change is suggested because the New York Stock Exchange recently adopted Rule 434, which requires that a member firm apply only to the Exchange for extension. In addition, as the term "designated examining authority" is used in several places in the guide, it should be defined in the glossary.

Paragraph 2.53 - As the expenses associated with an underwriting are generally not deferred, the second sentence should be modified to state that they are "accumulated in the general ledger in separate liability accounts."

Paragraph 2.92 - The term "CNS" should be replaced with "net settlement" in both instances where it is used in this paragraph. The Government Securities Clearing Corporation is owned by its participants and is affiliated with National Securities Clearing Corporation. Participating government securities dealers use a net settlement system for the clearance and settlement of government securities. The process is *not* the continuous net settlement used for equities where fails are recycled.

Paragraph 2.93 - In the second sentence, "cash settlements" should be replaced with "executions" since settlements take place later in the day.

Paragraph 2.106 - An additional bullet point should discuss the fact that SEC Rule 15c3-1 and Rule 15c3-3 include special provisions to treat aged foreign fails differently from domestic fails with respect to net capital charges and buy ins.

Paragraph 2.142 - The third sentence should read, "The borrowing broker-dealer is required to deposit cash or other collateral, which may be in the form of securities issued or guaranteed by the U.S. or its agencies, certain certificates of deposit or banker's acceptances or irrevocable letters of credit." As currently worded the sentence includes the entire universe of fixed income securities, some of which cannot be pledged under Federal Reserve Board Regulation T. Regulation T also requires that letters of credit be "irrevocable."

Paragraph 2.149 - The parenthetical in the first sentence should read "reverse repos or resales."

Paragraph 2.158 - The second sentence should read, "other means such as electronic files (for example, image processing) have been approved by the SEC as an alternative method of preserving a firm's records, provided certain criteria are met."

Paragraph 2.160 - The following sentence should be added to the end of the paragraph. "The rule also requires notification if certain minimum net capital requirements are not met."

Paragraph 2.163 - Form 1042-S, which identifies a foreign person's U.S. source income subject to withholding, and the consolidated Form 1042, should be included in the list of information notices that a broker-dealer is required to file with the Internal Revenue Service for certain customer transactions.

Paragraph 2.164 - Additional detail regarding withholding tax documentation should be provided, e.g., Form W-8 (certificate of foreign status); Form W-9 (the request for taxpayer identification number and certification); Form 1001 (ownership, exemption, or reduced rate certificate); Form 4224 (exemption from withholding of tax on income effectively connected with the conduct of a trade or business in the U.S.); and Form 8709 (exemption from withholding on investment income of foreign governments and international organizations).

Chapter 3

Paragraph 3.2 - Rule 15a-6, Exemption of Certain Foreign Brokers or Dealers, should be added to the list of primary rules, with the increase in international business.

Paragraph 3.16 - The word "entire" is misleading because there are possession or control requirements for partially paid securities as well.

Paragraph 3.47 - The statement should be modified to reflect changes in the capital rule regarding withdrawals, and should read "percentage requirements also restrict the withdrawal of equity capital, the repayment of subordinated obligations and the making of any unsecured advance or loan to a stockholder, partner, sole proprietor, employee or affiliate."

Paragraph 3.52 - This section is repeated from Section 2.161. However, it seems more appropriate to include it here with only a brief summary in Section 2.161.

Paragraph 3.53 - Consider adding the following sentence to the end of the paragraph. "All locations for a particular security must be verified as of the same date."

Paragraph 3.67 - The first line should clarify that the information is to be provided for each material associated person (MAP). It should also note that for MAP's who are subject to the supervision of a federal banking agency, or who are insurance companies, special exemptions exist regarding the information to be filed. In these cases, the broker-dealer is allowed to satisfy the filing requirements by submitting certain reports filed by the MAP with its federal bank regulator if it is a bank, or the state insurance regulator if an insurance company.

Chapter 4

Paragraph 4.24 - The use of the word "may" in the second sentence is misleading. "Any material balances included in this category should be shown separately as due from or due to correspondent brokers."

Paragraph 4.46 - The third sentence should be clarified with the addition of the following sentence. "However, securities that have been sold to a DVP customer or to another broker-dealer, which have not yet been paid for, can be pledged as collateral for a firm bank loan. Non-customer bank loans are typically used to finance positions of a broker-dealer correspondent or an affiliate."

Paragraph 4.52 - The second bullet point contains a typographical error.

Chapter 5

Paragraph 5.51 - Consider the addition of the following analytical procedure. "Compare sales credits on OTC trades to OTC trading volume."

Paragraph 5.111 - At the end of the paragraph, consider adding, "Auditors should also ensure that receivables are not netted against payables, and that all credits (payables) are classified as abandoned property and escheated after prescribed periods."

Paragraph 5.123 - After "SEC Rule 15c3-3" add the reference "for Possession or Control of Securities."

Auditing Considerations Matrix:

Under Rule 15c3-3, subsection 1, consider adding, "this will include aging of certain positions such as transfers and borrows." The second sub-test under the first bullet should read, "recompute the amount."

Consider replacing the second sentence in the third bullet with "select new or existing deficits and determine their cause."

Under Rule 17a-13, consider adding the following sentence to the second bullet. "Any security position which is in a good control location, is part of the confirmation process and has gone unconfirmed for 30 days should be moved from a good control location to suspense."

3

Chapter 7

Paragraph 7.39 - The parenthetical should read, "sometimes referred to as a bridge loan."



November 29, 1994

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Re: File 4340.SG

Dear Mr. Goll:

We are pleased to express our views on the proposed audit and accounting guide, *Audits of Brokers and Dealers in Securities*, (the "Guide"). The Guide provides a sound basis for understanding the nature and scope of broker-dealer activities and is more informative than the previous audit guide.

Nevertheless, we believe the Guide will not be complete until certain issues currently under study by the Financial Accounting Standards Board (the "FASB") are resolved. We support your intention to amend the Guide for these issues which focus primarily on derivative financial instruments, hedging and hedge accounting, and securitizations. These areas are critical to the industry and are expected to be a source of continued growth.

Despite the recent issuance of Statement of Financial Accounting Standards No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, current accounting guidance on derivative instruments and hedging and hedge accounting is unclear. As a result, the accounting is guided by industry practice and convention. We recommend that the Guide incorporate current accounting practice on derivatives and hedge accounting to ensure consistency among brokers and dealers until further guidance is provided by the FASB. Documenting current accounting practice may assist the FASB with their deliberations.

The Guide should provide more detail on structured transactions and other complex financial instruments, such as total return swaps and equity derivatives. The operations, accounting, and control chapters of the Guide should also be expanded to include further guidance on collateralized mortgage obligations, asset-backed securities, reconstituted strips, and discounted notes. In addition, the Guide should address accounting issues involving corporations which use their broker-dealer subsidiaries as intermediaries for derivative transactions.

The following suggestions on specific issues are presented in the order in which they appear in the Guide.

Paragraph 1.4: We believe companies hedge other risks in addition to currency and interest rate risk and recommend the addition of "other" to the seventh bullet. Also, when describing credit cards, checking accounts, and insurance products, we recommend replacing the term "nontraditional" with "other" financial services in the last bullet.

4

Paragraph 1.30: Although a footnote about the change to a three day settlement effective June 1995 is included in paragraph 2.16, we also believe the issue should be referred to in this paragraph.

Paragraph 1.73: We agree with the statement that a writer of a cap or floor has no risk of counterparty default unless, however, the cap or floor fee (premium) is paid over the life of the cap or floor agreement. Paragraph 1.73 should be adjusted to be consistent with paragraph 1.71 regarding counterparty default.

Paragraph 1.106: Define the various types of repurchase agreements mentioned: overnight repos, term repos, repos to maturity, and matched repos.

Paragraph 4.39: Incorporate the modification of Financial Accounting Standards Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, (Interpretation No. 39), if adopted, in the Guide.

Paragraph 4.42: Clarify when accreted interest on a fixed-income security (e.g., strips and other discounted notes) should be broken out separately from the market valuation of the security. Changes in the value of certain other financial instruments, such as forward contracts, arise from interest as well as market considerations. How should income from these instruments be treated?

Paragraph 7.17: Clarify balance sheet and income recognition and further define "combined financial instruments". Broker-dealers take advantage of various arbitrage opportunities which could be considered combined financial instruments. The Guide uses the example of a reverse repo to maturity which can also be combined with a swap contract as part of an overall trading strategy. Does the treatment of a reverse repo to maturity without a swap differ from one with a swap? The Guide should also address the impact of Interpretation No. 39 on the valuation of combined financial instruments if the definition of combined financial instruments is expanded.

Paragraph 7.17: We believe it is important for users of the Guide to understand that combined financial instruments may be valued based on the overall transaction, rather than the separate components. For purposes of SEC Rule 15c3-1, however, each financial instrument will have its own individual haircut.

Paragraph 7.19: We believe that attributing a value to the replacement rate for excess receivables or payables categorized as a "tail" to combined financial instruments is inconsistent with the recommendation of paragraph 7.17.

Paragraph 7.27: Are the recommendations of this paragraph applicable in all situations? If a broker-dealer, for example, is long mortgage-backed securities that would satisfy a short TBA (to be announced) mortgage-backed securities forward contract, would offsetting the long and short be appropriate?

Paragraph 7.30: Netting of customer receivables and payables, particularly those balances arising from agency transactions, should be addressed.

Paragraph 7.40: The FASB is currently working on developing accounting standards for the securitization of financial instruments. We believe, however, that further accounting guidance on asset securitization is needed in this Guide. Examples of industry practices would be useful.

Paragraph 7.60: Define the term "box spreads".

Page 103: Clarify treatment of unrealized gains and losses on TBA's. We believe netting unrealized losses against unrealized gains is only allowed by counterparty under Interpretation No. 39. Netting is not permitted across contracts with different counterparties.



We hope the AICPA finds our comments and recommendations useful and suggest that they be carefully considered when preparing the final Guide. Please direct any questions to Jeffrey A. Meshberg at (212) 236-6363 or me.

Sincerely,

A handwritten signature in cursive script, appearing to read "Frank T. Vayda".

