

NASD

NOTICE TO MEMBERS: 76-1
Notices to Members should be
retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 12, 1976

TO: ALL NASD MEMBERS
RE: 1976 Schedule of Holidays

Listed below is the NASD 1976 Schedule of Holidays.

February 16, Monday	Washington's Birthday
April 16, Friday	Good Friday
May 31, Monday	Memorial Day
July 5, Monday	Independence Day
September 6, Monday	Labor Day
November 2, Tuesday	National Election Day
November 25, Thursday	Thanksgiving Day
December 24, Friday	Christmas
December 31, Friday	New Year's

Sincerely,

Gordon S. Macklin
President

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 12, 1976

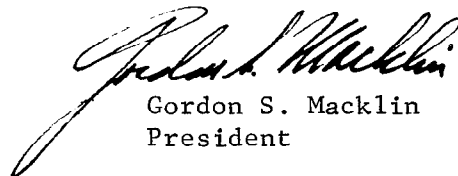
TO: ALL NASD MEMBERS

RE: Corrected 1976 Schedule of Holidays
(Replaces Notice to Members 76-1)

Listed below is the NASD 1976 Schedule of Holidays.

February 16, Monday	Washington's Birthday
April 16, Friday	Good Friday
May 31, Monday	Memorial Day
July 5, Monday	Independence Day
September 6, Monday	Labor Day
November 2, Tuesday	National Election Day
November 25, Thursday	Thanksgiving Day
December 24, Friday	Christmas

Sincerely,



Gordon S. Macklin
President

NASD

NOTICE TO MEMBERS: 76-2
Notices to Members should be
retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

January 12, 1976

TO: All NASD Members

RE: Quarterly Check-List of Notices to Members (Fourth Quarter, 1975)

Listed below are the Notices to Members which have been issued during the fourth quarter of 1975.

Members should note that only one copy of each Notice to Members is mailed to every main office of every member. Copies are not mailed to branch offices or to additional personnel in the main office other than the Executive Representative. Therefore, we suggest that all members retain the original copy of each Notice to Members in a separate file in their main office, and that copies needed for internal or branch office distribution be duplicated from the original Notice.

If your main office file is missing any of the following notices, please write to the Office Services Administrator at the NASD Executive Office. Requests for copies should be accompanied by a self-addressed label.

<u>Serial No.</u>	<u>Subject</u>	<u>Date</u>
75-62	Quarterly Check-List (Third Quarter 1975)	10/6/75
75-63	Reporting Transactions via Form T	10/6/75
75-64	New York City Corporate Bond Tax	10/7/75
75-65	Responsibilities of Members Concerning Commissions, Markups and Charges for Services in a Competitive Environment	10/28/75
75-66	Registration of Personnel Engaged in Municipal Securities Transactions	11/10/75
75-67	Appointment of SIPC Trustee for Westco Financial Corporation	11/18/75

- more -

75-68	Adoption of Amendments to Article III Section 26 and 29 of Rules of Fair Practice	11/19/75
75-69	Christmas Day and New Non-NCC Transactions	12/11/75
75-70	Application of Sales Charge Refund Requirements to Exchanges of Mutual Fund Shares	12/11/75
75-71	New York (State) Stock Transfer Tax New York City (Corporate) Bond Transfer Tax	12/29/75
75-72	Uniform Net Capital Rule Interpretations	12/31/75
75-73	NASD Qualification Program for Principals	12/31/75
75-74	NASD Qualification Examination Program	12/31/75

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NASD

NOTICE TO MEMBERS: 76 - 3

Notices to Members should be retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 15, 1976

I M P O R T A N T

TO: All NASD Members

RE: Subordination Agreements

In Notice to Members No. 75-57 dated August 25, 1975 the Association outlined its responsibilities under the amendment to SEC Rule 15c3-1 (the "Uniform Net Capital Rule") for the review and acceptance as satisfactory subordination agreements all agreements filed with it by those of its members for whom the Association has been designated examining authority.

The Notice also discussed in detail NASD procedures governing the filing of these agreements, including the introduction of standardized forms. These were developed not only to accelerate the review process and to facilitate prompt acceptance, but perhaps more importantly to our members, to simplify the preparation of subordination agreements while at the same time greatly reducing the costs which were previously inherent in such filings.

In furtherance of this goal, the Association has put into place the following four (4) additional forms which it recommends be utilized by members making filings with us:

- | | |
|------|---|
| SL-2 | Temporary Subordinated Loan Agreement |
| SL-4 | Temporary Secured Demand Note Collateral Agreement |
| SL-5 | Subordinated Loan Agreement for Equity Capital |
| SL-6 | Secured Demand Note Collateral Agreement for Equity Capital |

Filing instructions have also been developed for these new agreements. Form TSA encompasses all temporary subordination agreement filings while Form ESA covers equity agreement filings.

Forms SL-1 and SL-3, already in use, have undergone minor amendments, as have the filing instructions governing their submission to the Association. These revised filing procedures are now set forth in Form SA.

For the most part, members have been following the Association's filing procedures. However, one area has presented a problem, that being failure to file agreements according to prescribed procedures at least thirty (30) days prior to the proposed effective date. We wish to emphasize the necessity for doing so. This will insure sufficient time for the processing and acceptance of agreements. Also, those members not utilizing our standard forms must still follow the Association's filing procedures as set forth in Forms SA, TSA and ESA.

The attached summarizes the Association's subordination agreement program. Briefly, there are six (6) standard forms (Forms SL-1 through SL-6) designed to handle all filings with the Association. In addition, there are filing instructions for each type of agreement (i.e. standard, temporary and equity). All forms can be obtained through the NASD District Office in your area and requests for subordination agreement forms will be accompanied by the appropriate instructions.

Any questions regarding this notice should be directed to Bradford M. Patterson at (202) 833-7324 or to the NASD District Office in your area.

Sincerely,



Frank J. Wilson
Senior Vice President
Regulation

Attachment

<u>FORM</u>	<u>TITLE</u>	<u>PROCEDURES</u>
SL-1	Subordinated Loan Agreement	Form SA
SL-2	Temporary Subordinated Loan Agreement	Form TSA
SL-3	Secured Demand Note Collateral Agreement	Form SA
SL-4	Temporary Secured Demand Note Collateral Agreement	Form TSA
SL-5	Subordinated Loan Agreement for Equity Capital	Form ESA
SL-6	Secured Demand Note Collateral Agreement for Equity Capital	Form ESA
SDN	Secured Demand Note	
SLD	Reprint of Appendix D	

77
NOTICE TO MEMBERS: 76-4
Notices to Members should be
retained for future reference.

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 22, 1976

IMPORTANT

PLEASE DIRECT THIS NOTICE
TO ALL
FINANCIAL AND OPERATIONAL OFFICERS AND PARTNERS

TO: All NASD Members

RE: SEC Adopts FOCUS Report and Amends Various
Financial Reporting Rules

SUMMARY

On December 17, 1975, the SEC announced the adoption of a new uniform report, known as FOCUS, as part of a major effort to streamline financial and operational reporting by brokers and dealers.^{1/} The new report has been adopted pursuant to Rule 17a-5 under the Securities Exchange Act of 1934.^{2/} When fully implemented, the FOCUS Report will replace the information presently required by various SEC forms, Forms M and Q, the Joint Regulatory Report, the income and expense reports, and various other financial and operational forms and reports now required by self-regulatory organizations.

In adopting the FOCUS Report, the Commission also announced a series of amendments to Rule 17a-4, Rule 17a-5, Rule 17a-10, Rule 17a-11 and Rule 17a-20 to further implement the FOCUS Report and this newly-revised system of financial and operational reporting for brokers and dealers. Specifically, Rule 17a-4 has been amended to require that brokers and dealers maintain, for a minimum period of three years, certain books and records required for the preparation of the FOCUS Report. Rule 17a-5 was amended

^{1/} The term FOCUS is an acronym for a "financial and operational combined uniform single" report.

^{2/} See Securities Exchange Act Release No. 11935, dated December 17, 1975, a copy of which is reprinted beginning at page 14 of this notice to members from the Federal Register, Vol. 40, No. 250, dated Tuesday, December 30, 1975.

to specify the preparation and filing requirements of the FOCUS Report including Parts I, II, and IIA of Form X-17A-5 and the annual audit report.

Amendments to Rule 17a-10 have shortened the time period within which Form X-17A-10 must be filed. In addition, Form X-17A-10 has been substantially amended to conform to the format of the FOCUS Report and to reduce the amount of income and expense information required. This reduced information is effective for calendar year 1975. Rule 17a-11 has been amended to require a broker-dealer subject to it to file Part II of Form X-17A-5 plus supplementary schedules as required, in place of Form X-17A-11. Furthermore, the events which require reporting of material inadequacies under Rule 17a-11 have been revised and the filing by the broker-dealer of a corrective plan to remedy such inadequacies is now required. Also, Rule 17a-20 has been amended to both reduce the amount of information required by Form X-17A-20 and the frequency with which such report must be filed. Other amendments to Rule 17a-20 eliminate from the reporting requirement those broker-dealers with less than 20 percent of gross revenue derived from brokerage commission transactions.

As part of this new financial reporting system, the Commission simultaneously announced the approval of plans filed by the NASD and several other self-regulatory organizations pursuant to Rule 17a-5, Rule 17a-10 and Rule 17a-20.

Due to the effectiveness of amended Rule 15c3-1 (the "net capital rule") on January 1, 1976, the SEC acted to expedite the adoption of the FOCUS Report in order that the revised reporting system and the new uniform net capital rule would be concurrently implemented.

* * *

BACKGROUND

The FOCUS Report and the other revisions which have been made to the existing scheme of financial reporting, as described more fully below, are mainly the result of recommendations furnished the SEC by the Report Coordinating Group, a federal advisory committee, appointed by the Commission in May 1974. This Committee was established, with the NASD as a member, to assist the SEC in its efforts to reduce, consolidate and simplify current reporting requirements.

The new reporting system converts the existing reporting systems of the various self-regulatory organizations and the Commission to a reporting system based upon general purpose financial statements. Also, the new system has been structured to consolidate reporting requirements for purposes of surveillance, the annual audit, customer statements and economic data collection, including the monitoring of the impact of competitive commission rates.

SURVEILLANCE REPORTS

The newly-adopted reporting program replaces all similar existing programs of the NASD, the SEC and the various exchanges. Consequently, as of the reporting period commencing January 1, 1976, the NASD shall no longer require the filing of either Form M or Form Q. In their place is the FOCUS Report which now requires the monthly reporting of summary data of the Form M type by certain specified broker-dealers (Part I) and detailed quarterly reporting by all of the Form Q or Joint Regulatory Report (JRR) type (Part II). Smaller broker-dealers and certain specialty firms file a "short form" abbreviated version of the quarterly report known as Part IIA.

FOCUS Report - Part I

As noted above, the Part I Report is very similar to the Form M Report in that it is a summary report containing key financial and operational information. This part is designed so that trends for a full year in any of the line items is displayed on a horizontal line on the report. Also, because of its format, the Part I Report can be readily completed with a minimum expenditure of preparation time since nearly all of the information contained therein is presently required to be generated and maintained by long existing rules of the Commission, the NASD and the exchanges. The purpose of this part is to provide regulators with timely information to assist in the early detection of financial and operational problems without undue inconvenience to members.

FOCUS Report - Part II

Part II of the FOCUS Report is a general purpose financial and operational report. It is designed to accomplish several objectives: attain simplicity and uniformity; obtain essential regulatory information; and, develop financial statements in a format consistent with generally accepted accounting principles. The instructions to Part II set forth detailed definitions. Such definitions are intended as a guide for the correct completion of Parts II and IIA, and apply only to those parts. Part II contains the following financial statements and schedules:

Financial Statements

Statement of Financial Condition;
Statement of Income (Loss);
Statement of Changes in Stockholders' Equity
or Partners' or Sole Proprietor's Capital; and
Statement of Changes in Liabilities Subordinated
to Claims of General Creditors.

Schedules

Information for Possession or Control
Requirements Under Rule 15c3-3;
Computation of Net Capital Under Rule 15c3-1;
Computation for Determination of Reserve
Requirements Exhibit A of Rule 15c3-3;
Total Capital and Subordinated Capital Maturing
or Proposed to be Withdrawn Within the Next
Six Months and Details Thereof; and
Financial and Operational Data.