Frank T. Vayda
Director of Corporate Reporting

cc: J. Meshberg

4



November 10, 1994

Mr. Al Goll
Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

File Reference No. 4340.SG

Dear Mr. Goll:

The Committee on Accounting Principles of the Illinois CPA Society (the "Committee") is pleased to have the opportunity to comment on your exposure draft of a proposed audit and accounting guide entitled, Audits of Brokers and Dealers in Securities (the "Guide"). The organization and operating procedures of the Committee are reflected in the appendix to this letter. The comments represent the position of the Illinois CPA Society rather than any of the members of the Committee and of the organizations with which they are associated.

The Committee concurs with the basic conclusions reached in the Guide.

We would be pleased to discuss our comments with members of the Board or staff.

Very truly yours,

Joan E. Waggoner, Chair
Committee on Accounting Principles

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APPENDIX A

**ILLINOIS CPA SOCIETY
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES**

1993 - 1994

The Accounting Principles Committee of the Illinois CPA Society (the Committee) is composed of 27 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee ranging from newly appointed to 15 years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions, representing the Society, on matters regarding the setting of accounting principles.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting principles. The subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which, at times, includes a minority viewpoint.

5



FLORIDA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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September 28, 1994

Mr. Al Goll
Technical Manager
File 4340.56
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Mr. Goll:

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants (Committee) has reviewed and discussed the exposure draft of the proposed Audit and Accounting Guide for Audits of Brokers and Dealers in Securities dated August 16, 1994 (the guide). We respectfully submit our comments below:

Paragraph 7.17 - The Committee agrees that the combined financial instruments that are created from an arbitrage trading strategy should be valued based on the overall components of the transactions. The Committee believes that this valuation method should be stated as the preferential method in a more positive manner.

Paragraph 7.18 should therefore be restated to reflect the incurred emphasis in paragraph 7.17.

The Committee believes that paragraph 5.70 regarding guidance should include a reference to SAS 48.

The Committee recognizes the need to provide auditors with specific guidance on the substantive tests and tests of controls detailed in the Regulatory section on pages 154-156. We are concerned, however, that future changes in statutory requirements would render portions of the section obsolete and confuse auditors as to the applicability of the guide as a whole. Consideration should be given to providing guidance in the Regulatory area in some other manner that lends itself to more frequent updating, as required by changes.

Our committee appreciates the opportunity to comment on the exposure draft.

Sincerely,

MICHAEL O'ROURKE, CPA
CHAIRMAN (305) 667-3500

Members coordinating response:

G. Michael Stone (813) 842-3180
Javier Nunez (305) 446-0114

6

November 9, 1994

Mr. Al Goll, Technical Manager
Accounting Standards Division - File 4340.SG
American Institute of CPA's
1211 Avenue of the Americas
New York, NY 10036-8775

EXPOSURE DRAFT

PROPOSED AUDIT AND ACCOUNTING GUIDE
AUDITS OF BROKERS AND DEALERS IN SECURITIES

AUGUST 16, 1994

Response prepared by: Accounting and Auditing Standards Committee
Louisiana Society of CPA's
Jon Flair, Chairman
Larry Johnson, Member
Lyn Tew, Member
Albert Roevens, Jr., Member
Raymond Prince, Member
Keith Besson, Member

Comments

1. We are in general agreement with the Board's revision to the Proposed Audit and Accounting Guide - Audits of Brokers and Dealers in Securities. One member emphasized his agreement with the Board's opinion to prohibit the combining of subordinated debt with stockholder's equity in the GAAP financial statements.
2. Two members express agreement with the proposed accounting for combined financial instruments. One of these states that he agrees that it is more appropriate to reflect the ultimate cash flow gain or loss on an amortized basis over the term of the combined financial instrument; however he is concerned that the Board should be more objective or specific instead of using the phrase "with a term approaching the maturity".
3. One member suggested adding to the Glossary definitions for "Broker" and "Broker/Dealer". A definition is found for Dealer and various passages within the Guide do serve to clarify the role of the Broker & Broker/Dealer; however, the reader could probably benefit from the inclusion of these two items in the Glossary.
4. Three of our above members and their related firms lack experience with clients who are brokers and dealers in securities. As a result they are not sufficiently knowledgeable with practices in this industry to determine the effect that this new guide would have. They have read it and have no comments.



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November 3, 1994

Mr. Al Goll
Accounting Standards Division, File 4340.SG
American Institute of Certified Public Accountants
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New York, New York 10036-8775

Mr. Goll:

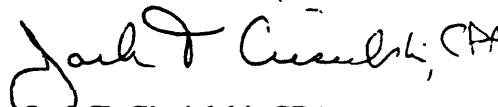
The Accounting Standards Committee of the Maryland Association of Certified Public Accountants is pleased to comment on the Exposure Draft, Proposed Audit and Accounting Guide, "Audits of Brokers and Dealers in Securities". Our Committee is composed of CPAs with widely diverse backgrounds including a number of Big Six and small firm practitioners, an SEC employee, a security analyst, employees of publicly and privately held companies, and several academicians. Despite our varying backgrounds, our members were in general agreement on the issues in the Exposure Draft.

We concur with the proposed change in Paragraph 4.7, which prohibits combined subordinated debt and stockholders' equity amounts in the GAAP presentation balance sheets of broker-dealers. We believe the separate display of these amounts would provide more meaningful information to statement users.

We also agree with the provisions of Paragraph 4.17 regarding combined financial instruments. We believe that consideration should be given to differences between current interest rates and contractual interest rates in determining fair value of such instruments. However, we believe the Guide should provide further examples, or a sample list of indicators that show when one rate is more proper than the other.

Should you have any questions, feel free to contact us.

Sincerely,


Jack T. Ciesielski, CPA
Chairman

8

OFFICERS

MARILYN A. PENDERGAST, CPA PRESIDENT
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VIRGINIA L. GOYER, CPA VICE-PRESIDENT
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JOSEPH L. CHARLES, CPA SECRETARY
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nysscpa

November 16, 1994

Mr. Al Goll
Technical Manager
File 4340.SG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Audit and Accounting Guide-Audits of Brokers and Dealers in Securities

Dear Mr. Goll:

We are enclosing the comments of the New York State Society of Certified Public Accountants in response to the above propose audit guide. These comments were prepared by the Society's Stock Brokerage Accounting and Auditing Standards and Procedures Committees.

If you have any questions regarding the comments, please call us and we will arrange for someone from the committee to contact you.

Thank you for your consideration.

Very truly yours,

Marc H. Stoltz, CPA
Chairman, Stock Brokerage
Accounting Committee

Walter M. Primoff, CPA
Director, Professional Programs

cc: Accounting and Auditing Committee Chairmen

9

OFFICERS

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HARVEY L. SONNENBERG, CPA	VICE-PRESIDENT
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COMMENTS

Of
Stock Brokerage Accounting Committee and Auditing Standards & Procedures Committee of
The New York State Society of Certified Public Accountants

On
Exposure Draft, dated August 16, 1994, of proposed Audit and Accounting Guide titled
"Audits of Brokers and Dealers in Securities"

The above-named Committees have reviewed the Exposure Draft and have concluded that the proposed Guide will be a comprehensive and useful resources for the profession. The Draft accumulates and gives effect to pronouncements issued and experience gained in the years intervening since the last such Guide and should provide excellent guidance to assist preparers of financial statements of broker-dealers in securities and independent auditors in auditing and reporting on those financial statements.

There are no substantive concerns with the Draft. There are, however, minor errors and areas of needed clarification or expansion which the Committees feel should be addressed. These are covered in the comments which follow. The comments are arranged in the sequence in which found in the Draft and not on the basis of their importance.

Summary

It is unclear whether this section will appear in the final Guide. It is the feeling of the Committees that the Summary contains useful information, particularly in highlighting the rules and regulations of the various regulatory agencies. The substance of pages v and vi should be incorporated in the final Guide, perhaps in the Preface.

Contents

To maintain the distinction in each chapter between paragraphs X.1, X.10, and X.100, it would be useful, at a minimum, to number the opening paragraphs, for example, as 1.01, 1.02,...to 1.09. It is felt that this would minimize the reader's confusion when cross references are given.

Chapter 1

par. 1.46 / p. 9 This paragraph should be updated to reflect pending rule changes regarding changes in settlement periods - see paragraph 2.16.

9

Chapter 2

par. 2.120 / p.42 This paragraph should be reworded to reflect the fact that, in many cases, automated systems now issue segregation and release instructions based on identified parameters and, thus, the margin department is not always necessarily involved as suggested by the second sentence.

Chapter 3

par 3.48 / p.61 After the last bullet, a parenthetical sentence should be added to the effect that "For a further discussion, see the specific requirements contained in Rule 15c 3-1". The subject of deferred income taxes is sufficiently complicated that, in lieu of a detailed (or ~~inappropriately simplified~~) discussion, the cross reference would be appropriate.

par 3.50 / p.62 This paragraph concludes with the words "...but excluding certain items". Examples of such exclusions should be provided since they may not necessarily be immaterial. An example would be indebtedness adequately collateralized by securities which are carried long by the broker-dealer and which have not been sold (in effect, liabilities collateralized by proprietary positions).

par 3.113 / p.73 The second sentence indicates that if a broker-dealer's SIPC assessment is *other than the minimum assessment*, a supplemental letter report is to be issued covering certain agreed-upon procedures. The minimum assessment measure is a SIPC exemption to the audit requirement of the rule. There is also an exception that should be noted; that, although the entity may not otherwise be exempt, if the broker-dealer's gross revenues are not in excess of \$500,000, no supplemental letter report is required.

Chapter 4

par 4.24 / p. 79 In the phrase "...on behalf or through correspondents" in the first sentence, the reference to "or through" is ambiguous and needs clarification to distinguish, for consistency within the paragraph, between introducing firms and clearing firms. Additionally, in the last sentence it would be more definitive guidance to substitute "consideration should be given" for "may be shown".

par 4.52 / p. 84 A typographical error occurs at the second bullet; "sing" should be deleted.

par 4.58 / p. 85 This section should be updated to give effect to the recently issued SFAS 119.

Exhibit 4.3 / p. 90 The caption "Receivable from broker-dealers and clearing organizations" is detailed in Note 4 on page 99 as including \$7,756 for "Deposits received for securities loaned". This \$7,756 appears to be a misclassification of an asset as deposits received for securities loaned can only be a payable. The entire caption (\$16,616) could be combined with "Securities borrowed, \$8,860".

Further, the intent of the line "Spot commodities owned, at market value" is unclear. What items are expected to be included? Definition is not provided in the section "Statement-of-Financial-Condition Account Descriptions" on pages 79 to 84. For example, are they to include foreign currencies? If so, would that include all positions, or only those that are held as trading positions (as opposed to clearing or accommodation purposes)?

Exhibit 4.7 / p. 95 There are several corrections needed to this Consolidated Statement of Cash Flows.

"Deferred taxes" should be relocated to appear after "Depreciation and amortization" as a noncash adjustment.

The caption "Net receivable from brokers and dealers" should be changed to be consistent with the presentation in the statement of financial condition.

Add a footnote that "Securities purchased under agreements to resell" can be classified as operating or investing, depending upon the nature of the activity.

The last caption under "Cash flows from operating activities" should read "Net cash *provided* by operating activities".

Should the unrealized appreciation or depreciation in these investments reflected in investing activities be shown separately or as a non-cash item?

The last caption under "Cash flows from financing activities" should read "Net cash *used* in financing activities".

Exhibit 4.8, note 2 / p. 96-97 In the section "Securities' [sic] transactions", the third line from the end of the first paragraph indicates that "...sales concessions [are recorded] on settlement date". The Committees question whether the *trade date* should more appropriately be the record date.

Consider revising the last line of the first paragraph at the top of page 97 to read "...at fair value as determined by *management* since it may be more accurate to attribute this function to management than to the Board of Directors.

Exhibit 4.8, note 14 / p. 102-104 This note should be updated to reflect the guidance in newly issued SFAS 119.

The guidance as to "when-issued securities" in the third sentence from the end of the first full paragraph on page 103 is inconsistent with the discussion provided in paragraph 7.38 on page 181 and should be revised.

Exhibit 4.8, note 16 / p. 104-105 It is suggested that a footnote be added to the table on page 104 to note that in cases when the estimated fair value of the financial instruments is the same as their carrying value, an alternative presentation would be to simply make a statement to that effect.

Further in that table, it is unclear what "Fair Value" represents for "Repurchase agreements" and "Reverse repurchase agreements". Does the difference between "Carrying Amount" and "Fair Value" represent interest rate or credit risk changes that would cause a repurchase or reverse repurchase agreement, if marketable, to trade at a discount or premium? If so, the cost of compiling this information may be significant and burdensome as securities firms' systems are not geared to track such information.

The first paragraph on page 105 requires clarification to avoid an internal inconsistency. The first sentence comments that there are transactions that are not recognized in the statement of financial condition, yet states in the last sentence that their fair values are recorded in the statement of financial condition.

Also, the cross reference in the first paragraph on the top of page 105 should be to Note 14, not Note 13.

Exhibit 4.8. note 19 / p. 106 Footnote 11 to note 19 is incorrect on the fourth line of the suggested alternative footnote wording. The \$100 figure should be \$250 under the alternative method.

Exhibit 4.9. Sched. 1 / p. 109 Provide, by footnote, reference information permitting the reader to reconcile "Furniture, equipment, and leasehold improvements, net" and "Other assets" under "Nonallowable assets" to ~~their~~ comparable statement of financial condition captions.

Exhibit 4.9. Sched. 1 / p. 111 In the caption "Computation of alternative net capital requirement", the minimum net capital requirement for clearing brokers carrying customers under the alternative method is \$250,000 not \$100,000.

Footnote 18 to this schedule could include a comment that under the alternative method the sections "Aggregate indebtedness" and "Computation of basic net capital requirement" can be excluded.

Chapter 5

General comment It is felt that a discussion of the auditors' use of specialists, especially as it relates to securities and derivatives pricing, would be a helpful addition to the auditing guidance. The pricing of these items is a complicated and difficult task and there is a lack of understanding of the product, often suggesting that audit teams at least consider the need for expertise in these areas, even to the extent of seeking outside independent specialists when necessary. This area of specialty has recently taken on increased importance and may not have been as significant in the early planning stages of the draft Guide.

par 5.16 / p. 119 The second sentence of the paragraph emphasizes the effect of audit risk on the scope of audit procedures. Specific examples of these sensitive "aspects of the broker-dealer's operations" would be helpful. At a minimum, this paragraph should be cross referenced to the auditing considerations starting on page 142. Additionally, it would be helpful to make mention of the effect on audit planning of communications from regulators and their findings when conducting their own periodic regulatory examinations.

par 5.19 / p. 119 The listing of "common factors" used by auditors in ascertaining the materiality level of a broker-dealer should include reference to the *qualitative* aspect of misstatements. In that same vein, there should be included a discussion of how the traditional means of determining materiality, such as using a measure of assets or revenues, may not always be appropriate, and that regulatory capital needs also be addressed during this phase of audit planning.

par 5.22 / p. 120-121 This section of the Guide is intended to list various characteristics of errors and irregularities. One such characteristic under "Operating and industry characteristics" (the third bullet) is that "There is a high level of liquidity in the statement of financial condition." The Committees question how this condition could lead to *increased* risk.

The following additions are suggested because of the importance of the subject of errors and irregularities:

Under "Operating and industry characteristics", at the third bullet from the end (on page 121) relating to reliance on complex computer applications, add a comment that these applications may be run by outside service organizations.

Under "Engagement characteristics", consider adding:

Management is strained to provide operating and regulatory capital.

Management fails to exercise reasonable control over operations and accounting matters, especially over customers' transactions.

Outside financing and activity levels with other brokers are dependent on predetermined financial and regulatory ratios or improved financial and regulatory condition.

Lack of an internal audit function.

Consultants acting as defacto compliance or supervisory officers.

par 5.27 / p. 122 The examples used for applications of sampling appear to be almost exclusively concerned with internal control and regulatory compliance matters. Perhaps an additional example of an application of audit sampling to a substantive area of the audit would be useful, such as the use of a probability in proportion to size sampling plan on securities owned.

par 5.45 / p. 126 The introductory discussion of analytical procedures should give recognition to the fact that analytical procedures can often be difficult to utilize effectively on many broker-dealer engagements owing to the magnitude of the transactions in relation to their financial statement impact and the specialized nature of the financial statements of the industry. A discussion of this problem may be useful.

par 5.54 / p. 128 The first listed item could be expanded to read "Valuation of nonmarketable securities, limited markets securities, or other investments" in order to recognize the importance of the underlined item.

par 5.57 / p. 129 The portion of this paragraph dealing with the "inability to continue to meet its obligations" should be expanded to include reference to its regulatory capital and reserve requirements.

par 5.102 / p. 137 To provide more complete guidance, the underlined words could be added to the next to last sentence of the paragraph, as follows: "...the auditor should also consider confirming some accounts with zero balances and those accounts with unusual or high volume for the period under audit."

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Chapter 7

par 7.18 / p. 177 The last sentence of the paragraph suggests that the amortized basis "may be more appropriate" under certain circumstances. Inasmuch as mark-to-market is a generally accepted practice, more guidance and specific parameters are needed to identify when the amortized basis is appropriate.

par 7.24 / p. 178 This paragraph should address the handling of delayed-delivery contracts in a more positive manner, not appearing to infer that they are necessarily off-balance-sheet items, and provide guidance consistent with the existing audit Guide.

par 7.27 / p. 179 This paragraph is confusing and should be reworded . Specifically, the reference in the last sentence to the position remaining long in inventory appears to contradict the rest of the paragraph.

9

Yvonne J. Downs
Vice President and Administrator
Office of Investigations and Audits

November 16, 1994

Mr. Al Goll
Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

RE: File 4340.SG

Dear Mr. Goll:

The Board of Trade of the City of Chicago ("CBOT®") would like to thank the American Institute of Certified Public Accountants ("AICPA") for the opportunity to comment on the AICPA's Exposure Draft of its Proposed Audit and Accounting Guide-Audits of Brokers and Dealers in Securities.

In general, the proposed audit guide is a very comprehensive document on the accounting for securities transactions at brokers and dealers. Comments on specific chapters are provided in this letter.

One aspect that should be addressed more comprehensively within the guide is the handling and treatment of futures transactions. Many brokers and dealers are also registered to service their customers' futures transactions. To hold any commodity customer funds, brokers and dealers must register as Futures Commission Merchants ("FCMs") with the Commodity Futures Trading Commission ("CFTC"). In addition, many brokers and dealers trade futures on a proprietary basis.

The materiality of commodity-related business at different brokers and dealers varies greatly. Many larger brokers and dealers hold hundreds of millions dollars of commodity customer funds which may represent only a small percentage of the firm's operations. Alternatively, the primary business of some brokers and dealers is related to commodity futures activity. Audit procedures designed to ensure commodity funds are properly handled and accounted for should also be included in the audit guide.

The proposed audit guide alludes to the fact that the AICPA is developing an audit guide for FCMs. The CBOT encourages the AICPA

to issue the guide as soon as possible so that all entities reviewing accounting policies and procedures of FCMs could benefit from the AICPA's direction. Nevertheless, the AICPA should expand its coverage of accounting and record keeping issues for futures and options on futures transactions in the proposed audit guide on brokers and dealers.

Chapter 1, The Securities Industry

When explaining various aspects of the securities industry, the AICPA might consider providing a definition of an FCM and describe how futures exchange-traded commodity transactions are effected. In addition, when explaining futures trading, the audit guide might mention that electronic trading systems exist that allow for futures trading after normal trading hours have ended.

Chapter 2, Broker-Dealer Functions, Books, and Records

In section 2.100, the proposed audit guide lists records and documents required by the CFTC. However, there are many reports generated by commodity activities which are essential in the preparation of financial statements that are not specifically required by CFTC regulations. For example, a listing of current and non-current customer and non-customer debits and deficits and a margin call listing are needed to determine a firm's net capital. The AICPA should identify these documents within the audit guide.

Chapter 3, Regulatory Considerations

The Computation of Net Capital is one of the most important reports prepared by broker/dealers. Verifying the numerous deductions from capital should be identified as a significant part of the audit process by the AICPA's guidelines. The proposed audit guide covers the capital computation in two sections, 3.48 and 3.49. Many of the deductions to capital are difficult to compute. The audit guide should explain how to calculate many of the securities and commodities-related deductions and haircuts. These deductions include capital charges on repurchase agreements, reverse repurchase agreements, fixed commitments, proprietary futures and options on futures positions, and foreign currency charges.