FOCUS Report - Part IIA

Part IIA is an abbreviated version of Part II. It includes a Statement of Financial Condition, a Computation of Net Capital Under Rule 15c3-1, a Statement of Income (Loss), and a Schedule of Details of Total Capital and Subordinated Capital Maturing or Proposed to be Withdrawn Within the Next Six Months.

Rule 17a-11 Reports

Rule 17a-11 has been revised to conform to the new net capital rule by the addition of subparagraph (b)(2) which applies to the alternative method of capital computation. Subparagraph (b)(2) is revised to clarify that a broker or dealer must file a report at the end of the month if a capital computation made at any time during the month indicates that his total net capital is below the minimum requirement. The report to be filed under Rule 17a-11 is now Part II of Form X-17A-5 plus any additional statements which may be required. Because of this, Form X-17A-11 has been eliminated.

Also, new paragraph (d) requires a broker-dealer who discovers or receives notice of a material inadequacy pursuant to paragraph (h)(2) of Rule 17a-5 to give telegraphic notice to the Commission and to file a corrective plan within forty-eight hours thereafter.

Finally, the rule has been amended to require that all notifications under Rule 17a-11 be given to and/or filed with both the SEC and the designated examining authority for the member.

SEC Approves NASD and Other Self-Regulators' Plans For Implementing FOCUS

With the adoption of the FOCUS Report, the Commission also announced the approval of plans filed by the NASD and seven other self-regulatory organizations for implementing FOCUS Reports Parts I, II and

IIA.^{3/} Through the submission of plans, the various self-regulatory organizations have agreed to collect the information required by Rule 17a-5 directly from their members thereby eliminating a direct filing requirement with the SEC for their respective members. Pursuant to each plan, every self-regulatory organization is required to submit copies of the applicable parts of the FOCUS Report to the SEC as to each member participating in its plan.

Part I of the FOCUS Report is to be filed on a monthly basis with a firm's principal examining authority by all clearing and carrying firms. Pursuant to the NASD's plan, this report will also be filed by introducing firms who are designated to the NASD. Pursuant to the NASD's plan, Part I Reports are required to be filed by all subject firms with the District Office of the Association for the district in which the member maintains its principal place of business on or before the tenth calendar day of the month following the month-end reporting date. The NASD's plan states that the initial Part I Report will be required to be filed at the NASD by all subject members on or before February 10, 1976, covering the month of January 1976.

The Part II Report is to be filed with the principal examining authority each calendar quarter by all clearing and carrying firms no later than the seventeenth business day following the quarter ending date. For NASD subject firms, this requirement commences with the quarter ending March 31, 1976, with the initial report to be filed with the Association's Executive Office in Washington, D. C. on or before April 26, 1976. The plans in respect to Part IIA Reports are identical to those for Part II except that the Part IIA will be filed by firms which do not clear or carry customer accounts. Also, every broker-dealer required to file an annual audit report pursuant to Rule 17a-5 must file a fifth quarterly report as of the date selected for the annual audit if such date does not coincide with a calendar quarter.

According to the NASD plan, the requirement to file a monthly and/or quarterly report directly with the Association does not apply to any member participating in a plan adopted by another regulatory body which has been declared effective by the Commission pursuant to the provisions of Rule 17a-5. That is, any Association member for whom the Association is not the designated examining authority shall not be required to file FOCUS Reports directly with the NASD. Such reports will be filed by such joint members with their designated examining authority.

In addition, the requirement to file monthly and/or quarterly reports does not apply to any insurance company member which is registered

^{3/} In addition to the NASD plan, the SEC approved plans filed by American Stock Exchange, Boston Stock Exchange, Chicago Board Options Exchange, Midwest Stock Exchange, New York Stock Exchange, Pacific Stock Exchange and PBW Stock Exchange.

with the SEC as a broker-dealer and, which is exempt from SEC Rule 15c3-1 and is otherwise operating in compliance with subparagraph (k)(1)(iv) of SEC Rule 15c3-3.

Summary of
NASD FOCUS Report Filing Requirements

Filers	Filing Requirements			Exempt
	Part I (Monthly)	Part II (Quarterly)	Part IIA (Quarterly)	
<u>Clearing and Carrying Firms</u> - \$25,000 minimum net capital category firms	Yes	Yes	No	N/A
<u>Nonclearing and Noncarrying Introducing Firms</u> - \$5,000 minimum net capital category firms	Yes	No	Yes	N/A
<u>Limited Product Firms</u> - all other \$5,000 as well as \$2,500 minimum net capital category firms	No	No	Yes	N/A
<u>Insurance Company Members</u> - Firms exempt from the net capital rule	No	No	No	Yes

NOTE: All Association members covered by the NASD plan for implementing the FOCUS Report will receive ample copies of all appropriate forms together with instructions within the next few weeks. The distribution system will be similar to that previously used for Forms M and Q.

ANNUAL AUDIT REPORT

The new reporting system also simplifies the annual audit requirement of broker-dealers. Pursuant to Rule 17a-5(d), an annual audited report

is required to be filed on either a fiscal or calendar year basis. As part of that report, the following financial statements and schedules are required:

Financial Statements

Statement of Financial Condition;
Statement of Income (Loss);
Statement of Changes in Financial Position;
Statement of Changes in Stockholders' Equity
or Partners' or Sole Proprietor's Capital; and
Statement of Changes in Liabilities Subordinated
to Claims of General Creditors.

Schedules

Computation of Net Capital Pursuant to
Rule 15c3-1;
Computation for Determination of Reserve
Requirements Pursuant to Rule 15c3-3;
Information Relating to the Possession or
Control Requirements Under Rule 15c3-3; and
A Reconciliation Pursuant to Rule 17a-5(d)(4).

The net capital and Reserve Formula computations made by the broker-dealer in the Part II or Part IIA filing for the corresponding period must be reconciled by the auditor as part of his report if the broker-dealer's computations differ materially from those contained in the audited report.

The date of the audit may be at any point within the calendar year. As noted earlier, however, if such date does not coincide with the close of a calendar quarter, the broker-dealer must file an additional Part II or Part IIA of the FOCUS Report as of the date of the annual audit. This fifth filing is intended to establish a means of integrating the annual audit report into the on-going surveillance systems of the SEC and the self-regulatory organizations.

The audited financial statements are required to be filed with the Commission in Washington, D. C., the regional office of the Commission for the region in which the broker-dealer has its principal place of business, and at the principal office of the designated examining authority for the broker-dealer no later than sixty days after the date selected for the annual audited financial statements. Copies of the annual audited report are also required to be filed with all self-regulatory organizations of which a broker-dealer is a member. The filing of the annual audit reports with the NASD is a new requirement since the NASD has not heretofore had a rule or regulation requiring such. In that connection, members are advised that a copy of the annual audit report is to be directed to the National Association of Securities Dealers, Inc.,

c/o Enforcement Department, 1735 K Street, N. W., Washington, D. C.
20006 at the time of filing such report with the SEC.

Audit Objectives and Procedures

Rule 17a-5 also prescribes the audit objectives to be used in the preparation of the broker-dealer's audited financial statements. Paragraph (g) requires the annual audit to be made in accordance with generally accepted auditing standards. The audit is to be conducted in such a manner as to provide the accountant with the basis for expressing an opinion on the financial statements of the broker-dealer as of the date of the examination.

Paragraph (h) prescribes the extent and timing of procedures to be followed in the annual audit and permits the accountant to exercise discretion in the area of the extent and timing of such procedures.^{4/} In exercising judgment, the independent public accountant is permitted, for the first time, to apply auditing procedures less than 100 percent, i. e., sampling techniques are now allowed, but only if, based upon his review and evaluation of existing internal controls in accordance with generally accepted auditing standards, he has concluded that such lesser scope is appropriate in the circumstances to permit an expression of opinion on the required financial statements. This particular amendment may result in a reduction in auditing fees for many members. In addition, the accountant has a responsibility to notify the chief financial officer of the broker or dealer of any material inadequacies discovered in the course of the audit or interim work. If the broker or dealer fails to notify the Commission, the accountant himself must do so.

Accountant's Report on Material Inadequacies

Paragraph (j) requires that the broker-dealer file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist at the audit date and any corrective action taken or proposed by the broker-dealer in regard thereto.

Nature and Form of Audit Reports

Paragraph (b), which prescribes the nature and form of reports which must be filed by the broker-dealer has been renumbered (e). Subparagraph (4)(iii)(b) thereof requires that amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7) be compared with amounts reflected in Form X-17A-5 for the fiscal year beginning with fiscal year 1976, rather than the present comparison with the amounts reflected in Form

^{4/} It is expected that the American Institute of Certified Public Accountants will promulgate guidelines and educational materials concerning audit procedures in this area.

X-17A-10. However, Form SIPC-7 is compared with Form X-17A-10 for calendar year 1975.

Qualification of Accountant

Subparagraph (2) has been added to paragraph (f) of Rule 17a-5 to require every broker-dealer to file with the Commission as of December 10th of each year a statement indicating the existence of an agreement with an independent public accountant covering a contractual commitment to conduct the broker-dealer's annual audit pursuant to Rule 17a-5 for that year. In light of the fact that the date of filing this statement for calendar year 1976 (December 10, 1975) has already passed, the statements which would have been filed on that date are now required to be filed with the SEC no later than February 10, 1976. Such letter may be permanent in nature, i. e., effective until withdrawn or a new letter may be filed each year.

Exemptions and Extensions of Time

Paragraph (d) of the rule has been redesignated paragraph (1) and requires the broker-dealer to include certain representations in its application for an extension of time for filing the annual audit report. The application must be received by the Commission's principal office in Washington, D. C., and the appropriate regional office of the Commission prior to the time that the report is normally due pursuant to paragraph (d). In a departure from past practice, it should be noted that the application will no longer be automatically granted by inaction on the part of the Commission.

In connection with the above, the Commission has advised that all extensions shall be granted or denied by the appropriate regional office within ten days after receipt of the request, unless the regional office indicates that more time is required to properly analyze the request.

Notification of Change of Fiscal Year

In the event that a broker-dealer changes his fiscal year, he is now required to give notice to both the Commission and his designated examining authority. Such notification must contain a detailed explanation of the reasons for the change and state whether the change will result in a delayed filing of the annual audit report. If the audit report will be delayed, the broker-dealer must include the representations required by subparagraph (a)(1) of paragraph (1).

CUSTOMER STATEMENTS

Paragraph (c) of Rule 17a-5 combines former paragraphs (m), (n) and (o) and prescribes the form and content of statements to be furnished to customers by all broker-dealers required to file an annual audit report

with certain exceptions as noted for firms engaged in limited activities. The financial information required by the amended rule includes:

- a balance sheet;
- a footnote indicating the broker-dealer's actual and required net capital;
- a statement or notice to the effect that a copy of any material inadequacies commented upon by the auditor in connection with the audit report is available for inspection by the customer at the SEC's Washington and regional offices for the region in which the broker-dealer maintains his principal place of business; and
- a notice that the most recent annual audit report of the broker-dealer is similarly available for review.

The only other substantive change in this area is that the time period for sending this material to customers has been increased from 30 to 45 days after the broker-dealer files his annual audited report with the Commission. According to the SEC, this was done following a re-evaluation of the length and complexity of the statements to be sent.

ECONOMIC DATA COLLECTION

Rule 17a-10

Form X-17A-10, the annual report of income and expense, has been amended to conform to the format of the FOCUS Report. In addition, the amount of income and expense information required by the form has been substantially reduced so as to eliminate information no longer considered essential and that which is duplicative of data contained in the FOCUS Report. Parts II and IIA, as noted earlier, are to be filed on a calendar quarter basis. For the first time, the financial and operational data required for surveillance purposes and that required for economic analysis have been integrated into a single reporting system. In reducing the amount of information required by Form X-17A-10, the SEC has correspondingly reduced the time period for filing the report from 120 days to 45 days except that in respect to the initial report to be filed pursuant to amended Rule 17a-10 for calendar year 1975, such time period has been extended to 60 days.

Adopted Form X-17A-10 consists of an Introduction, three parts and certain additional schedules. The schedules will be filed only by certain large broker-dealers. The Introduction will be filed by all broker-dealers. Part I of Form X-17A-10 will be filed by those broker-dealers with annual

gross revenue related to the securities business of less than \$500,000. This represents approximately 83 percent of all broker-dealers. Part II of Form X-17A-10 will be filed by all broker-dealers with annual gross revenue related to the securities business of \$500,000 or more. Subsidiary schedules requesting additional information will be filed only by those broker-dealers with annual gross revenue related to the securities business of \$10 million or more during the calendar year. Part III of Form X-17A-10 will be filed by insurance companies which are registered as broker-dealers solely for the purpose of selling variable annuities and which are exempted from Rule 15c3-1.

As in the case of the FOCUS Report, the Association and other self-regulatory organizations have filed plans with the Commission which were subsequently declared effective for collecting data and transmitting such to the SEC pursuant to amended Rule 17a-10. Pursuant to these plans, all NASD members, other than NASD members who are also members of the New York Stock Exchange (NYSE), will file Form X-17A-10 Reports directly with the NASD; all NYSE members with the NYSE; and, all sole members of regional exchanges directly with their respective exchanges.

Under each of the plans, member firms will be required to file Form X-17A-10 by the new date of 60 days after the end of the calendar year for calendar year 1975 and 45 days after the end of the calendar year for each calendar year thereafter.

NOTE: The SEC has advised the Association that copies of amended Form X-17A-10 are not as yet available for distribution. Consequently, it is likely that the Commission will act to extend the 60-day period so as not to unduly burden broker-dealers subject to this reporting requirement. Copies of the amended form together with instructions will be sent to members covered by the Association's plan as soon as such are available.

Rule 17a-20

Rule 17a-20, which was adopted as part of the Commission's program to monitor the impact of competitive commission rates, has been amended to reduce the frequency of filing of the report as well as the line item detail contained therein. The report has become a quarterly report with the elimination of monthly filings. Also, the form is no longer required to be filed by broker-dealers who derive less than 20 percent of income from commission business done on an exchange.

In connection with these amendments, the SEC has declared effective modifications by the NASD and NYSE to plans previously approved

by the Commission for the collection of data pursuant to Rule 17a-20.^{5/} NASD members subject to the rule will continue to file a separate Form X-17A-20 Report. The new form will be required to be filed with the NASD's Executive Office in Washington, D. C. by all subject firms on or before April 26, 1976 for the calendar quarter ending March 31, 1976. The revised form and instructions will be sent to all members covered by the NASD's plan under separate cover sometime during the month of February.

* * *

In adopting the FOCUS Report and other amendments to the various financial reporting rules, the Commission stated that, "...while the (new) reporting system is efficient in theory and the form satisfactory in substance, certain modifications may subsequently be necessary in order to achieve a smoother practical application. It is the Commission's view that the areas requiring additional refinement will become apparent after the self-regulators and brokers and dealers have had several months' exposure with the FOCUS reporting structure. Therefore, comments are requested on or before March 31, 1976, suggesting the adoption on or before June 30, 1976, of proposed amendments to the FOCUS Report and the accompanying implementation program. "

In that regard, commentators have been asked to consider, in addition to other issues, the following subjects:

- 1) the viability of the format of Part I, Part II and Part IIA of Form X-17A-5, and suggested additions or deletions thereto;
- 2) the appropriateness of filing frequencies of Part I, Part II and Part IIA of Form X-17A-5;
- 3) the feasibility of further combining Form X-17A-5, Form X-17A-10 and Form X-17A-20 in order to effect a greater reduction in reporting requirements;
- 4) possible alternative means by which the annual audit requirements, the collection of surveillance material and the collection of economic data on a comparable time basis for all broker-dealers may be achieved;
- 5) the effectiveness of the revised annual audit report

^{5/} Only the NASD and NYSE have submitted plans for the collection of information pursuant to Rule 17a-20.

format and accompanying changes to Rule 17a-5 and Rule 17a-11; and,

- 6) the appropriateness of requiring municipal securities broker-dealers to be subject to the FOCUS reporting structure.

In view of the importance of this new program, the Association strongly recommends that members take this opportunity to respond to the Commission with detailed comments and constructive suggestions. All such comments should be submitted in writing on or before March 31, 1976. All communications on this subject should be directed to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D. C. 20549. Reference should be made to File No. S7-594.

Due to the significance of this new program and the impact that it will have on the Association and its membership, it would be extremely helpful if members would provide the Association with duplicate copies of their correspondence to the Commission on this subject. Such should be forwarded to:

National Association of Securities Dealers, Inc.
c/o Department of Regulatory
Policy and Procedures
1735 K Street, N. W.
Washington, D. C. 20006

For reference purposes, a copy of Securities Exchange Act Release No. 11935 follows. It is reprinted from the Federal Register, Vol. 40, No. 250, dated Tuesday, December 30, 1975.

Questions concerning this notice should be directed to Christopher R. Franke at (202) 833-7320, or Glenn C. Faulkner at (202) 833-4878.

Very truly yours,



Frank J. Wilson
Senior Vice President
Regulation

59706

RULES AND REGULATIONS

CHAPTER II—SECURITIES AND
EXCHANGE COMMISSION

[Release No. 34-11935]

FOCUS

BROKER-DEALER REPORTS

The Securities and Exchange Commission today announced the adoption of the FOCUS Report, a financial and operational combined uniform single report under the Securities Exchange Act of 1934. The FOCUS Report replaces the information presently required by Form X-17A-5 [17 CFR 249.617], Form X-17A-10 [17 CFR 249.618]¹, and Form X-17A-11 [17 CFR 249.621], which are the Commission's forms, the Joint Regulatory Report, Forms "M" and "Q," the income and expense reports, and various other financial and operational forms and reports required by self-regulatory organizations.

The Commission also announced the amendment of Rule 17a-4 [17 CFR 240.17a-4], Rule 17a-5 [17 CFR 240.17a-5], Rule 17a-10 [17 CFR 240.17a-10], Rule 17a-11 [17 CFR 240.17a-11], and Rule 17a-20 [17 CFR 240.17a-20], in order to further implement the adoption of the FOCUS Report and a streamlined system of financial and operational reporting for brokers and dealers. Rule 17a-4 [17 CFR 240.17a-4] is amended to require that brokers and dealers maintain, for a minimum period of 3 years, certain books and records required for the preparation of the FOCUS Report. Rule 17a-5 [17 CFR 240.17a-5] is amended to specify the preparation and filing requirements of the FOCUS Report including Parts I, II, and III of Form X-17A-5 [17 CFR 249.617] and the annual audit report. Rule 17a-10 is amended to shorten the time period within which Form X-17A-10 [17 CFR 249.618] must be filed. Form X-17A-10 [17 CFR 249.618] is substantially amended to conform to the format of the FOCUS Report and to reduce the amount of income and expense information required. This reduced information is effective for calendar year 1975. Rule 17a-11 [17 CFR 240.17a-11] is amended to require a broker or dealer subject to it to file Part II of Form X-17A-5 [17 CFR 249.617] plus supplementary schedules as required, in place of Form X-17A-11 [17 CFR 249.621]. In addition, those events which require reporting of ma-

¹ Form X-17A-10 [17 CFR 249.618] is substantially in FOCUS Report format, with some modifications.

terial inadequacies have been revised, and the filing by the broker or dealer of corrective plans to remedy such inadequacies is required. Rule 17a-20 [17 CFR 240.17a-20] is amended to substantially reduce the information required by Form X-17A-20 [17 CFR 249.636], and to eliminate from the reporting requirements those brokers and dealers with less than 20 percent of gross revenue derived from brokerage commission transactions.

Each of said rules is also amended to conform to Section 15(a)(1) of the Securities Exchange Act of 1934, as amended. That Section now requires all brokers and dealers, whether or not they are members of a national securities exchange, to register with the Commission. Consequently the term "member of an exchange" has been deleted from the phrase "member of an exchange, broker or dealer," as such term is no longer necessary.

The Commission also announced the approval of certain plans submitted by various self-regulatory organizations pursuant to Rule 17a-5 [17 CFR 240.17a-5], Rule 17a-10 [17 CFR 240.17a-10] and Rule 17a-20 [17 CFR 240.17a-20]:

American Stock Exchange ("ASE")
Boston Stock Exchange ("BSE")
Chicago Board Options Exchange ("CBOE")
Midwest Stock Exchange ("MSE")
National Association of Securities Dealers ("NASD")
New York Stock Exchange ("NYSE")
Pacific Stock Exchange ("PSE")
PBW Stock Exchange ("PBW")

Due to the implementation of amended Rule 15c3-1 [17 CFR 240.15c3-1] on January 1, 1976, the financial and operational reports, and the surveillance systems of the Commission and the self-regulatory organizations will become obsolete as of that date. For this reason, the Commission has expedited the adoption of the FOCUS Report and related rule changes in order that the revised reporting system may be implemented concurrently with amended Rule 15c3-1 [17 CFR 240.15c3-1].

I. *Introduction.* Section 17(a)(1) of the Securities Exchange Act of 1934, as amended, provides that the Commission shall prescribe by rule the records to be kept and the reports to be made and disseminated by brokers and dealers. Section 17(e) of the Securities Exchange Act of 1934, as amended, requires every broker or dealer to file annually with the Commission a certified balance sheet and income statement, and such other information concerning its financial condition as the Commission may prescribe by rule, and authorizes the Commission to prescribe the form and content of such financial statements and the accounting standards to be followed in their preparation.

The creation of the SEC Advisory Committee on Broker-Dealer Reports and Registration Requirements was announced by the Commission in September 1972, marking the beginning of a program to review the reporting requirements imposed on brokers and dealers by rules of the Commission and the self-regulators. In December 1972 the Com-

mittee submitted its recommendations to the Commission in the "Advisory Committee's Study on Broker-Dealer Reports and Registration Requirements" (Stepanek Report). The Stepanek Report concluded that there then existed unnecessary and duplicative reporting requirements resulting from lack of coordination by the various regulating entities.

The Commission subsequently established a Staff Task Force to determine whether the recommendations of the Committee could be implemented and if so, in what manner. The Staff Task Force delivered its report to the Commission substantially supporting the conclusions and recommendations of the Stepanek Report. The Commission thereafter formulated a program of implementation based upon the recommendations of the Stepanek Report as supported by the Staff Task Force. In its "Announcement of a Program of Implementation Regarding the SEC Advisory Committee Study on Broker-Dealer Reports and Registration Requirements" . . . the Commission:

1. stated its intention to develop a key regulatory report² and sought public comments thereon; and
2. stated its intention to establish a Report Coordinating Group under the Federal Advisory Committee Act to advise the Commission on the consolidation and reduction of reporting requirements and to assist the Commission in the development of a key regulatory report.³

In May 1974 the Commission announced the membership of the Report Coordinating Group ("Group"), a federal advisory committee.⁴ At its first meeting on June 3, 1974, the Group reviewed the Stepanek Report and decided to give the highest priority to developing recommendations regarding a uniform financial and operational report.⁵

² The key regulatory report is denominated the FOCUS Report symbolizing a Financial and Operational Combined Uniform Single report.

³ These two items are only part of a complete program described in Securities Exchange Act Release No. 10612, January 24, 1974, 39 FR 5204, February 11, 1974.

⁴ The Report Coordinating Group was established in accordance with the provisions of the Federal Advisory Committee Act, 5 U.S.C. Appendix 1, 86 Stat. 770 (1972).

⁵ The Group also concentrated its efforts on the development of uniform registration and record retention forms. Uniform registration forms for brokers and dealers were adopted by the Commission on May 16, 1975 (Securities Exchange Act Release No. 11424, 40 FR 30634, July 22, 1975). Subsequent to the submission of the Report Coordinating Group's First Annual Report, a Trading Forms Task Force has deliberated for several months and has recommended the elimination or consolidation of the 104 trading forms described in the First Annual Report. The Task Force now proposes 44 simplified and consolidated forms in their place.

An Assessment Forms Task Force working during the same period has made additional proposals for the further simplification of assessment procedures. For background and prior status of these two projects, see *First Annual Report of the Report Coordinating Group, June 16, 1975.*

RULES AND REGULATIONS

On August 9, 1974 the Commission issued guidelines for a uniform financial and operational report. In accordance with these guidelines the Group reviewed the reports, forms and similar material required of brokers and dealers by the Commission, the self-regulatory organizations and others. The Group, with the dedicated assistance of staff persons from all sectors of the industry, developed a FOCUS Report Discussion Paper which was distributed on October 15, 1974.

Comments suggesting further simplification and changes in the items of the FOCUS Report were considered in the drafting of the FOCUS Report Revised Discussion Paper released on December 16, 1974.⁶ The FOCUS Report Revised Discussion Paper set forth a three part reporting format of financial and operational data to be completed by certain firms at specified intervals.