Additionally, the audit guide should explain how the capital requirements are computed. The minimum capital requirements is established by determining the greater of three different computations. The audit guide should explain all three methodologies.

Chapter 5, Auditing Considerations

In section 5.110, the AICPA should expand the audit procedures performed on subordinated debt to include a review of the actual loan agreements. This review will indicate if any loan covenants exist that could have an impact on a broker/dealer's regulatory capital. Also, in section 5.124, the audit guide should indicate that an audit of the capital requirements is also required. This computation will determine the amount of regulatory capital a broker/dealer is required to maintain. Because this value may be determined by the segregation and foreign secured statements, the

guide should indicate that these reports should also be audited.

Chapter 6, Internal Control Structure

The audit guide might be expanded to identify effective internal control procedures for commodity operations. These include:

1. daily position and money reconciliations between the clearing organization's reports and firm's internal bookkeeping system and general ledger;
2. verifying margin calls are accurately calculated and cash is received from those margin calls in a timely manner;
3. verifying control over data entry system;
4. limiting the number of employees who are authorized to perform money and securities transactions;
5. periodic reconciliations between depository reports and internal bookkeeping system reports.

Conclusion

The AICPA's Proposed Audit and Accounting Guide for Audits of Brokers and Dealers in Securities is going to be a very beneficial document which effectively addresses many issues involved with the securities side of the business. However, more information could be incorporated on futures and options on futures transactions done for customers or traded on a proprietary basis. Furthermore, the CBOT encourages the AICPA to expedite the completion of its audit guide on Futures Commission Merchants.

The CBOT would like to thank the AICPA for giving it the opportunity to comment on the exposure draft of its proposed audit guide. The CBOT would also be happy to assist the AICPA incorporate any comments into the proposed audit guide. Please contact Bruce Domash at (312)341-5989 if you have questions or would like any assistance.

Sincerely,



Yvonne J. Downs
Vice President
Office of Investigations and Audits



COMMODITY FUTURES TRADING COMMISSION

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**DIVISION OF
TRADING AND MARKETS**

December 8, 1994

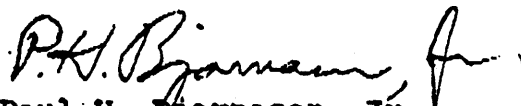
Mr. Al Goll, Technical Manager
Accounting Standards Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: File 4340.SG

Dear Mr. Goll:

I wish to provide a comment on the AICPA's Exposure Draft of its Proposed Audit and Accounting Guide - Audits of Brokers and Dealers in Securities (the "ED"). I wish to recommend an enhancement of the amount of information required to be provided in the notes to the financial statements regarding off-balance sheet, customer-owned assets. In particular, the ED provides that assets held in a trust-like capacity, such as customer-owned securities and long option values, do not appear in the carrying firm's balance sheet and they are not required to be disclosed in the proposed audit guide. Such assets, which are used to collateralize customer commodity account obligations and to margin customer commodity accounts, are one indication of the amount of financial resources behind a firm's customer business and, thus, may be useful to the users of financial statements. Therefore, I recommend that the audit guide require disclosure of such off-balance sheet amounts.

Sincerely,


Paul H. Bjarnason, Jr.
Chief Accountant

11



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220



OCT 12 1994

Mr. Al Goll
Technical Manager
Accounting Standards Division
1211 Ave. of the Americas
New York, NY 10036-8775

Dear Mr. Goll:

Thank you for the opportunity to comment on the Exposure Draft: Proposed Audit and Accounting Guide - Audits of Brokers and Dealers in Securities. We do not have any comment; however, we did forward the Exposure Draft to the two financial regulatory agencies within the Treasury Department -- the Office of the Comptroller of the Currency and the Office of Thrift Supervision. Both agencies indicated they will submit their comments directly to you.

If we can be of further service, please call Donald Kassel, Acting Director for Banking Audit Program Group at (202) 927-5220.

Sincerely,

Jay M. Weinstein
Assistant Inspector General
for Audit

cc: James B. Thomas, Jr., Chair President's Council
on Integrity & Efficiency, Standards Subcommittee

Arthur T. Henshaw, Acting Deputy Assistant Inspector
General for Audit Program Services

12



**Federal Farm Credit Banks
Funding Corporation**

10 Exchange Place, Suite 1401
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November 30, 1994

Mr. Al Goll
Technical Manager
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AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: August 16, 1994 Exposure Draft
Audits of Brokers and Dealers in Securities

Dear Al:

Thank you for providing a copy of the above to me.

I have one comment. In the first paragraph, lines 5 and 6 read in part

during the period *ended* from [*define period*]

OK
We have had some difficulty persuading auditors to specify the start and end dates of the period covered, and the ambiguous wording of the draft encourages vagueness. For example, we have received audits reading

during the period ended from December 31, 1993

Go
which does not make much sense. We would like to see a specific start and end date, but at a minimum I think the words "ended" and "from" should be dropped since it is not possible to complete the current phrase either grammatically or with the specificity we require.

Please call me at 201-200-8020 if this is not clear. Thank you.

Sincerely,

Fred W. Havell

Fred W. Havell
Managing Director
Dealer Surveillance and Credit

13

Charles Bailly & Company

Certified Public Accountants

Norwest Center
406 Main Avenue, Suite 3000
Fargo, North Dakota 58126-0001
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September 26, 1994

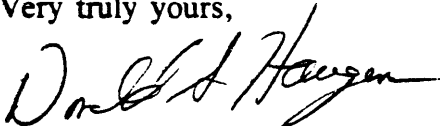
Mr. Al Goll, Technical Manager
Accounting Standards Division
File 4340.SG AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Goll:

I am the partner in charge of audits of "fully disclosed" broker/dealers for Charles Bailly & Company in Fargo, North Dakota. I would like to make the following suggestions to improve the Audit and Accounting Guide for "Audits of Brokers and Dealers in Securities". I would like to see a separate section on auditing of "fully disclosed" broker/dealers. This would assist the smaller CPA firms that would be involved with this specific type of audit. In particular, I would like to see more specific guidance in the area of receivables from clearing broker/dealers, mutual funds and insurance companies. The reason for the need for specific guidance is that I find that the information I receive in confirmations from the above is not very informative if I even get a response. The only information confirmed is what they have cleared for payment and not pending trades they have received. This results in reconciliations that are more time consuming and I feel less adequate support for year end open receivable trades.

If you would like to discuss my comments further, please call me at 701-239-8516.

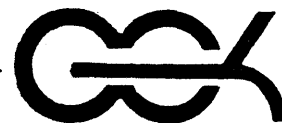
Very truly yours,



Donald S. Haugen, CPA
Partner

pjm

14



November 29, 1994

Mr. Al Goll
Technical Manager
File 4340.SG
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Proposal Audit and Accounting Guide - Audits of Brokers and Dealers in Securities

Dear Mr. Goll:

As a member of the New York State Society of Certified Public Accountants Stock Brokerage Accounting Committee I was involved in the comment letter dated November 16, 1994.

I have two observations regarding this comment letter to the proposed guide. On the third page of this response, Chapter 4, Exhibit 4.7 page 95:

1. The suggested footnote for Reverse Repurchase agreements should also include Repurchase Agreements, stating the repurchase agreements can be classified as operating or financing, depending on the nature of the activity.
2. In the next to last correction suggested, the word "or" should be deleted from "... or as a non-cash item?"

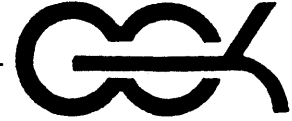
In addition, I have a few additional comments that came from individuals within my firm, Goldstein Golub Kessler & Company, P.C., that I hope will be taken into consideration. The comments are arranged in the sequence in which found in the Draft and not on the basis of their importance.

Page 112 and 113

Under the caption "Debit Balances" there is a category "OTHER" which is not reflected in the actual Rule 15c3-3 but is reflected in the FOCUS report as a category under Credit and Debt Balances. If there are balances in this account the FOCUS report instructs that items in this

15

Mr. Al Goll
November 29, 1994
Page 2



category be listed. We suggest showing "other(list)" as reflected in the FOCUS report on both sides Debits and Credits and describe what items are included.

Page 113

We suggest presenting the calculations described in footnote 21 as part of the schedule as opposed to the footnote.

Page 193 and 195

In the second full paragraph: "in making ... aggregate indebtedness (or aggregate debits) ..." Rule 17a-5 (g) (1) does not refer to aggregate debits and in fact this area would be covered by the periodic computations of the reserve required by Rule 15c3-3. For a broker dealer not carrying customers there should be no aggregate debits. We suggest removing this wording.

Page 195

In the second full paragraph where it is stated that "we did not review ... in making the quarterly securities examinations, ..., because the company does not carry security accounts for customers ..." We question if a broker dealer is really exempt from Rule 17a-13 because they do not carry security accounts for customers ... There are three conditions that must be met to qualify for the exemption. A broker-dealer trading for its own account would still appear to be subject to Rule 17a-13.

If you have any questions regarding the comments, please call me at (212) 523-1554.

Thank you for your consideration.

Very truly yours,

Terry H. Orlansky
Partner

THO/lk

TO41129A

15

Frank H. Spearman III
851 Malcolm Ave., Los Angeles, CA 90024

November 8, 1994

Mr. Al Goll, Technical Manager
Accounting Standards Division
AICPA
1211 Avenue of the Americas
New York, New York, 10036-8775

Re: File 4340.SG

Dear Sir:

I am responding to the Exposure Draft, Proposed Audit and Accounting Guide, Audits of Brokers and Dealers in Securities, August 16, 1994 ("The Draft").

By way of background, I am a retired partner of Deloitte & Touche. During my active practice, I served a wide spectrum of broker/dealers, from NYSE member firms to very small broker/dealers. I was one of the few (3 of about 15, as I recall) accountants who served on the Securities and Exchange Commission's Report Coordinating Group, which designed the FOCUS Report. My article on the FOCUS Report appeared in the September 1976 issue of the Journal of Accountancy; a reprint copy is enclosed for ready reference.

I have read the Draft and have reviewed a current copy of the FOCUS Report furnished to me by the local regional office of the SEC.