Since the release of the FOCUS Report Revised Discussion Paper, the Group has held additional public meetings to further simplify the FOCUS Report and at the same time improve its effectiveness as a surveillance tool for the Commission and the self-regulators. The Group released its final recommendation for a FOCUS Report in its First Annual Report on June 16, 1975.⁷ The FOCUS Report is the product of the efforts of the Group assisted in large part by the comments and suggestions of members of the industry, the self-regulatory organizations, the accounting profession and interested members of the public. The Commission, after considering the recommendations of the Report Coordinating Group and the comments thereon, believed that the adoption of a reporting system based upon and including the FOCUS Report, with some modifications to the program recommended, would provide an opportunity for uniform industry-wide regulation and would substantially reduce the reporting burdens on the securities industry without compromising the interest of the public and the regulators. In an effort to achieve that goal, on November 1, 1975 there was published in the FEDERAL REGISTER (40 FR 51060) a notice of proposed rulemaking with proposed amended Rule 17a-4 [17 CFR 240.17a-4], Rule 17a-5 [17 CFR 240.17a-5] and related Form X-17A-5 [17 CFR 249.617], Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618], Rule 17a-11 [17 CFR 240.17a-11] and related Form X-17A-11 [17 CFR 249.621], and Rule 17a-20 [17 CFR 240.17a-20].

After careful consideration of the public comments submitted and further refinement to the reporting structure, the Commission adopts the FOCUS Report and related rules and forms as set forth herein recognizing that while the reporting system is efficient in theory, and the form satisfactory in substance, certain modifications may subsequently be necessary in order to achieve a smoother practical application. It is the Commission's view that the areas requir-

ing additional refinement will become apparent after the self-regulators and the brokers and dealers have had several months experience with the FOCUS reporting structure; therefore, comments are requested on or before March 31, 1976, suggesting amendments to the FOCUS Report on June 30, 1976. The Commission also requests that the Report Coordinating Group included in its final report to the Commission those amendments it considers necessary. The Commission thereafter intends to review the FOCUS Report at the beginning of each calendar year, in cooperation with the self-regulators and with the advice of the Report Coordinating Group, in order to continue modifying and updating the financial and operational reporting systems to keep pace with the changing securities industry.

II. Amendment of Rule 17a-4 [17 CFR 240.17a-4]. Rule 17a-4 [17 CFR 240.17a-4] is amended by adding subparagraph (b) (8) to require every broker or dealer who is required to file Part II or Part IIA of Form X17A-5 [17 CFR 249.617] to make and keep certain additional books and records. Such a requirement should not constitute a significant additional burden, inasmuch as said records are now prepared during the course of operation of the broker's or dealer's business. These new schedules replace a number of schedules in current Form X-17A-5 [17 CFR 249.617] and will provide detailed information required for a proper analysis and review of the annual audit report.

III. Amendment of Rule 17a-5 [17 CFR 240.17a-5] and Related Form X-17A-5 [17 CFR 249.617]⁸-A. Reports to be Filed by Brokers and Dealers. Rule 17a-5(a) (2) [17 CFR 240.17a-5(a) (2)] is amended to prescribe which firms must file the different parts of Form X-17A-5 [17 CFR 249.617]. Clearing or carrying firms which have not received notice that they exceed certain safe parameters of financial and operational condition must file Part I monthly and Part II on calendar quarters.⁹ Firms which do not carry or clear customer accounts must file Part IIA on calendar quarters. Firms which receive notice of exceeding certain parameters of financial and operational condition must file Part II monthly. Part IIA will be filed quarterly

⁸ The following is a comparison of the current, proposed, and adopted paragraphs:

⁹ This reporting sequence enables the Commission to fulfill its Congressional mandate to collect and report on economic data concerning the securities industry, while simultaneously streamlining the financial and operational reporting required by brokers and dealers. It allows almost the complete integration of the current economic data reporting requirements of Rule 17a-10 [17 CFR 240.17a-10] and Rule 17a-20 [17 CFR 240.17a-20].

Under Section 23 of the Securities Exchange Act of 1934, as amended by the Securities Act Amendments of 1975, the Commission has a duty to make such reports to Congress. The information necessary to prepare such reports would be derived from the calendar quarter filings of Form X-18A-6 [17 CFR 249.617] and the annual filing of Form X-17A-10 [17 CFR 249.618].

in lieu of Part II by small brokers and dealers, firms not clearing and not carrying customer accounts, and firms conducting a limited type of business. Such of these firms which exceed parameters set by the self-regulators must file Part IIA monthly. In addition, every broker or dealer required to file an annual audit report under paragraph (d) must file Part II or IIA, as applicable, as of the date selected for the annual audit report if such date does not coincide with a calendar quarter.

Rule 17a-5 [17 CFR 240.17a-5]

Current paragraph	Proposed paragraph	Adopted paragraph
(a).....	17a-5(a).....	17a-5(a).
(b).....	17a-5(b).....	17a-5(d).
(c).....	17a-5(c).....	17a-5(e).
(d).....	17a-5(d).....	17a-5(k).
(e).....	17a-5(e).....	17a-5(l).
(f).....	17a-5(f).....	17a-5(i).
	17a-5(g).....	17a-5(j).
	17a-5(h).....	17a-5(g).
	17a-5(i).....	17a-5(h).
(g), (h), and (i)...	17a-5(j).....	17a-5(i).
	17a-5(k).....	17a-5(j).
(j).....	17a-5(l).....	17a-5(k).
(k).....	17a-5.....	17a-5(b).
(l).....	17a-5.....	
(m), (n), and (o)...	17a-5(m).....	17a-5(c).
		17a-5(m).
		17a-5(n).

As proposed for comment, Rule 17a-5 (a) [17 CFR 240.17a-5(a)] did not specify the number of days within which the monthly and quarterly reports must be filed. The Commission requested comment upon this issue, and after consideration of those comments submitted has determined that Part I will be filed within 10 business days of the end of each month, and Parts II and IIA will be filed within 17 business days of the end of each month.

Subparagraph (a) (4) permits the broker or dealer to satisfy the filing requirements under subparagraph (a) (2) by complying with filing requirements established by a plan submitted to the Commission by the appropriate national securities association. Pursuant to the plan, the exchange or association is required to transmit to the Commission a copy of the applicable parts of Form X-17A-5 [17 CFR 249.617] as to each member participating in the plan. The plan must also set forth the time limitations within which the various parts of Form X-17A-5 [17 CFR 249.617] must be filed.

Requests for extension of time or exemption from any of the requirements of paragraph (a) will be considered pursuant to paragraph (1).

Report to be Filed Upon Termination of Membership. Paragraph (j) is renumbered (b) and requires that any broker or dealer who ceases to be a member in good standing of a national securities exchange file with the Commission, no later than two days after the termination, Part II of Form X-17A-5 [17 CFR 249.617] as of the termination. In addition, a national securities exchange which acts to terminate the membership of a broker or dealer or learns of any such action is required to notify the Commission of such action and notify the broker or dealer of its reporting under this paragraph.

⁶ Securities Exchange Act Release No. 11140.

⁷ Securities Exchange Act Release No. 11499.

59708

RULES AND REGULATIONS

Financial Statements to be Furnished to Customers. Paragraph (c) combines former paragraphs (m), (n) and (o) and prescribes the form and content of statements to be furnished to customers by all brokers and dealers required to file an annual audit report, with the exception of certain brokers or dealers with limited activities as enumerated in subparagraph (c)(1). The statements, as set forth in subparagraph (c)(2), include a balance sheet, a footnote indicating the broker's or dealer's actual net capital and its required net capital, a notice that a copy of any material inadequacies commented upon by the independent public accountant in connection with the annual audit report is currently available for the customer's inspection at the Commission's principal office in Washington, D.C. and the Commission's regional office for the region in which the broker or dealer has its principal place of business, and a notice indicating that the Statement of Financial Condition of the most recent annual audit report of the broker or dealer is similarly available for inspection. After a re-evaluation of the length and complexity of the statements which must be furnished to customers, the Commission has determined that the period of time within which these statements must be furnished shall be 45 days.

B. Accountants' Reports—Annual Audit Report. The Commission also requires that brokers and dealers file an annual audit report on a fiscal or calendar year basis.¹⁰ Rule 17a-5(d)(1) [17 CFR 240.17a-5(d)(1)] requires the following financial data to be included in the annual audit report:

Financial Statements:

Statement of Financial Condition;
Statement of Income (Loss);
Statement of Changes in Financial Position;
Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital;
Statement of Changes in Liabilities Subordinated to Claims of General Creditors;

Schedules:

Computation of Net Capital Pursuant to Rule 15c3-1 [17 CFR 240.15c3-1];
Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3 [17 CFR 240.15c3-3];
Information Relating to the Possession or Control Requirements Under Rule 15c3-3 [17 CFR 240.15c3-3]; and
A Reconciliation Pursuant to Rule 17a-5(d)(4) [17 CFR 240.17a-5(d)(4)].

All of the financial statements and schedules are to be filed on a public basis except those which are bound separately as provided in paragraph (e)(3).

The audited financial statements will be filed at the principal office of the Commission in Washington, D.C., the regional office of the Commission for the region in which the broker or dealer has its principal place of business, and at the prin-

¹⁰ This is in accordance with Section 14 of the Securities Acts Amendments of 1975 which amended Section 17(e)(1)(A) of the Securities Exchange Act of 1934 to require that the audited financial statements be submitted on a fiscal or calendar year basis.

cipal office of the designated examining authority for said broker or dealer no later than sixty days after the date selected for the annual audited financial statements. The computations contained in the corresponding filing of Part II or Part IIA pursuant to Rules 15c3-1 [17 CFR 240.15c3-1] and 15c3-3 [17 CFR 240.15c3-3], must be reconciled in a report filed pursuant to amended Rule 17a-5(d)(4) [17 CFR 240.17a-5(d)(4)], if such reports differ materially from the computations contained in the audit report.

The term "fiscal year" is defined as the broker's or dealer's fiscal year for reporting purposes. For purposes of defining a time period such as fiscal or calendar quarter, the last business day of such period would be acceptable. The date of the audit may be at any point within the calendar year; however, if such date does not coincide with the close of a calendar quarter, the broker or dealer must file an additional Form X-17A-5 [17 CFR 249.617], Part II or IIA as prescribed in paragraph (a), as of the date of the annual audit. This fifth filing allows the integration of the annual audit report into the surveillance programs of the Commission and the self-regulators.

Section 17(e) of the Securities Exchange Act of 1934 requires all brokers and dealers, including introducing firms, to file an annual audited report, including an income statement. The Commission requested comments on the feasibility of requiring floor members to file an annual audited report, and after consideration of those comments submitted has determined that the adequacy of the self-regulators' surveillance programs is such that the annual audited report will not be necessary.

Audit Objectives & Procedures. Rule 17a-5 ([17 CFR 240.17a-5]) also prescribes the audit objectives to be used in the preparation of the broker's or dealer's audited financial statements.¹¹ Paragraph (g) requires the annual audit to be made in accordance with generally accepted auditing standards. The audit is to be conducted in such a manner as to provide the accountant with the financial statements of the broker or dealer as of the date of the examination. The audit should be designed in such a manner as to provide the accountant with reasonable assurance of the discovery of any material inadequacies in the accounting system, the internal accounting control, procedures for safeguarding securities or the procedures followed in complying with Rule 17a-13 [17 CFR 240.17a-13], which are existing at the date of the audit. If during the course of the audit, inadequacies which have occurred during the period since the date of the last audit are determined to have existed either through preliminary work or through any other procedure conducted in connection with the annual audit such

¹¹ This is in accordance with Section 17(e)(2) of the Securities Exchange Act of 1934, as amended by the Securities Acts Amendments of 1975.

inadequacies must be reported as part of the annual audit report.

Paragraph (h) prescribes the extent and timing of procedures to be followed in the annual audit and permits the accountant to exercise discretion in the area of the extent and timing of such procedures.¹² In addition, the accountant has a responsibility to notify the chief financial officer of the broker or dealer of any material inadequacies discovered in the course of the audit or interim work. If the broker or dealer fails to notify the Commission, the accountant himself must do so.

A determination of a material inadequacy may, in many instances, require completed audit procedures in a particular area, appropriate review at the decision making level by management and the independent accountant, and possible consultation with counsel. While it is expected that a determination in this context involves a contemplative process, the length and complexity of the deliberations should depend on the circumstances and be completed in the shortest time possible.

Accountant's Report on Material Inadequacies. Paragraph (j) requires that the broker or dealer file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist at the audit date and any corrective action taken or proposed by the broker or dealer in regard thereto.

Nature and Form of Audit Reports. Paragraph (b), which prescribes the nature and form of reports which must be filed by the broker or dealer, is renumbered (e). Subparagraph (4)(iii)(b) thereof requires that amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7) be compared with amounts reflected in Form X-17A-5 [17 CFR 249.617] for the fiscal year beginning with fiscal year 1976, rather than the present comparison with the amounts reflected in Form X-17A-10 [17 CFR 249.618]. As proposed for comment, this paragraph did not allow for a transition period between the Form SIPC-7/Form X-17A-10 comparison and the Form SIPC-7/Form X-17A-5 comparison. The Commission has determined that a smoother adjustment will result if Form SIPC-7 is compared with Form X-17A-10 [17 CFR 249.618] for calendar year 1975 and with Form X-17A-5 [17 CFR 249.617] for fiscal year 1976 and thereafter.

Qualification of Accountant. Subparagraph (2) has been added to paragraph (f) which requires every broker or dealer to file with the Commission as of December tenth of each year a statement indicating the existence of an agreement with an independent public accountant covering a contractual commitment to conduct the broker's or dealer's annual audit pursuant to Rule 17a-15 [17 CFR 240.17a-15] for that year.

¹² It is expected that the American Institute of Certified Public Accountants will promulgate guidelines and educational materials concerning audit procedures in this area.

RULES AND REGULATIONS

59709

In light of the fact that the date of filing this statement for calendar year 1976 (December 10, 1975) has already passed, the statements which would have been filed on that date shall be filed no later than February 10, 1976. Such letter may be of a permanent nature, i.e., effective until withdrawn, or a new letter may be filed each year.

As proposed for comment, paragraph (f) did not offer the option of filing a permanent letter. After considering public comment, the Commission has determined that this option will further reduce the reporting requirements of brokers and dealers. In addition, new subparagraph (f)(3) requires that the accountant be independent in accordance with Rules 2-01(b) and (c) of Regulation S-X [17 CFR 210.2-01(b) and (c)].

Technical Requirements of Accountant's Report. Paragraph (i) combines former paragraphs (g), (h) and (l) in setting forth the technical requirements of the accountant's report, the representations and opinions to be expressed by the accountant with respect to the annual audit, and the manner in which exceptions noted by the accountant are to be stated. Paragraph (i) also notes that the accountant would be required to perform additional audit procedures if such procedures are necessary to accomplish the audit objectives.

Exemptions and Extensions of Time. Paragraph (d) of the rule has been redesignated paragraph (1) and requires the broker or dealer to include certain representations in its application for an extension of time for filing the annual audit report. The application must be received by the Commission's principal office in Washington, D.C., and the appropriate regional office of the Commission prior to the time that the report is normally due pursuant to paragraph (d). The application is not deemed granted by inaction on the part of the Commission, as is now provided for by the last sentence of the paragraph; accordingly, that sentence has been deleted from paragraph (1).

As proposed for comment, Rule 17a-5 [17 CFR 240.17a-5] did not set forth procedures for granting extensions of time for filing the annual audit report. After reviewing the comments suggesting such procedures, the Commission has determined that the extensions shall be granted or denied by the appropriate regional office within 10 days after receipt of the request, unless the regional office indicates that more time is required to properly analyze the request.

As proposed for comment, Rule 17a-5 [17 CFR 240.17a-5] did not provide an exemption for life insurance companies registered as brokers or dealers for the purpose of selling variable contracts and exempt from Rule 15c3-1 [17 CFR 240.15c3-1] by virtue of a previous application setting forth already existing higher permanent capital standards. The Commission requested comments on whether such life insurance companies should be subject to the requirements of the

FOCUS Report, and after consideration of the comments submitted has determined that those life insurance companies which are registered as brokers and dealers engaging exclusively in the sale of variable contracts, and which are exempt from Rule 15c3-1 [17 CFR 240.15c3-1], shall be exempt from the requirements of Rule 17a-5 [17 CFR 240.17a-5]. Such companies will file an annual report on Part III of Form X-17A-10 [17 CFR 249.618].

Notification of Change of Fiscal Year. Proposed Rule 17a-5 [17 CFR 240.17a-5] did not set forth notification procedures pursuant to a broker's or dealer's change of fiscal year. The Commission has determined that such notice is necessary and has defined the procedures in paragraph (m). The notice will be filed with the Commission and the designated examining authority and will explain the reasons for the change and state whether or not the change will result in a delayed filing of the annual audit report. If the audit report will be delayed, the broker or dealer must include the representations required by subparagraph (a)(1) of paragraph (1).

C. Structure of the FOCUS Report (Form X-17A-5 [17 CFR 240.617]). The statements and schedules contained in the FOCUS Report replace present Form X-17A-5 [17 CFR 249.617], but the designation "Form X-17A-5" is retained. Form X-17A-5 [17 CFR 249.617] is divided into two parts with additional supplementary schedules. Part I is a summary report containing key financial and operational information consisting of core line items for all brokers and dealers and supplementary items for small brokers and dealers. These line items will provide regulators with timely information needed for the continued viability of the present day early warning system. This part is designed so that the trend for a full year in any of the line items is shown on a horizontal line on the report.

Nearly all of the information in Part I is presently required to be generated and maintained by rules of the Commission, national securities associations and national securities exchanges. Accordingly, Part I will replace a number of forms currently used by members of the securities industry. Based upon plans of the various self-regulators filed with the Commission and approved today, Part I will replace the monthly reports that the various self-regulators currently require of firms which do not exceed certain safe parameters of financial and operational condition.

Part II of the Form X-17A-5 [17 CFR 249.617] is a general purpose financial and operational report. It is designed to accomplish several objectives: attain simplicity and uniformity, obtain essential regulatory information, and develop financial statements in a format consistent with generally accepted accounting principles. The instructions to Part II set forth detailed definitions. Such definitions are intended as a guide for the correct completion of Parts II and IIA and apply only to those Parts. Part II

contains the following financial statements and schedules:

Financial Statements:

Statement of Financial Condition;
Statement of Income (Loss);
Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietor's Capital; and
Statement of Changes in Liabilities Subordinated to Claims of General Creditors.

Schedules:

Information for Possession or Control Requirements Under Rule 75c3-1 [17 CFR 240.15c3-1];
Computation of Net Capital Under Rule 15c3-1 [17 CFR 240.15c3-1];
Computation for Determination of Reserve Requirements Exhibit A of Rule 15c3-3 [17 CFR 240.15c3-3];
Total Capital and Subordinated Capital Maturing or Proposed to be Withdrawn Within the Next Six Months and Details Thereof; and
Financial and Operational Data.

Part IIA is an abbreviated version of Part II. It includes a Statement of Financial Condition, a Computation of Net Capital Under Rule 15c3-1 [17 CFR 240.15c3-1]; a Statement of Income (Loss), and a Schedule of Details of Total Capital and Subordinated Capital Maturing or Proposed to be Withdrawn Within the Next Six Months.

As proposed for comment, Parts II and IIA did not include a Schedule of Information for Possession or Control Requirements Under Rule 15c3-3 [17 CFR 240.15c3-3]. After consideration of the public comments and a re-evaluation of the importance of this information, the Commission has determined that such information shall be required quarterly.

Based upon plans of the various self-regulators filed with the Commission and approved today, Part II and Part IIA will replace reports currently required on a monthly and quarterly basis by various self-regulators.

Copies of amended Form X-17A-5 [17 CFR 249.617] have been filed with the Office of the Federal Register and copies thereof may be obtained on request from the Securities and Exchange Commission, Washington, D.C. 20549.

IV. Amendment of Rule 17a-10 [17 CFR 240.17a-10] and Related Form X-17A-10 [17 CFR 249.618]. In response to comments received from members of the public and regulatory authorities a number of changes have been made in Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618]. In the original proposal, brokers and dealers with certain exceptions were required to file such reports 45 days after the end of the calendar year. In Rule 17a-10 [17 CFR 240.17a-10], as adopted, brokers and dealers will be given 60 days after the end of the calendar year in which to file Form X-17A-10 [17 CFR 249.618] for calendar year 1975, in order to allow brokers and dealers to become familiar with the revised form.

Proposed Form X-17A-10 [17 CFR 249.618] consisted of two parts. In place of a separate introduction to each part of the form, one uniform introduction for all parts of the form has been developed

59710

RULES AND REGULATIONS

in order to simplify the form and to enhance computerization of the data. The number of parts to the form have been expanded from two to three. Part III of Form X-17A-10 [17 CFR 249.618] is to be filed by insurance companies which are registered as brokers and dealers for the purpose of selling variable annuities and are exempted from Rule 15c3-1 [17 CFR 240.15c3-1]. Several items were added to the revenue and expense statements of Part I and Part II of Form X-17A-10 [17 CFR 249.618] in order to be consistent with generally accepted accounting principals and a number of technical changes were made in order to improve the quality of the information collected.

Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618] will be amended, beginning with calendar year 1975, so as to eliminate certain information no longer considered essential, to conform to the format of the FOCUS Report and to reduce the reporting burden on brokers and dealers. For the first time, the financial and operational data required for surveillance purposes and the information required for economic analysis will be integrated into a single reporting system. Rule 17a-10 [17 CFR 240.17a-10] will be amended to shorten the time period from 120 days to 45 days within which revised Form X-17A-10 [17 CFR 249.618] must be filed. The extension of time after the close of the calendar year will be reduced from 150 days to 105 days. The Commission proposes these changes in view of the reduced amount of information required by revised Form X-17A-10 [17 CFR 249.618]. In addition, shortening the filing period would result in more timely information being provided to the Commission.

Adopted Form X-17A-10 [17 CFR 249.618] consists of an Introduction and three parts with additional schedules, the schedules to be filed only by certain large brokers and dealers. The Introduction will be filed by all brokers and dealers. Part I of Form X-17A-10 [17 CFR 249.618] will be filed by those brokers and dealers with annual gross revenue related to the securities business of less than \$500,000, approximately 83 percent of all brokers and dealers. Part II of Form X-17A-10 [17 CFR 249.618] will be filed by all brokers and dealers with annual gross revenue related to the securities business of \$500,000 or more. Subsidiary schedules requesting additional information will be filed only by those brokers and dealers with annual gross revenue related to the securities business of ten million dollars or more during the calendar year. Part III of Form X-17A-10 [17 CFR 249.618] will be filed by insurance companies which are registered as brokers and dealers solely for the purpose of selling variable annuities and which are exempted from Rule 15c3-1 [17 CFR 240.15c3-1].

This is the first major revision in Form X-17A-10 [17 CFR 249.618] since the form became mandatory for, calendar year 1969. The purpose Rule 17a-10 [17 CFR 240.17a-10] and the related form is

to provide the Commission with comprehensive financial data on a comparable basis for all segments of the broker-dealer industry. The Commission is required to carry out broad and comprehensive regulatory responsibilities as mandated by the Securities Acts Amendments of 1975. As a result of the introduction of competitive commission rates and the development of a national market system, and because of significant developments impacting the economics of the securities industry, the need for timely and comparable data regarding various segments of the industry continues to be essential.

Copies of amended Form X-17A-10 [17 CFR 249.618] have been filed with the Office of the Federal Register and copies thereof may be obtained on request from the Securities and Exchange Commission, Washington, D.C. 20549.

V. Amendment of Rule 17a-11 [17 CFR 240.17a-11] and Revocation of Form X-17A-11 [17 CFR 249.621]. Rule 17a-11 [17 CFR 240.17a-11] is revised to conform to the new net capital rule by the addition of subparagraph (b) (2) which applies to the alternative method of capital computation. Subparagraph (b) (2) is revised to clarify that a broker or dealer must file a report at the end of the month if a capital computation made at any time during the month indicates that his total net capital is below the minimum requirement. The report to be filed is Part II of Form X-17A-5 [17 CFR 249.617] plus any additional statements which may be required, thus eliminating the need for Form X-17A-11 [17 CFR 249.621].

New paragraph (b) requires any broker or dealer who discovers or who receives notice of a material inadequacy pursuant to paragraph (h) (2) of Rule 17a-5 [17 CFR 240.17a-5] to give telegraphic notice to the Commission and file a corrective plan within forty-eight hours thereafter.

As proposed for comment, paragraph (d) of Rule 17a-11 [17 CFR 240.17a-11] required the broker or dealer to give telegraphic notice only when the independent public accountant has notified the broker or dealer of a material inadequacy. The Commission has determined that a broker or dealer who himself discovers a material inadequacy should also give telegraphic notice pursuant to paragraph (f), and paragraph (d) is amended accordingly.