Many years ago, as chairman of the local securities industry committee of the California Society/CPA's, I had agreed to respond to technical inquiries on broker/dealer matters from other Society members. In some cases, the inquiring practitioner was not aware that there was an audit guide on the subject. The point is that a new audit and accounting guide must deal with the problems in the hinterland as well as those on Wall Street.

I am particularly concerned by the absence in the Draft of guidance in dealing with the special problems of partnerships and sole proprietors. The instructions for Form X-17A-5, Part II and Part IIA include some specific instructions in respect to sole proprietors:

A. The General Instructions include the following:

"If the broker or dealer is a sole proprietor, all securities owned and all accounts carried for it by other brokers, dealers, or others which contain money balances and/or securities shall be reported, as appropriate"

B. The instructions for Computation of Net Capital and Aggregate Indebtedness include an item under the caption

"Other (deductions) or Credits". "Sole proprietors (individual members) who are not associated with a broker or dealer who is a member of a national securities exchange shall record here:

16

1. The total of any liabilities incurred in the course of business which are not reported in the statement of financial condition and which would have a material effect on net capital.
2. The excess of liabilities which have not been incurred in the course of business as a broker dealer over assets not used in the business."

AUDITING CONSIDERATIONS - SOLE PROPRIETORS

In the light of the foregoing special instructions applicable to sole proprietors, there are some additional auditing procedures which may be appropriate in particular circumstances:

1. If the sole proprietor is or has been previously divorced, the existence of liabilities arising from the divorce decree should be evaluated as part of liabilities not incurred in the course of the business.
2. If the sole proprietor is married and lives in a community property state, and the wife of the sole proprietor holds any securities, including a securities account carried by another broker/dealer, such interests may be deemed to be a joint account carried by others, to the extent of the sole proprietor's community property interest therein, if any.
3. If the sole proprietor owns real estate not used in the business, an inspection of the sole proprietor's income tax returns may show the existence of a home mortgage, or rental or other real estate on which liabilities may exist. In the light of the recent substantial decline in the market value of real estate (California is not unique), appropriate auditing procedures should be followed to determine that the related liabilities do not exceed the fair value of the real estate.
4. The sole proprietor's individual income tax returns present an additional need to search for liabilities not incurred by the proprietorship. If the auditor did not prepare the sole proprietor's income tax returns, additional auditing procedures should be undertaken to determine that the tax returns had been filed and the amount shown due or receivable thereon has been paid or received. Appropriate auditing procedures should be considered to determine whether additional income taxes have been asserted with respect to any taxable years for which the statutes of limitations has not run.
5. With respect to real estate owned by the sole proprietor, whether used in the business or otherwise, it is appropriate to consider additional auditing procedures to determine that there are no liabilities for delinquent real property taxes.
6. With respect to credit card debt of the sole proprietor, a credit report from a credit reporting entity may disclose liabilities not

incurred in the operation of the business, as well as business related liabilities, if any.

REPORTING CONSIDERATIONS - SOLE PROPRIETORS

1. If a sole proprietor has an excess of liabilities over the fair value of assets not used in the business, such excess liabilities must be disclosed in a note to the financial statements, since that amount is part of the computation of net capital. This amount is a deduction on line 4B of the form for computation of net capital.

2. Withdrawals of Equity Capital proposed to be withdrawn by a sole proprietor within six months from the date of the financial statements are reportable as part of the FOCUS Report, however, they are not deducted in computing net capital. This would include periodic "proposed" withdrawals for personal use and payment of income taxes (such as a personal "drawing account"). Disclosure of the fact of proposed withdrawals (but not the amount) should be in a note to the financial statements, with the caveat that withdrawals may not be made which would cause the proprietorship not to meet the applicable net capital requirements at the time.

PARTNERSHIPS

1. Broker/dealers organized as a partnership present some additional reporting considerations. Some partnership agreements include provisions which are sometimes called equity agreements, the substance of which is that all equities in general partners accounts are at the risk of the business. These additional equities may include cash securities accounts, margin accounts, and excess collateral in accounts collateralizing secured demand notes.

a. The reporting of general and limited partners' securities accounts which are not subject to an equity agreement are reportable under item 5 of the statement of financial condition (Part II), Receivables from Noncustomers (carrying broker/dealers). There is no provision for reporting such accounts for noncarrying broker/dealers (Part IIA).

b. In the case of partnerships with equity agreements, there is an additional problem in reporting securities accounts of limited partners, who are deemed to be noncustomers with respect to their securities accounts which are not part of their capital accounts.

c. The equities in partners securities accounts which are subject to an equity agreement (which would include limited partners capital accounts) are reported in the statement of financial condition under item 10 (Part II) or item 6 (Part IIA). The auditor must have a clear understanding of the partnership agreement to be able to correctly classify all

16

accounts in the FOCUS Report.

2. Since a partnership does not pay income taxes, which are liabilities of the individual partners, periodic withdrawals of Equity Capital for payment of partners individual income taxes and for periodic withdrawals for personal use, sometimes called drawing accounts, which are proposed to be withdrawn within 6 months of the date of the statement of financial condition (Part II or IIA) are reportable on the schedule of proposed withdrawals. The pertinent part of the instructions to that schedule are:

"These anticipated accruals would include amounts of bonuses, partners' drawing accounts, taxes, and interest on capital, voluntary contributions to pension or profit sharing plans, etc., which have not been deducted in the computation of net capital, but which you anticipate will be paid within the next six months."

REPRESENTATION LETTER (APPENDIX K)

The note on page 206 of the Draft should be expanded to include:

1. For partnerships: a separate representation letter should be obtained from each partner which identifies each individual securities account of the partner which is includable as partnership property in the financial statements and for the purpose of computing net capital, as well as those securities accounts which are not subject to an equity agreement, but which are reportable as noncustomer accounts.
2. Additional language needs to be added with respect to sole proprietors for the matters mentioned above under auditing considerations - sole proprietors.

SUMMARY

The Committee should consider the spirit in which I have offered the foregoing observations and recommendations which are based on a lifetime in accounting and auditing for broker/dealers. My experience with audits of sole proprietor broker/dealers included several different entities. Each presented what I now view as challenging auditing problems. My experience with partnerships ranged from a small two-partner member of the AMEX to a large partnership member of the NYSE.

To simplify the Committee's task, it may be appropriate to include in the final Draft an additional Appendix, entitled "Special Considerations for Sole Proprietors and Partnerships". I would be pleased to consult further with the Committee, if it would be helpful.

Yours truly,

Frank H. Spearman III
Frank H. Spearman III

16

financial reporting for securities brokers

by Frank H. Spearman III*

A timely overview of the SEC's FOCUS report, which was designed to simplify the reporting requirements for broker-dealers.

The Securities and Exchange Commission on December 17, 1975, announced the adoption of the FOCUS report as the primary reporting system for financial responsibility and operational reporting by brokers or dealers in securities. FOCUS, an acronym for financial and operational combined uniform single report, is for reporting periods ending after January 1, 1976. Since the auditing requirements for broker-dealer audits have been significantly changed, accountants who examine the financial statements of broker-dealers must become familiar with the requirements of the FOCUS report so they can be of maximum assistance to their clients.

The adoption of the new reporting system is the culmination of several years of work by two advisory committees created by the SEC to assist it in the review of reporting requirements imposed on broker-dealers and to develop an integrated

reporting system based on guidelines established by the SEC.

An advisory committee was formed by the SEC in September 1972 to consider the then existing reporting requirements for broker-dealers in securities. That committee (the Stepanek committee) concluded that existing reporting requirements were duplicative and uncoordinated and that further study was needed.

A second advisory committee, the Report Coordinating Group, considered the existing reporting system and recommended the adoption of a simplified system, known as the FOCUS report, to replace the existing system for reporting financial and operational data.

The new reporting concept

The Report Coordinating Group judged that some reports were of marginal value as regulatory tools and should be eliminated. The Answers to Financial Questionnaire and the New York Stock Exchange annual I&E report¹ were eliminated. Other

Frank H. Spearman III, CPA, is a partner of Haskins & Sells in Los Angeles. He is currently a member of the AICPA task force on entertainment companies. In the past, Spearman has served on the committee on the entertainment industries which published the industry accounting guide, "Accounting for Motion Picture Films." Spearman has also served as chairman of the Securities Industries Committee of the Los Angeles Chapter of the California Society of CPAs.

* Author's note: This article is based on a presentation to the Investment House Cashiers' Association of Los Angeles on January 14, 1976.

¹ The Answers to Financial Questionnaire (Form X-17A-5) was a prescribed-format specialized trial balance based on the respondent's financial position at a particular date, with special-purpose supplemental schedules and information. The NYSE annual I&E report was a detailed report of calendar year operations of the exchange member.

reports, notably the monthly and quarterly reports filed with the National Association of Securities Dealers (NASD), had substantial merit and were considered suitable for revision and simplification.

A goal of keeping reports as simple and uniform as practicable was adopted by the Report Coordinating Group. Another objective was that of minimum levels of reporting in the light of type of business done and the financial integrity of the reporting broker-dealer. The layered-reporting concept called for a system of progressively more detailed reports:

1 Part I—a monthly report of key indicators of financial and operational data provided by financially sound broker-dealers operating within limits established by the appropriate regulatory bodies. This report is filed only by carrying or clearing brokers.

2 Part IIA—a simplified quarterly report for use by broker-dealers that do not carry customer accounts or clear securities or who are subject to SEC Rule 15c3-1(a) (2) or (3). This report consists of basic financial statements in condensed form and supplemental financial and operational data.

3 Part II—a more detailed quarterly report suitable for firms that carry or clear customer securities accounts. The basic financial statements include a balance sheet, income statement, statement of changes in subordinated liabilities and statement of changes in shareholders' equity or partners' or proprietor's net worth, together with prescribed supplemental information and schedules.

4 The annual audit report, consisting of general purpose financial statements prepared in accordance with generally accepted accounting principles and special purpose supplemental schedules.

Recordkeeping considerations

Before considering the forms used for the FOCUS report, the changes in SEC Rule 17a-4 (covering recordkeeping and retention) should be pointed out. Under the prior SEC Rule 17a-5, a series of schedules was required in Part II of Form X-17A-5 to support certain items included in the Answers to Financial Questionnaire. The independent accountant prepared, and retained as part of his workpapers, schedules necessary to classify and summarize data that was reported in summary fashion in the questionnaire. This data was prepared only at the time of the annual audit. Now things have changed. Schedules such as positions in proprietary accounts are no longer filed as part of the annual audit report but are prepared only at the time of the annual audit. Some of the information, such as that needed to classify customer accounts properly, is still needed, but the details of the data are prepared and retained by the broker-dealer.