In addition, Rule 17a-11 [17 CFR 240.17a-11] is amended to require that notice and reports given thereunder shall also be given to the Commodity Futures Trading Commission if such broker or dealer is a member of that Commission.

VI. Amendment of Rule 17a-20 [17 CFR 240.17a-20] and Related Form X-17A-20 [17 CFR 249.636]. Rule 17a-20 [17 CFR 240.17a-20], which was adopted as part of the Commission's program to monitor the impact of competitive commission rates, is amended to reduce the frequency of filing. The Commission has determined that the program's effectiveness will not be decreased by requiring quarterly rather than monthly filing by

all brokers and dealers subject to Rule 17a-20 [17 CFR 240.17a-20].

Paragraph (a) is amended to eliminate from the reporting system certain brokers and dealers who do not derive at least 20 percent of their revenues from securities commissions. Certain technical changes have also been made in order to coordinate the filing requirements with revised Rule 17a-10 [17 CFR 240.17a-10].

As proposed for comment, Rule 17a-20 [17 CFR 240.17a-20] required quarterly filing of current Form X-17A-20 [17 CFR 249.636]. In an effort to further reduce the reporting requirements of brokers and dealers, the Commission has determined that the information required to be reported by Form X-17A-20 [17 CFR 249.636] may be substantially reduced with no detriment to its utility as a monitoring mechanism.

Copies of amended Form X-17A-20 [17 CFR 249.636] have been filed with the Office of the Federal Register and copies thereof may be obtained on request from the Securities and Exchange Commission, Washington, D.C. 20549.

VII. Approval of Plans Filed Pursuant to Paragraph (a) (4) of Rule 17a-5 [17 CFR 240.17a-5], Paragraph (b) of Rule 17a-10 [17 CFR 240.17a-10], and Paragraph (a) (3) of Rule 17a-20 [17 CFR 240.17a-20].—A. Rule 17a-5 [17 CFR 240.17a-5]. Eight self-regulatory organizations have filed plans pursuant to paragraph (a) (4) of Rule 17a-5 [17 CFR 240.17a-5], which would allow brokers or dealers who are members of an exchange or association filing an appropriate plan declared effective by the Commission to dispense with a separate filing of the FOCUS Report to the Commission. The ASE, BSE, CBOE, MSE, NASD, NYSE, PSE, and PBW have agreed to collect directly from their members the information required by the rule thereby eliminating for their member firms a direct filing requirement with the Commission.

The plans contain the following general elements. Part I of the FOCUS Report is to be filed monthly with the designated examining authority by all clearing or carrying firms no later than the tenth business day after the end of the month.¹³

Part II is to be filed each calendar quarter, by clearing or carrying firms, with the designated examining authority no later than the seventeenth business day after the end of the instant

¹³ Introducing firms which are designated members of the NASD would file the Part I monthly for an indefinite period pursuant to the accelerated reporting provisions of paragraph (a) (2) (iv) of Rule 17a-5 [17 CFR 240.17a-5]. NYSE designated members would not file the Part I in months in which the Part II is being filed. Pursuant to paragraph (a) (2) (iv) of Rule 17a-5 [17 CFR 240.17a-5], PSE designated firms which clear or carry the accounts of other broker-dealers will file Part I monthly for a phase-in period of 3 months with further evaluation of a continuing need to be made at the conclusion of that period.

RULES AND REGULATIONS

59711

quarter.¹⁴ A fifth Part II filing would be submitted by the broker or dealer in connection with the annual audit no later than the seventeenth business day after the end of the fiscal or calendar year audit date when such date is other than on a calendar quarter. The plans for the Part IIA are identical to those for the Part II except that the Part IIA will be filed by firms which do not clear nor carry customer accounts.¹⁵

All plans state that accelerated reporting will only be required sparingly when circumstances so dictate in light of the goal of reduced reporting.¹⁶ In addition all such plans (except for the NASD) have, pursuant to paragraph (1) (3) of Rule 17a-5 [17 CFR 240.17a-5], requested conditional exemptions from the FOCUS Report for certain individual members, floor traders, floor brokers and specialists.

The Commission has reviewed the procedures and provisions of the plans including the requests for conditional exemption for certain member firms and, pursuant to paragraph (a) (4) of Rule 17a-5 [17 CFR 240.17a-5], having due regard for the public interest and the protection of investors and the fulfillment of the Commission's functions under the provisions of the Securities Exchange Act of 1934, declares the plans to be effective as of January 1, 1976, the proposed effective date of Rule 17a-5 [17 CFR 240.17a-5] as amended.

B. Rule 17a-10 [17 CFR 240.17a-10]. Eight self-regulatory organizations have filed modifications to existing plans or have for the first time filed plans pursuant to paragraph (b) of Rule 17a-10 [17 CFR 240.17a-10].¹⁷ Paragraph (b) of Rule 17a-10 [17 CFR 240.17a-10] allows brokers or dealers which are members of an exchange or association which files an appropriate plan declared effective by the Commission to dispense with a separate filing of Form X-17A-10 [17 CFR 249.618] to the Commission. The modification of existing Rule 17a-10 [17 CFR 240.17a-10] plans is due to the amendments in Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618] adopted hereinabove, which will require the plans to conform with those amendments.

¹⁴ PSE members which file the quarterly Part II will accompany that filing with their workpapers on proprietary position data for the phase-in period with a review of the continuing need to be made at the conclusion of that period. ASE designated firms will file Part II of January, 1976 as a phase-in period before moving to the general reporting pattern.

¹⁵ Pursuant to paragraph (a) (2) (iv) of Rule 17a-5 [17 CFR 240.17a-5], NYSE designated firms which introduce accounts but have subsidiaries required to consolidated in accordance with Rule 15c3-1 [17 CFR 240.15c3-1] will indefinitely file the quarterly Part II and PSE designated firms which clear or carry accounts for other broker-dealers will file Part II for a first quarter phase-in period with a review of the continuing need to be made at that time.

¹⁶ See notes 14 and 15 *supra* for certain instances where the acceleration power is being invoked.

¹⁷ The ASE, BSE, CBOE, MSE, NASD, NYSE, PSE and PBW.

Under the plans, member firms will be required to file the Form X-17A-10 [17 CFR 249.618] by the new date of 60 days after the close of the calendar year 1975 and 45 days after the close of the calendar year for each calendar year thereafter.¹⁸ All NYSE member firms will file directly with the NYSE; all NASD member firms (other than NYSE member firms) with the NASD; and all sol¹⁹ member firms of regional exchanges with their respective exchanges.

The Commission has reviewed the procedures and provisions of the plans and modifications to existing plans and pursuant to paragraph (b) of Rule 17a-10 [17 CFR 240.17a-10], having due regard for the fulfillment of the Commission's functions under the provisions of the Securities Exchange Act of 1934, declares the plans and modifications to existing plans to be effective as of January 1, 1976, the proposed effective date of the amendments to Rule 17a-10 and related Form X-17A-10 [17 CFR 249.618].

C. Rule 17a-20 [17 CFR 240.17a-20]. The proposed modifications to Rule 17a-20 [17 CFR 240.17a-20] and related Form X-17A-20 [17 CFR 249.636] would reduce the frequency of filing as well as the line item detail of the form. All firms subject to the rule would now report quarterly rather than monthly and reporting would be eliminated for brokers or dealers who do not derive at least 20 percent of their revenues from securities commissions.

The Commission has declared effective plans submitted by the NASD and NYSE pursuant to paragraph (a) (3) of Rule 17a-20 [17 CFR 240.17a-20].²⁰ Due to the amendments to the rule and form described hereinabove, the NASD and NYSE have submitted modifications to their Rule 17a-20 [17 CFR 240.17a-20] plans which incorporate those amendments. NASD member firms subject to the rule would continue to file a separate Form X-17A-20 [17 CFR 249.636]. NYSE member firms will not complete a separate Form X-17A-20 [17 CFR 249.636], but will file a modified Statement of Income (Loss) as part of their quarterly Part II or Part IIA FOCUS Report submission.²¹

The Commission has reviewed the procedures and provisions of the proposed modifications to the plans and, pursuant to paragraph (a) (3) of Rule 17a-20 [17 CFR 240.17a-20], having due regard for the fulfillment of the Commission's functions under the provisions of the Securities Exchange Act of 1934, declares the modifications to the plans to be effective as of the effective date of the amendments to Rule 17a-20 [17 CFR 240.17a-20] and related Form X-17A-20 [17 CFR 249.636].

VIII. Delegation of Authority. Pursuant to subparagraph (1) (3) of Rule 17a-5 [17 CFR 240.17a-5], the Commission

¹⁸ The NASD plan covers the calendar year 1975 only.

¹⁹ Securities Exchange Act Release No. 11395, May 2, 1975, 40 FR 20073, May 8, 1975.

²⁰ All other firms subject to the rule would file directly with the Commission. These would constitute less than 9 firms.

has the power to exempt a broker or dealer, unconditionally or on specified terms and conditions, from all or part of the requirements of that rule. The Commission has amended Rule 30-3(a) (5) of its Rules of General Organization [17 CFR 200.30-3(a) (5)] to delegate to the Director of the Division of Market Regulation and to the Associate Director and Assistant Director of the Office of Broker-Dealer Compliance and Financial Responsibility, the authority to grant exemptions pursuant to Rule 17a-5(1) (3) [17 CFR 240.17a-5(1) (3)].

The FOCUS Report and Amendments to Rule 17a-4, [17 CFR 240.17a-4], Rule 17a-5 [17 CFR 240.17a-5] and related Form X-17A-5 [17 CFR 249.617], Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618], Rule 17a-11 [17 CFR 240.17a-11] and related Form X-17A-11 [17 CFR 249.621], and Rule 17a-20 [17 CFR 240.17a-20] and related Form X-17A-20 [17 CFR 249.636] are effective January 1, 1976. The existing reporting systems of the Commission and of the self-regulatory organizations become obsolete as of January 1, 1976, by virtue of the implementation of amended Rule 15c3-1 [17 CFR 240.15c3-1]; therefore it is essential that the FOCUS Report and the accompanying rule and form amendments be adopted as of that date. As the modifications set forth herein do not substantially alter the rules and forms as proposed, or involve rules of agency organization, procedure or practice, and in light of the fact that the public interest and protection of investors require that effective surveillance and reporting systems be in place as of January 1, 1976, the Commission finds for good cause in accordance with the Administrative Procedure Act (5 U.S.C. 553(b) (3) (A) and (B)), that notice and public procedure are unnecessary as a prerequisite to the adoption of any previously unpublished portions of the FOCUS Report and related rule and form amendments. Further, in order to assure that adequate surveillance and financial reporting systems will continually be in effect, the Commission, pursuant to Section 553(d) (3) of the Administrative Procedure Act (5 U.S.C. 553(d) (3)), finds that there is good cause to declare, and does declare, the adopted amendments to Rule 17a-4 [17 CFR 240.17a-4], Rule 17a-5 [17 CFR 240.17a-5] and related Form X-17A-5 [17 CFR 249.617], Rule 17a-10 [17 CFR 240.17a-10] and related Form X-17A-10 [17 CFR 249.618], Rule 17a-11 [17 CFR 240.17a-11] and related Form X-17A-11 [17 CFR 249.621], and Rule 17a-20 [17 CFR 240.17a-20] and related Form X-17A-20 [17 CFR 249.636] to be effective on January 1, 1976.

IX. Competitive Considerations. The Commission has determined that the FOCUS Report and accompanying rule and form amendments impose no burden on competition not necessary or appropriate in furtherance of the purposes of the Act and are not inconsistent with the public interest or the protection of investors. This determination is based on the reason that the adopted amendments

59712

RULES AND REGULATIONS

to the rules and forms lessen any existing burden on competition by reducing the reporting required and resultant costs of brokers and dealers.

X. *Request for Comments.* Due to the implementation of amended Rule 15c3-1 [17 CFR 240.15c3-1] on January 1, 1976, the financial reporting and surveillance systems of the Commission and the self-regulators will become obsolete. Public interest and the protection of investors therefore appear to require that the FOCUS Report and accompanying rule and form amendments be adopted as efficient in theory, and the form satisfactory in substance, certain modifications may subsequently be necessary in order to achieve a smoother practical application. It is the Commission's view that the areas requiring additional refinement will become apparent after the self-regulators and the brokers and dealers have had several months experience with the FOCUS reporting structure. Therefore, comments are requested on or before March 31, 1976, suggesting the adoption on or before June 30, 1976, of proposed amendments to the FOCUS Report and the accompanying implementation program.

Commentators are requested to consider, in addition to other issues, the following subjects:

- (1) the viability of the format of Part I, Part II and Part IIA of Form X-17A-5 [17 CFR 249.617], and suggested additions or deletions thereto;
- (2) the appropriateness of filing frequencies of Part I, Part II and Part IIA of Form X-17A-5 [17 CFR 249.617];
- (3) the feasibility of further combining Form X-17A-5 [17 CFR 249.617], Form X-17A-10 [17 CFR 249.618] and Form X-17A-20 [17 CFR 249.636] in order to effect a greater reduction in reporting requirements;
- (4) possible alternative means by which the annual audit requirements, the collection of surveillance material and the collection of economic data on a comparable time basis for all brokers and dealers may be achieved;
- (5) the effectiveness of the revised annual audit report format and accompanying changes to Rule 17a-5 [17 CFR 240.17a-5] and Rule 17a-11 [17 CFR 240.17a-11]; and
- (6) the appropriateness of requiring municipal securities brokers and dealers to be subject to the FOCUS reporting structure.

Interested persons should submit their comments in writing on or before March 31, 1976. All such communications should be directed to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549. Comments should refer to File No. S7-594 and will be available for public inspection.

(Secs. 2, 6, 10, 15, 17, 23, 48 Stat. 881, 885, 891, 895, 897, 901 (15 U.S.C. 78b, 78f, 78j, 78o, 78q, 78w) as amended by Secs. 2, 4, 11, 14, 18, Pub. L. 94-29).

By the Commission

[SEAL] GEORGE A. FITZSIMMONS,
Secretary.

DECEMBER 17, 1975.

PART 200—ORGANIZATION, CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. Commission action: Pursuant to section 23 of the Securities Exchange Act of 1934, the Securities and Exchange Commission amends § 200.30-3 in Chapter II of Title 17 of the Code of Federal Regulations by revising the introductory paragraph and (a) (5) to read as follows:

§ 200-30-3 Delegation of authority to Director of Division of Market Regulation.

Pursuant to the provisions of Public Law No. 87-592, 76 Stat. 394. (15 U.S.C. 78d-1, 78d-2), the Securities and Exchange Commission hereby delegates, until the Commission orders otherwise, the following functions to the Director of the Division of Market Regulation to be performed by him or under his direction by such person or persons as may be designated from time to time by the Chairman of the Commission:

- (a) * * *
- (5) Pursuant to Rule 17a-5(1)(3) (§ 240.17a-5(1)(3) of this chapter), to consider applications, by brokers and dealers for exemptions from, and extension of time within which to file, reports required by Rule 17a-5 (§ 240.17a-5 of this chapter), and to grant, and to authorize the issuance of orders denying, such applications provided such applicant is advised of his right to have such denial reviewed by the Commission.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. Commission action: Pursuant to sections 2, 10, 15, 17(a), 17(e) and 23(a) of the Securities Exchange Act of 1934, the Securities and Exchange Commission amends § 240.17a-4 in Chapter II of Title 17 of the Code of Federal Regulations by revising paragraph (b) (8) to read as follows:

§ 240.17a-4 Records to be preserved by certain brokers and dealers.

- (b) * * *
- (8) Records which contain the following information in support of amounts included in reports on Form X-17A-5 (§ 249.617 of this chapter) Part II or Part IIA and in annual audited financial statements required by § 240.17a-5:
 - (i) money balance position, long or short, including description, quantity, price and valuation of each security including contractual commitments in customers' accounts, in cash and fully secured accounts, partly secured accounts, unsecured accounts, and in securities accounts payable to customers;
 - (ii) money balance and position, long or short, including description, quantity, price and valuation of each security including contractual commitments in non-customers' accounts, in cash and fully secured accounts, partly secured and unsecured accounts, and in securities accounts payable to non-customers;
 - (iii) position, long or short, including description, quantity, price and valuation of each security including con-

tractual commitments included in the Computation of Net Capital as commitments, securities owned, securities owned not readily marketable, and other investments owned not readily marketable;

(iv) amount of secured demand note, description, of collateral securing such secured demand note including quantity, price and valuation of each security and cash balance securing such secured demand note;

(v) description of futures commodity contracts, contract value on trade date, market value, gain or loss, and liquidating equity or deficit in customers' and non-customers' accounts;

(vi) description of futures commodity contracts, contract value on trade date, market value, gain or loss and liquidating equity or deficit in trading and investment accounts;

(vii) description, money balance, quantity, price and valuation of each spot commodity position or commitments in customers' and non-customers' accounts;

(viii) description, money balance, quantity, price and valuation of each spot commodity position or commitments in trading and investment accounts;

(ix) number of shares, description of security, exercise price, cost and market value of put and call options including short out of the money options having no market or exercise value, showing listed and unlisted put and call options separately;

(x) quantity, price, and valuation of each security underlying the haircut for undue concentration made in the Computation for Net Capital;

(xi) description, quantity, price and valuation of each security and commodity position or contractual commitment, long or short, in each joint account in which the broker or dealer has an interest, including each participant's interest and margin deposit;

(xii) description, settlement date, contract amount, quantity, market price, and valuation for each aged failed to deliver requiring a charge in the Computation of Net Capital pursuant to § 240.15c3-1;

(xiii) detail relating to information for possession or control requirements under § 240.15c3-3 and reported on the schedule in Part II or IIA of Form X-17A-5 (§ 249.617 of this chapter);

(xiv) detail of all items, not otherwise substantiated, which are charged or credited in the Computation of Net Capital pursuant to § 240.15c3-1, such as cash margin deficiencies, deductions related to securities values and undue concentration, aged securities differences and insurance claims receivable; and

(xv) other schedules which are specifically prescribed by the Commission as necessary to support information reported as required by § 240.17a-5.

2. Commission action: Pursuant to sections 2, 10, 15, 17(a), 17(e) and 23 of the Securities Exchange Act of 1934, the Securities and Exchange Commission revises § 240.17a-5 in Chapter II of Title 17 of the Code of Federal Regulations to read as follows:

RULES AND REGULATIONS

59713

§ 240.17a-5 Reports to be made by certain brokers and dealers.

(a) *Filing of Monthly and Quarterly Reports.* (1) This paragraph (a) shall apply to every broker or dealer registered pursuant to Section 15 of the Act.

(2) (i) Every broker or dealer subject to this paragraph (a) who clears or carries customer accounts shall file Part I of Form X-17A-5 (§ 249.617 of this chapter) within 10 business days after the end of each month.

(ii) Every broker or dealer subject to this paragraph (a) who clears or carries customer accounts shall file Part II of Form X-17A-5 (§ 249.617 of this chapter) within 17 business days after the end of the calendar quarter and within 17 business days after the date selected for the annual audit of financial statements where said date is other than a calendar quarter. Certain of such brokers or dealers shall file Part IIA in lieu thereof if the nature of their business is limited as described in the instructions to Part II of Form X-17A-5 (§ 249.617 of this chapter).

(iii) Every broker or dealer who does not carry nor clear customer accounts shall file Part IIA of Form X-17A-5 (§ 249.617 of this chapter) within 17 business days after the end of each calendar quarter and within 17 business days after the date selected for the annual audit of financial statements where said date is other than the end of the calendar quarter.

(iv) Upon receiving written notice from the Commission or the examining authority designated pursuant to Section 17(d) of the Act, a broker or dealer who receives such notice shall file monthly, or at such times as shall be specified, Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) and such other financial or operational information as shall be required by the Commission or the designated examining authority.

(3) The reports provided for in this paragraph (a) shall be considered filed when received at the Commission's principal office in Washington, D.C. and the regional office of the Commission for the region in which the broker or dealer has its principal place of business. Except as provided for in paragraph (e)(3), such reports shall be available for examination at the principal office of the broker or dealer.

(4) The provisions of subparagraphs (2) and (3) of paragraph (a) shall not apply to a member of a national securities exchange or a registered national securities association if said exchange or association maintains records containing the information required by Part I, Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter), as to such member, and transmits to the Commission a copy of the applicable parts of Form X-17A-5 (§ 249.617 of this chapter) as to such member, pursuant to a plan, the procedures and provisions of which have been submitted to and declared effective by the Commission. Any such plan filed by a national securities exchange or a registered national securities

association may provide that when a member is also a member of one or more national securities exchanges, or of one or more national securities associations, the information required to be submitted with respect to any such member may be submitted by only one specified national securities exchange or registered national securities association. For the purposes of this section, a plan filed with the Commission by a national securities exchange or a registered national securities association shall not become effective unless the Commission, having due regard for the fulfillment of the Commission's duties and responsibilities under the provisions of the Act, declares the plan to be effective. Further, the Commission, in declaring any such plan effective, may impose such terms and conditions relating to the provisions of the plan and the period of its effectiveness as may be deemed necessary or appropriate in the public interest, for the protection of investors, or to carry out the Commission's duties and responsibilities under the Act.

(b) *Report Filed Upon Termination of Membership Interest.* (1) If a broker or dealer holding any membership interest in a national securities exchange ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission Part II of Form X-17A-5 (§ 249.617 of this chapter) as of the date of such event.

The report shall be filed at the Commission's principal office in Washington, D.C., and with the regional office of the Commission for the region in which the broker or dealer has its principal place of business: *Provided, however,* That such report need not be made or filed if the Commission, upon written request or upon its own motion, exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement: *Provided, further,* That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by subparagraph (1) of this paragraph shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the broker or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by the chief executive officer, or, in his absence, by the person authorized to act in his place.

(3) For the purposes of this paragraph (b) "membership interest" shall include the following: full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(4) For the purposes of this paragraph (b), any broker or dealer shall be

deemed to have ceased to be a member in good standing of such exchange when he has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker's or dealer's membership interest in such exchange.

(5) Whenever any national securities exchange takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event, and shall send a copy of such notification to the broker or dealer and notify such broker or dealer of his responsibilities under this paragraph (b).

(c) *Customer Statements.*—(1) *Who must furnish the statements.* Every broker or dealer shall file with the Commission at its principal office in Washington, D.C., with the regional office of the Commission for the region in which the broker or dealer has its principal place of business, and with each national securities exchange and registered national securities association of which it is a member, and shall send to its customers the statements prescribed by subparagraphs (2) and (3) of this paragraph (c), except if the activities of such broker or dealer are limited to any one or combination of the following and are conducted in the manner prescribed herein:

(i) As introducing broker or dealer, the forwarding of all the transactions of his customers to a clearing broker or dealer on a fully disclosed basis: *Provided,* That such clearing broker or dealer reflects such transactions on its books and records in accounts it carries in the names of such customers and that the introducing broker or dealer does not hold funds or securities for, or owe funds or securities to, customers other than funds and securities promptly forwarded to the clearing broker or dealer or to customers;

(ii) The prompt forwarding of subscriptions for securities to the issuer, underwriter or other distributor of such securities and of receiving checks, drafts, notes, or other evidences of indebtedness payable solely to the issuer, underwriter or other distributor who delivers the security directly to the subscriber or to a custodian bank, if the broker or dealer does not otherwise hold funds or securities for, or owe money or securities to, customers;

(iii) The sale and redemption of redeemable shares of registered investment companies or the solicitation of share accounts of savings and loan associations in the manner contemplated by the \$2,500 minimum net capital requirement

RULES AND REGULATIONS

59714

of § 240.15c3-1 or the offering to extend any credit to or participate in arranging a loan for a customer to purchase insurance in connection with the sale of redeemable shares of registered investment companies; or

(iv) Conduct which would exempt the broker or dealer from the provisions of § 240.17a-13 by reason of the provisions of paragraph (a) of that section.