Although the new rule does not describe it as such, one of the basic records needed to prepare Part II of the FOCUS report is a classified, valued stock record that shows for each applicable account the quantity, description, unit price and valuation of each position in the account; together with the associated ledger money balance. From this data, customer and noncustomer accounts may be margined and the appropriate report classification determined. Similarly, trading and investment accounts, secured demand note collateral accounts, fail accounts and other "street" accounts² may be valued and summarized.

There is a requirement under the new Rule 17a-4 that schedules be prepared and retained to support the various charges, such as haircuts on securities positions and aged fails,³ which enter into the computation of net capital under Rule 15c3-1.

The details of the information in respect to possession or control of securities under Rule 15c3-3 must also be prepared and retained. A portion of this information is reported in a schedule submitted with Part II of the FOCUS report.

Each broker-dealer would be well advised to set up a checklist of the records to be prepared and retained under Rule 17a-4 with a view to early determination of the procedures that may be required to modify existing records so they comply with the changed rule. In many cases, the existing EDP software used to prepare similar schedules for the former Answers to Financial Questionnaire may be adaptable to preparation of the records required by the new rule.

Part I, FOCUS report

Part I is to be prepared monthly by carrying or clearing broker-dealers and filed with the SEC in Washington and with the appropriate regional SEC office within 10 business days after the end of each month. If the broker-dealer is a member of an exchange or association that has filed a plan with the SEC, the broker-dealer will file FOCUS reports with the exchange or association, which in turn will submit the information to the SEC. If a broker-dealer has multiple memberships, it will

² The term "street" accounts applies to the open items in securities with the wholesale (other brokers, banks, etc.) side of the business as opposed to the retail (customer) part of the business or items included in house accounts (inventories, box positions).

³ The terms "haircuts on securities" and "aged fails" apply to charges made against net worth to provide a cushion against possible decline in value of items included at full value to compute net worth.

16

file under such plans with only one exchange or association. Presumably, the filing will be made with the designated examining authority.

In MF Educational Circular No. 495, dated December 24, 1975, the New York Stock Exchange announced its plan for FOCUS report requirements. For members of the NYSE, the FOCUS report will replace the joint regulatory report. As a temporary measure, the SEC has extended the filing date for Part I of the FOCUS report from the tenth to the seventeenth business day of the following month for NYSE members, at the request of the NYSE. However, the NYSE has encouraged its membership to file Part I as close to the tenth business day after the end of the month as possible.

Before preparing Part I, the responsible individual in the broker-dealer organization should be sure that he or she understands the instructions. If any instruction is unclear, the best source of help is the designated examining authority or the appropriate SEC regional office. After any doubtful instructions are clarified, the format of Part I should be reviewed to determine the questions that apply to the reporting broker-dealer. A worksheet listing the applicable items should be prepared and a work plan for preparation of Part I should be drafted. Sufficient information should be shown on the work plan to indicate who in the organization is to prepare the data needed for a particular item on the report. Important parts of the work plan are the time frame and the sequence in which items are to be prepared.

Some backward planning will be necessary. Working back from the required filing date, one can determine the mailing or delivery date. A broker-dealer in New York City has a different time frame in filing a report with the New York Stock Exchange than does a NYSE member firm located in Los Angeles. After determining the time available for preparation of the report, the work assignments should be appropriately allocated among those persons who will prepare the detail data in the form of schedules, tabulations, analyses and the like.

As individual parts of the report are completed, the work product should be reviewed and, if found correct, entered on a working draft of the report. When the working draft is completed, the report should be reviewed carefully. The supporting workpapers and working report draft should be assembled for retention and the report transcribed in proper form for filing.

The printed Part I provides columns for entry of the designated items for each month. These columns are completed only by broker-dealers that are not NYSE member firms. The NYSE member firms complete only the thirteenth column, "for current month." The NYSE plan con-



Edward Topple—NYSE photographer

Stock market paperwork may mount but broker-dealers will find that the FOCUS report reduces their regulatory reporting load.

templates submission of the data from Part I in a form precoded for computer processing.

Part II, FOCUS report

Part II is the detailed quarterly financial and operational report filed by broker-dealers that carry customers' securities accounts or clear securities transactions. It has three elements:

1 Basic financial statements, including a statement of financial condition, an income statement for the quarter, a statement of changes in shareholders' equity or partners' or sole proprietor's capital, and, if applicable, a statement of changes in liabilities subordinated to claims of general creditors.

2 Schedules, including information for possession or control requirements under Rule 15c3-3 (currently being revised), computation of net capital under Rule 15c3-1, computation for determination of reserve requirements pursuant to Exhibit A of Rule 15c3-3, and total capital and subordinated liabilities maturing or proposed to be withdrawn within the next six months and details thereof.

3 Financial and operational data. This supplementary information is, in part, statistical data on operations, but it also includes information useful to regulators as early warning indicators of potential problem areas.

Consolidation. The rules for preparing consolidated financial statements are in the instructions for Part II. These instructions result in financial statements that are usually in accordance with generally accepted accounting principles (GAAP), except where the SEC does not permit consolida-

16

tion. The instructions provide that consolidated financial statements be prepared as follows:

1 Required consolidation—The financial statements must include any subsidiary whose obligations or liabilities are guaranteed, endorsed or assumed directly or indirectly by the broker-dealer.

2 Permissive consolidation—Any other subsidiary may be consolidated.

If any consolidation has the effect of increasing the net capital of the broker-dealer (under Rule 15c3-1), and/or decreasing the ratio of aggregate indebtedness (AI) to net capital and/or decreasing the minimum net capital requirements under the alternate net capital computation, if elected, under Rule 15c3-1(f), then such benefits of consolidation may not be recognized unless an opinion of counsel has been obtained as to the availability of the portion of the net assets of the subsidiaries related to the interests therein of the broker-dealer as prescribed by Appendix C of Rule 15c3-1.

If the broker-dealer owns 50 percent or less of an investee for which it has not guaranteed, endorsed or assumed any liabilities, then the financial statements of the investee must be included in a note to the broker-dealer's financial statements. *Filing.* Part II is to be filed within 17 business days following the end of the calendar quarter, which may also be a fiscal quarter ending uniformly near the end of the quarter, such as the last Friday of the quarter.

If the broker-dealer is a member of one or more national securities exchanges or a registered national association (the NASD) that has adopted an approved plan for filing the FOCUS report, the filing will be made with one specified entity. Otherwise, the filing is to be made with the SEC in Washington and with the SEC office for the region in which the broker-dealer has its principal office. The effect of this rule will be that most broker-dealers will file with an exchange or the NASD; presumably, this filing will be with the designated examining authority.

There are two conditions under which filing of Part II is required more frequently than quarterly: (a) if the broker-dealer is so notified by either the SEC or its designated examining authority (by reason of exceeding safe limits or the like) and (b) if the date selected for the annual audit does not coincide with a calendar quarter end (as defined).

Certain plans adopted by self-regulators provide for different filing dates. The Pacific Stock Exchange, for example, requires the filing of Part II by the fifteenth calendar day following the end of the reporting quarter.

Format. The form and content of the income statement and the statements of changes in equity (or

capital) and changes in subordinated liabilities are not complex, and their preparation should present no unusual problems. For NYSE member firms, the format of the income statement is more complex because the plan adopted by the NYSE provides for the use of the income statement from Form X-17A-20 rather than the condensed format otherwise prescribed for FOCUS Part II. The use of the more detailed income statement relieves NYSE member firms from filing Form X-17A-20 each calendar quarter. Preparation of the statement of financial condition requires a considerable amount of analysis. Because of the complexity of the data to be included, it will normally be desirable to prepare a work plan for assembly of the details. The chief financial officer or a designated supervisor should plan the allocation of work among the available resources of the broker-dealer. As a starting point, the following material (or appropriate substitutes) will be required:

1 A general ledger trial balance as of the date of the financial statements.

2 A similar trial balance as of the preceding calendar quarter end—unless the income and expense accounts include only the data for the three months ended as of the date of the financial statements.

3 A valued and classified security ledger as of the date selected.

4 The computation for determining the reserve requirements under Rule 15c3-3.

The sequence in which data is prepared will vary among reporting broker-dealers, and experience will indicate the most efficient organization of the work plan.

The specialized format of Part II provides for reporting supplementary information on the face of the statement of financial condition. Assets are identified in separate columns as "allowable" or "nonallowable." The distinction is made in accordance with the criteria found in the uniform net capital rule (Rule 15c3-1). Liabilities are identified in separate columns to distinguish aggregate indebtedness as "AI liabilities" and "non-AI liabilities." Again, Rule 15c3-1 is the basis for the detail breakout. For those broker-dealers that have elected to compute net capital under the alternative method (Rule 15c3-1(f)), the distinction between AI liabilities and non-AI liabilities may be of limited interest, since the alternative method does not base required net capital on AI. The NYSE has announced at educational seminars that details of AI liabilities need not be reported by member firms that have elected to compute net capital under the alternative method.

16

After the data has been assembled and drafts of the financial statements prepared, they should be carefully reviewed to see that they meet the requirements in the instructions for Part II, which read in part

“ . . . and shall include, in the basic statement or accompanying footnotes, all informative disclosures necessary to make the statement a clear expression of the organization's financial and operational condition.”

As an example of a required disclosure, the general instructions for Part II provide that “any deviations from these specific instructions must be clearly explained in footnotes to the report.”

Matters which require special attention. At this writing, the Part II FOCUS schedule covering possession or control requirements for customer securities under Rule 15c3-3 is being studied for revision by the SEC. Most broker-dealers are familiar with the information previously reported in question 6.G of the Answers to Financial Questionnaire. Under Rule 17a-5 a portion of such data must be reported quarterly. Old question 6.G required the reporting of data in four categories; only one is required in Part II of the FOCUS report, but at this writing, the reporting of information on possession or control in quarterly reports has been temporarily suspended by the SEC pending further study. These are the “exception situations” for which required action was not taken and for which instructions should have been issued but were not.

Since the broker-dealer must make a daily determination of securities required to be in its possession or control under Rule 15c3-3, the problem lies in sorting out those cases that are “excused” from those cases that are not excused and therefore require action to be taken. In this regard, the recordkeeping systems of some broker-dealers may require modification, depending on how the reporting requirement, currently suspended, is finally resolved by the SEC. In the prior reporting system, the information was reported only annually, at the time of the annual audit, and the techniques used by the auditors to identify data for question 6.G may have been included in EDP software not normally available to the broker-dealers.

Another potential problem area lies in the proper and timely identification of the accounts of noncustomers. The applicable definitions of customers and noncustomers are found in Rules 15c3-1(c)(6) and (7). For early identification of noncustomers, the broker-dealer should plan ahead in some fashion to identify this special class of account separately.

Part IIA, FOCUS report

Part IIA is a condensed version of Part II. The principal difference is the significantly reduced number of items on the statement of financial condition. Another difference is the absence of a requirement to file a schedule of reserve requirements pursuant to Rule 15c3-3. This is an apparent contradiction, incidentally, in the requirement for information as to possession or control under Rule 15c3-3. This information relates to customers' fully paid and excess margin securities. Yet, by definition, a broker-dealer carrying customers' securities accounts is not permitted to file Part IIA.

The time specified for filing Part IIA is the same as that for Part II. Monthly rather than quarterly filings will be required if the broker-dealer is notified by its designated examining authority that it has exceeded safe limits. Also, an “extra” filing is required if the annual audit date does not coincide with a calendar quarter end.

The annual audit report

Designation of accountants. In each year following 1976, each broker-dealer must file not later than December 10 a statement in the form of a “Notice Pursuant to Rule 17a-5(f)(2),” which indicates the existence of an agreement, dated no later than the prior December 1, with an independent public accountant to conduct the broker-dealer's audit for the subsequent year. The notice identifies the broker-dealer, the accountant and the date selected.

For 1976, a transitional plan is provided under which the required notice must have been filed by February 10. The agreement may be of a continuing nature, in which case no further filing is required until such agreement is altered or terminated.

Selection of audit dates. Beginning in 1976, an annual audit report is required under Rule 17a-5 as of a date selected by each broker-dealer. Surprise audits are no longer permitted. A free choice of month end for the audit may be made in 1976; however, in subsequent years the annual audit must be as of the same fixed or determinable date, unless permission is received from the SEC to use a different one.

Since many broker-dealers use accounting periods that end on a Friday, some flexibility is available in designating the audit month end. A determinable date, as opposed to a fixed date, is one that can be determined by reference to the applicable annual calendar. For example, a broker-dealer might select “the last Friday in July” or “the Friday closest to July 31.” The annual audit report will therefore cover a period that is uniform from year to year except in those cases in which a 53-week year is needed to conform to the calendar.

The old requirement for an initial audit of a

16

new broker-dealer (previously required not sooner than one month or more than five months after the broker-dealer registration form became effective) has been dropped.

Filing. The annual audit report must be filed within 60 days after the date of the financial statements. If it cannot be filed without undue hardship within the prescribed time, an extension of up to 30 days may be obtained from the SEC. A request from the broker-dealer for extension of time must be filed, prior to due date, in a prescribed format, in three places: with the SEC in Washington, with the appropriate SEC regional office and with the designated examining authority. The independent public accountant must provide a separate letter, in specified format, to accompany the request. The appropriate regional SEC office is the entity designated to take action on any request for extension.

The annual audit report must be filed in the same three places. Copies of the report are to be provided to each additional self-regulatory organization of which the broker-dealer is a member. Whether such additional copies to be provided are to be sent directly by the broker-dealer or through the designated examining authority has not been made clear in the rule.

Certain exemptions from filing an annual audit report are available; however, these apply to a limited number of special-purpose broker-dealers.

If the statement of financial condition is filed separately from the rest of the annual audit report, the other parts may receive confidential treatment.

Form and content. The form of financial statements and schedules now prescribed for the annual audit report is quite different from the former Answers to Financial Questionnaire. Essentially, the new format consists of five financial statements and certain special-purpose supplemental schedules:

Financial statements

1 Statement of financial condition in a format and on a basis consistent with the "totals" reported on the similar statement contained in Part II or IIA.

2 Statement of changes in financial position. This statement is not included in Part II but has been specified in the introduction to the changes in Rule 17a-5. For some unexplained reason, some published editions of the text of the new rule (in the *Federal Register* and the text published by Commerce Clearing House) omitted reference to a statement of changes in financial position.⁴ This is presumably an oversight, since the omission of this statement would cause independent public accountants to qualify their opinions on the financial statements.

3 Statement of income.

4 Statement of changes in stockholders', partners' or sole proprietor's equity.

5 Statement of changes in liabilities subordinated to claims of general creditors. This statement is provided only if the conditions contemplated by such a statement existed at any time during the period covered by the financial statements.

Supplementary schedules

1 Computation of net capital under Rule 15c3-1.

2 Computation for determination of the reserve requirements under Exhibit A of Rule 15c3-3 (as recently revised).

3 Information relating to the possession or control requirements under Rule 15c3-3.

4 A reconciliation, including appropriate explanations, of the computation of net capital (Rule 15c3-1) and the computation for determination of the reserve requirements (Exhibit A of Rule 15c3-3). This reconciliation relates to the unaudited schedules filed with Part II or IIA by the broker-dealer as of the date of the audited financial statements. If there are no material differences between the unaudited schedules, a statement so indicating must be filed.

Audit objectives. The underlying concept of the annual audit has changed. Under the prior rule, the Answers to Financial Questionnaire were pre-

The accountant's determination that a material inadequacy exists may require completed audit procedures in a particular area, but that determination should be completed promptly.

sent in a prescribed format and the auditing procedures were specified in the minimum auditing requirements of Form X-17A-5. The new approach contemplates the application of generally accepted auditing standards (GAAS), with four specific audit objectives and a report on material inadequacies.

One consequence of the substitution of GAAS for minimum auditing procedures will be the judgmental selection of the timing and the extent of auditing procedures to be applied by the independent public accountant. On the basis of his evaluation of internal accounting controls of the broker-dealer, the accountant may conclude that certain procedures applied 100 percent under the former rule may now be applied on the basis of testing or sampling deemed appropriate in the circumstances.

⁴ The SEC corrected this error in the *Federal Register* of March 26, 1976, p.12638.

16

Such procedures as the circularization of customers' securities accounts, physical inspection and count of securities on hand and the verification of "street" items may now be performed on a basis less than 100 percent when justified by the auditor's evaluation of internal accounting controls.

Specific objectives. The new rule defines in a general way the scope of matters of regulatory interest by prescribing that the audit include the review of the broker-dealer's practices and procedures as follows:

1 The periodic computation of AI and net capital under Rule 17a-3 (a) (11) and the reserve required by Rule 15c3-3 (e).

2 The quarterly securities counts and other procedures prescribed by Rule 17a-13.

3 Compliance with the requirement for prompt payment by customers for securities purchased under Regulation T of the Federal Reserve System.

4 Obtaining and maintaining possession or control of all fully paid and excess margin securities under Rule 15c3-3.

Material inadequacy report. The scope of the audit must include a review of the accounting system, internal accounting control and procedures for safeguarding securities that is sufficiently comprehensive to provide reasonable assurance that any material inadequacy existing at the date of the examination will be disclosed. A reportable material inadequacy is defined in Rule 17a-5(g) (3).

A new concept has been adopted as to the timing and responsibility for reporting material inadequacies that should be of interest to the accountant. Under the old rule, material inadequacies, if any, were reported at the time of filing the Answers to Financial Questionnaire. The new rule prescribes a different procedure. If the accountant determines at any time during his audit (including interim work) that a material inadequacy exists that is reportable under the rule, he is required to report the existence of that material inadequacy to the chief financial officer of the broker-dealer. The new rule provides further that the broker-dealer must notify the SEC within 24 hours, pursuant to Rule 17a-11, and provide the accountant with a copy of such notice.

If the accountant does not receive from the broker-dealer a copy of the required notice to the SEC within the specified 24 hours, he is obligated to notify the SEC directly. Further, if the accountant receives a copy of the notice and there is anything with which he does not agree, he must notify the SEC of his disagreement.

The accountant's determination that a material inadequacy exists may require completed audit procedures in a particular area, but that determination should be completed promptly. The determination should be made at an appropriate supervisory level in the accountant's firm. Essen-

tially, the determination of an existing material inadequacy must be based on auditing procedures sufficient in scope to lead to a judgmental conclusion at an appropriate level. Many accountants will conclude that the requirement to "call it to the attention of the chief financial officer" will involve a written communication, personally delivered.

In addition to the notifications required when the existence of a material inadequacy is determined, a supplemental report must be filed, along with the annual audit report that describes any existing material inadequacies found (presumably, notice has been previously given, as described above) and any found to have existed at any time since the date of the previous audit. The supplemental report must indicate the corrective action taken or proposed to be taken by the broker-dealer. A negative report is required.

Because of the requirement to report on material inadequacies that have existed since the prior audit, the scope of the accountant's review must be comprehensive enough to provide reasonable assurance that any such material inadequacies will be identified.

SIPC supplemental report. Concurrently with the filing of the annual audit report, a supplemental report must be filed by the independent accountant on the status of the broker-dealer's membership in the Securities Investor Protection Corporation (SIPC). The rule provides for either a reconciliation of the annual general assessment payment or exclusion from membership, if applicable. This report was also required under the prior rule.

A transitional period will occur in 1976, pending the adoption of new rules by SIPC, from an annual calendar year general assessment to a fiscal year for SIPC purposes that coincides with the reporting fiscal year (if different from a calendar year) adopted by the broker-dealer in 1976.

A short year, for SIPC purposes, is expected to be adopted, which would be from January 1, 1976, to the date selected in 1976 for the annual audit. No change is contemplated for broker-dealers reporting on a calendar year basis. For those broker-dealers effecting changes in their SIPC years, eventually the SIPC annual general assessment reconciliation (Form SIPC-7) will be based on the revenues included in the audited financial statements.

New auditing considerations

Prior to January 1, 1976, the accountant was required to include in the scope of his examination of the broker-dealer's financial statements and schedules the procedures specified in a list of minimum auditing procedures which were then

16

found in the instructions to Form X-17A-5 (Answers to Financial Questionnaire). The scope of the requirements has been changed with the effect that the auditor may now select the procedures to be carried out, and the timing of such procedures, on the basis of his professional judgment in the light of the four specified audit objectives enumerated in the new rule.

Many auditing procedures were specified under the old minimum auditing procedures that required a 100 percent application of certain procedures, such as circularization of customer accounts and inspection of securities on hand. In the case of commercial companies, the 100 percent application of such procedures would have been considered by most auditors as "overkill." The judgmental selection of customer accounts for confirmation on the basis of a test sample has long been accepted as an appropriate auditing procedure. Some of the auditing procedures which may now be applied on the basis of judgmental samples are described below.

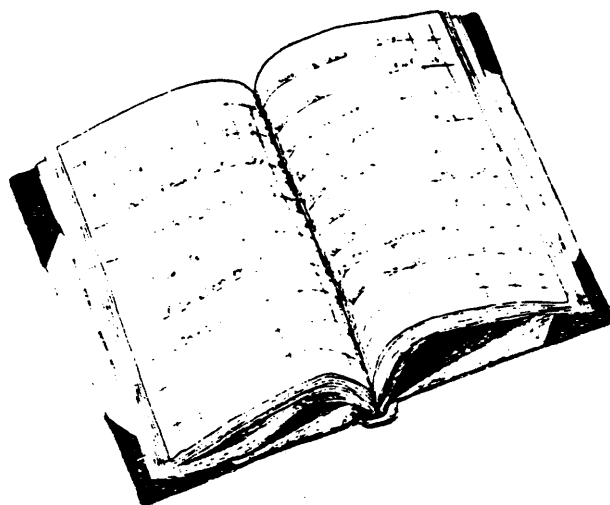
Customers' securities accounts. The auditor's purpose in circularizing customers is to obtain independent evidence of the correctness of the money and securities balances recorded in those customers' accounts by the broker-dealer at the examination date. Customers' accounts usually contain both money balances (debits and/or credits) and securities positions (long and/or short); consequently, the auditor should consider both the customers' money balances and the securities positions in exercising his judgment as to the customers' accounts he will select for circularization. The condition of a customer's account at the examination date will affect both the classification of that account in the statement of financial condition if there are money balances and certain computations that may be required in the specified supplemental schedules.

Before designing the sample of customers' accounts to be circularized, the auditor should consult with his client on whether the client prefers the auditor to use a sample larger than the minimum the auditor deems necessary in the circumstances to express his opinion on the financial statements taken as a whole. Some clients may, for the moderate additional cost involved, prefer a larger sample (perhaps, in some cases, even 100 percent) for the possible identification of errors or disputed items which, although individually and in the aggregate immaterial in amount, are items management wants to have identified and corrected.

There is no longer a requirement that positive requests for confirmation must be used. The auditor may now use either positive or negative confirmation requests, or a combination of them. Because of materiality considerations, certain large

customer accounts may be circularized with only positive requests for confirmation.

Some preplanning will be necessary to assure the auditor that all necessary data is available in the appropriate format to permit the selection of customers' accounts for circularization. Depending on the type of accounting records maintained by the broker-dealer, from handposted to EDP prepared, arrangements should be made in advance for the valuation of the securities positions in the customers' accounts. In those cases in which sophisticated EDP margin programs are available, either in-house or through a service bureau, the valuation procedures can be accomplished with little, if any, additional programing support.



Inspection of securities on hand. Under the old rule, all securities physically on hand were required to be inspected by the auditor and the quantities on hand compared with the quantities of such securities recorded in the securities ledger (free box, segregation or safekeeping). The auditor may now determine the procedures he will carry out. This will usually include an inspection of a sample selection of securities on hand with procedures for comparing the quantities of the selected securities with the amounts recorded in the securities ledger. In selecting the securities on hand to be inspected, the auditor should be guided by considerations of materiality resulting from the disparity in market values of the items in the securities from which the sample will be selected. Here, again, prior planning is necessary to assure a record format from which an appropriate sample may be selected. The usual format of an EDP prepared securities ledger will not be adequate to make the selection, because it is expressed in quantities (not values) of securities on hand. If a box position record with value extended

16

can be prepared, the selection will be significantly simplified, since any suitable statistical method could be applied to the computed values to make the selection of securities to be inspected.

Some special conditions should be considered. The sample may need to be stratified to apply different procedures to particular portions of the securities on hand. Highly negotiable securities in bearer form may require special attention. Securities held in safekeeping—in the customers' names—may be accorded different treatment. Securities in which there are substantial quantities on hand or in which there is significant movement at or about the examination date, such as an issue involved in a recent underwriting, may require special attention. Bonds with coupons due immediately following the examination date may also merit special attention.

Confirmation of street items. Some auditing procedures that are applied to street items may be applied on a 100 percent basis just as easily as on the basis of a sample; because of the higher degree of audit satisfaction achieved, the 100 percent technique should be used. Confirmations may be readily obtained for these items, such as all of the collateral held by banks against loans to the broker-dealer. Confirmations of continuous net settlement accounts with clearing organizations or securities depository accounts are usually obtained as an EDP listing provided directly to the auditor.

There are reporting considerations that will influence the procedures to be selected by the auditor, such as in cases in which certain items must be separately reported or are the basis for some potentially adverse treatment in the supplemental schedules of net capital or the computation for determination of the reserve requirements under Rule 15c3-3. The materiality considerations re-

lated to the financial statements as a whole may be too broad in the case of some street items, which may affect the supplemental schedules when the effect of a particular item on the net capital computation or the reserve requirement may be the difference between the broker-dealer being in compliance with, or being in violation of, the applicable rule.

Conclusion

The FOCUS report represents a far-reaching change from the past. The uniform, layered reporting system will reduce and simplify the regulatory reporting requirements for broker-dealers. There will undoubtedly be some growing pains in the early application of the new rule, but this will be a small price to pay for the ultimate reduction in the regulatory reporting burden which, over a period of many years, had become uncoordinated and duplicative. Eventually there may be an opportunity to eliminate the annual filing of Form X-17A-10, if the essential data required can be integrated with the quarterly filings of Part II of the FOCUS report and the data needed for economic analysis somehow captured for computer processing. ■

KEVIN WILSON
1535 PARKER STREET
BRONX, NEW YORK 10462
NOVEMBER 15, 1994

AL GOLL, TECHNICAL MANAGER, ACCOUNTING STANDARDS DIV.
FILE 4340.56

AICPA, 1211 AVENUE OF THE AMERICAS
NEW YORK, N.Y. 10036-8775

DEAR MR. GOLL,

MY COMMENTS ARE TO EXPAND ON YOUR SUBJECT OF MUTUAL FUNDS ON PAGE 140, PARAGRAPH 5.118. MUTUAL FUNDS ARE OFFERED TO PEOPLE IN MANY WAYS. SOME ADVERTISE ON TELEVISION, SOME IN NEWSPAPERS AND MAGAZINES, AND SOME BY RADIO OR SALESMEN'S PRESENTATIONS. THERE ARE NO-LOAD FUNDS, THESE HAVE NO SALES CHARGES. THEY ARE OFFERED AT NET ASSET VALUE. THIS IS CALCULATED BY COMPUTING NET ASSETS LESS LIABILITIES, DIVIDED BY THE NUMBER OF SHARES OUTSTANDING.

WHEN THERE IS A SALES CHARGE, OR COMMISSION, IT IS ADDED TO THE NET ASSET VALUE. IF NET ASSET VALUE IS \$10 PER SHARE, AND THE SALES CHARGE IS $8\frac{1}{2}\%$, SIMPLY DIVIDE \$10 BY 8.52 TO ARRIVE AT THE OFFERING PRICE. THERE IS ALSO A MANAGEMENT FEE, USUALLY APPROXIMATELY .75%, WHICH IS INCLUDED IN THE NET ASSET VALUE. THERE ARE MONEY MARKET, STOCK FUNDS, BOND FUNDS, SOME MIXED WITH STOCKS AND BONDS. SOME ARE EQUITY, EQUITY & INCOME, GROWTH, AGGRESSIVE GROWTH.

MUTUAL FUND COMPANIES COMPARE THEIR FUNDS PERFORMANCE WITH THE BENCHMARKS, SUCH AS S&P 500, DJIA, AND THE CONSUMER PRICE INDEX. INTERNAL REPORTS ARE PREPARED FOR MANAGEMENT USING VARIOUS SALES CHARGES. SOME NO-LOAD FUNDS PERFORM MUCH BETTER THAN THOSE WITH A SALES CHARGE. ALL INFORMATION IS IN A PROSPECTUS, AND INTERIM FINANCIAL REPORTS ARE GENERATED FROM THE ACCOUNTING, STATISTICAL, AND LITERATURE DEPARTMENTS.

SALES REPORTS ARE PREPARED SHOWING SALES BY FUND, LESS EXCHANGES TO OTHER FUNDS, LESS REDEMPTIONS.

- CONTINUED -

ALL MUTUAL FUND COMPANIES fill OUT SURVEYS AND QUESTIONNAIRES AND THESE HAVE ALL FINANCIAL INFORMATION FOR THE QUARTER, SEMI-ANNUAL, OR ANNUAL PERIOD BEING SURVEYED. LIPPER ANALYTICAL SERVICES, SCHAUBACKER, AND THE INVESTMENT COMPANY INSTITUTE ARE A FEW. THE LAST IS BASED IN WASHINGTON D.C.

MUTUAL FUND COMPANIES ALSO MANAGE PENSION FUNDS FOR SOME CORPORATIONS, PRIVATE COMPANIES, AND MUNICIPALITIES.

Also, maybe these terms could be added to your glossary which starts on page 213. 1. NET ASSET VALUE 2. OFFERING PRICE 3. SALES CHARGE 4. EXCHANGES 5. REDEMPTIONS 6. NO-LOAD 7. MANAGEMENT FEE 8. UNREALIZED GAINS AND LOSSES 9. AVERAGE ANNUAL RATE OF RETURN. ~~to yield~~ Also, if management of the company fails to provide an appropriate REPRESENTATION LETTER, it should be well documented of the deficiencies and noted in the LETTER TO THE SECURITIES AND EXCHANGE COMMISSION WHEN BROKER HAS NOT MADE PROPER NOTIFICATION. (page 197.)

Sincerely,
Kevin Wilson