(2) *Audited statements to be furnished.* The following statements shall be sent to customers within 45 days after the broker or dealer files with the Commission the information required by paragraph (d):

(i) A balance sheet with appropriate notes prepared in accordance with generally accepted accounting principles which shall be audited if the financial statements furnished in accordance with paragraph (d) of this section are required to be certified;

(ii) A footnote containing a statement of the amount of the broker's or dealer's net capital and its required net capital, computed in accordance with § 240.15c3-1. Such statement shall include summary financial statements of subsidiaries consolidated pursuant to Appendix C of § 240.15c3-1, where material, and the effect thereof on the net capital and required net capital of the broker or dealer;

(iii) If, in connection with the most recent annual audit report pursuant to § 240.17a-5, the independent accountant commented on any material inadequacies in accordance with paragraphs (g) and (h) and § 240.17a-11(d), there shall be a statement by the broker or dealer that a copy of such report and comments is currently available for the customer's inspection at the principal office of the Commission in Washington, D.C., and the regional office of the Commission for the region in which the broker or dealer has its principal place of business; and

(iv) A statement indicating that the Statement of Financial Condition of the most recent annual audit report of the broker or dealer pursuant to § 240.17a-5 is available for examination at the principal office of the broker or dealer and at the regional office of the Commission for the region in which the broker or dealer has its principal place of business.

(3) *Unaudited statements to be furnished.* The statements shall contain the information specified in subparagraphs (c) (2) (i) and (ii). Said unaudited statements shall be as of the date 6 months from the date of the audited statements required to be furnished pursuant to subparagraphs (c) (1) and (2) and shall be furnished not later than six months after the date that the audited statements required by subparagraph (c) (2) were furnished.

(4) *Definition of "customer."* For purposes of this paragraph (c), the term "customer" includes any person other than: (i) another broker or dealer who is exempted by subparagraph (c) (1); (ii) a general, special or limited partner or director or officer of a broker or dealer; or (iii) any person to the extent that such person has a claim for property or

funds which by contract, agreement or understanding, or by operation of law, is part of the capital of the broker or dealer or is subordinated to the claims of creditors of the broker or dealer, for or with whom a broker or dealer has effected a securities transaction in a particular month, which month shall be either the month preceding the balance sheet date or the month following the balance sheet date in which the statement is sent. The term "customer" also includes any person for whom the broker or dealer holds securities for safekeeping or as collateral or for whom the broker or dealer carries a free credit balance in the month in which customers are determined for purposes of this paragraph (c).

(d) *Annual Filing of Audited Financial Statements.* (1) (i) Every broker or dealer registered pursuant to Section 15 of the Act shall file annually, on a calendar or fiscal year basis, a report which shall be audited by an independent public accountant. Reports pursuant to this paragraph (d) shall be as of the same fixed or determinable date each year unless a change is approved by the Commission.

(ii) A broker or dealer succeeding to and continuing the business of another broker or dealer need not file a report under this paragraph as of a date in the fiscal or calendar year in which the succession occurs if the predecessor broker or dealer has filed a report in compliance with this paragraph as of a date in such fiscal or calendar year.

(iii) A broker or dealer who has not transacted a business in securities directly with or for other than members of a national securities exchange, and has not carried any margin account, credit balance or security for any person who is defined as a "customer" in paragraph (c) (4) of this section, shall not be required to file a report under this paragraph.

(2) The annual audited report shall contain a Statement of Financial Condition (in a format and on a basis which is consistent with the totals reported on the Statement of Financial Condition contained in Form X-17A-5 (§ 249.617 of this chapter), Part II or Part IIA), a Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and a Statement of Changes in Liabilities Subordinated to Claims of General Creditors. Such statements shall be in a format which is consistent with such statements as contained in Form X-17A-5 (§ 249.617 of this chapter) Part II or Part IIA.

(3) Supporting schedules shall include, from Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) a Computation of Net Capital Under § 240.15c3-1, a Computation for Determination of the Reserve Requirements under Exhibit A of § 240.15c3-3 and Information Relating to the Possession or Control Requirements Under § 240.15c3-3 and shall be filed with said report.

(4) A reconciliation, including appropriate explanations, of the Computation of Net Capital under § 240.15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit

A of § 240.15c3-3 in the audit report with the broker's or dealer's corresponding unaudited most recent Part II or Part IIA filing shall be filed with said report when material differences exist. If no material differences exist, a statement so indicating shall be filed.

(5) The annual audit report shall be filed not more than sixty (60) days after the date of the financial statements.

(6) The annual audit report shall be filed at the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the Commission's principal office in Washington, D.C., and the principal office of the designated examining authority for said broker or dealer. Copies thereof shall be provided to all self-regulatory organizations of which said broker or dealer is a member.

(e) *Nature and form of reports.* The financial statements filed pursuant to paragraph (d) of this section shall be prepared and filed in accordance with the following requirements:

(1) (i) An audit shall be conducted by a certified public accountant who shall be in fact independent as defined in paragraph (f) (3) herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d): *Provided, however,* That the financial statements filed pursuant to paragraph (d) need not be audited if, since the date of the previous financial statements of the report filed pursuant to § 240.15b1-2 or this section: (a) the securities business of such broker or dealer has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (b) its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance or security for any securities customer.

(ii) A broker or dealer who files a report which is not covered by an accountant's opinion shall include in the oath or affirmation required by paragraph (e) (2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the requirement that financial statements and schedules filed pursuant to paragraph (d) be covered by the opinion of an accountant.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, the financial statements and schedules are true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the broker or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partner-

RULES AND REGULATIONS

59715

ship, by a general partner; or if a corporation, by a duly authorized officer.

(3) All of the statements filed pursuant to paragraph (d) shall be public, except that, if the Statement of Financial Condition in a format which is consistent with Form X-17A-5 (§ 249.617 of this chapter), Part II or Part IIA, is bound separately from the balance of the annual audited financial statements filed pursuant to subparagraph (d)(1), the balance of the annual audited financial settlements shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any State, by national securities exchanges and registered national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this subparagraph (3) shall be deemed to be in derogation of the rules of any registered national securities association or national securities exchange which give to customers of a member broker or dealer the right, upon request to such member broker or dealer, to obtain information relative to its financial condition.

(4) The broker or dealer shall file with the report a supplemental report which shall be covered by an opinion of the independent public accountant on the status of the membership of the broker or dealer in the Securities Investor Protection Corporation ("SIPC") if, pursuant to subparagraph (c)(1), a report of the broker or dealer is required to be covered by an opinion of a certified public accountant or a public accountant who is in fact independent. The supplemental report shall cover the SIPC annual general assessment reconciliation or exclusion from membership forms not previously reported on under this subparagraph (4) which were required to be filed on or prior to the date of the report required by paragraph (b) of this section. The supplemental report, which shall be submitted in triplicate original to the regional office of the Commission for the region in which the broker or dealer has its principal place of business, be bound separately, be dated and be signed manually, shall include the following:

(i) A schedule of assessment payments also showing any overpayments applied and overpayments carried forward including: payment dates, amounts, and name of SIPC collection agent to whom mailed, or

(ii) If exclusion from membership was claimed, a statement that the broker or dealer qualified for exclusion from membership under the Securities Investor Protection Act of 1970, and the date and name of the SIPC collection agent with whom a Certification of Exclusion from Membership (Form SIPC-3) was filed, and

(iii) An accountant's report which shall state that in the accountant's opinion either the assessments were determined fairly in accordance with applicable instructions and forms, or that

a claim for exclusion from membership was consistent with income reported. If exceptions are noted, the accountant shall state any corrective action taken or proposed. The accountant's review on which his report is based shall include as a minimum the following procedures:

(A) Comparison of listed assessment payments with respective cash disbursements record entries;

(B) For calendar year 1975 or preceding years, comparison of amounts reflected in Form X-17A-10 (§ 249.618 of this chapter) with amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7);

(C) For all or any portion of a fiscal year ending in 1976 and each fiscal year thereafter, comparison of amounts reflected in Form X-17A-5 (§ 249.617 of this chapter) as required by paragraph (b) of this section, with amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7);

(D) Comparison of adjustments reported in Form SIPC-7 with supporting schedules and working papers supporting adjustments;

(E) Proof of arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the schedules and working papers supporting adjustments; and

(F) Comparison of the amount of any overpayment applied with the Form SIPC-7 on which it was computed; or

(G) If exclusion from membership is claimed, the accountant shall review Form X-17A-10 (§ 249.618 of this chapter) for calendar year 1975 or preceding years, Form X-17A-5 (§ 249.617 of this chapter) for all or any portion of a fiscal year ending in 1976 and each fiscal year thereafter to ascertain that the Certification of Exclusion from Membership (Form SIPC-3) was consistent with the income reported.

(f)(1) *Qualification of accountants.* The Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of his place of residence or principal office.

(2) *Designation of accountant.* Every broker or dealer subject to this section shall file no later than December 10 of each year a statement with the Commission's principal office in Washington, D.C., the regional office of the Commission for the region in which its principal place of business is located, and the principal office of the designated examining authority for such broker or dealer. Such statement shall indicate the existence of an agreement dated no later than December first, with an independent public accountant covering a contractual commitment to conduct the broker's or dealer's annual audit during the following calendar year.

The agreement may be of a continuing nature, providing for successive yearly audits, in which case no further filing is required. If the agreement is for a single audit, or if the continuing agreement previously filed has been terminated or amended, a new statement must be filed by the required date.

The statement shall be headed "Notice pursuant to Rule 17a-5(f)(2)" and shall contain the following information: (i) name, address, telephone number and registration number of the broker or dealer; (ii) name, address and telephone number of the accounting firm; and (iii) the audit date of the broker or dealer for the year covered by the agreement.

(3) *Independence of accountant.* An accountant shall be independent in accordance with the provisions of § 210.2-01(b) and (c) of this chapter.

(4) *Replacement of accountant.* A broker or dealer shall file a notice which must be received by the Commission's principal office in Washington, D.C., the regional office of the Commission for the region in which its principal place of business is located, and the principal office of the designated examining authority for such broker or dealer, not more than 15 business days after:

(i) The broker or dealer has notified the accountant whose opinion covered the most recent financial statements filed under paragraph (d) of this section that his services will not be utilized in future engagements; or

(ii) The broker or dealer has notified an accountant who was engaged to give an opinion covering the financial statements to be filed under paragraph (d) that the engagement has been terminated; or

(iii) An accountant has notified the broker or dealer that he would not continue under an engagement to give an opinion covering the financial statements to be filed under paragraph (d); or

(iv) A new accountant has been engaged to give an opinion covering the financial statements to be filed under paragraph (d) without any notice of termination having been given to or by the previously engaged accountant.

Such notice shall state (a) the date of notification of the termination of the engagement or engagement of the new accountant as applicable and (b) the details of any problems existing during the 24 months (or the period of, the engagement, if less) preceding such termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure, or compliance with applicable rules of the Commission, which problems, if not resolved to the satisfaction of the former accountant, would have caused him to make reference to them in connection with his report on the subject matter of the problems. The problems required to be reported in response to the preceding sentence include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Problems contemplated by this section are those which occur at the decisionmaking level—i.e., between principal financial officers of the broker-dealer and personnel of the accounting firm responsible for rendering its report. The notice shall also state whether the accountant's report on the financial statements for any of the past

59716

RULES AND REGULATIONS

two years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles, and describe the nature of each such adverse opinion, disclaimer of opinion, or qualification. The broker or dealer shall also request the former accountant to furnish the broker or dealer with a letter addressed to the Commission stating whether he agrees with the statements contained in the notice of the broker or dealer and, if not, stating the respects in which he does not agree. The broker or dealer shall file three copies of the notice and the accountant's letter, one copy of which shall be manually signed by the sole proprietor, or a general partner or a duly authorized corporate officer, as appropriate, and by the accountant, respectively.

(g) *Audit objectives.* (1) The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. The audit shall include all procedures necessary under the circumstances to enable the independent public accountant to express an opinion on the statement of financial condition, results of operations, changes in financial position, and the Computation of Net Capital under § 240.15c3-1, the Computation for Determination of Reserve Requirements for Brokers or Dealers under Exhibit A of § 240.15c3-3, and Information Relating to the Possession or Control Requirements under § 240.15c3-3. The scope of the audit and review of the accounting system, the internal control and procedures for safeguarding securities shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (a) the accounting system; (b) the internal accounting controls; (c) procedures for safeguarding securities; and (d) the practices and procedures whose review is specified in (i), (ii), (iii) and (iv) of this paragraph would be disclosed. Additionally, as specific objectives, the audit shall include reviews of the practices and procedures followed by the client:

- (i) in making the periodic computations of aggregate indebtedness and net capital under § 240.17a-3(a)(11) and the reserve required by § 240.15c3-3(e);
- (ii) in making the quarterly securities examinations, counts, verifications and comparisons and the recordation of differences required by § 240.17a-13;
- (iii) in complying with the requirement for prompt payment for securities of Section 4(c) of Regulation T (§ 220.4(c) of Chapter II of Title 12) of the Board of Governors of the Federal Reserve System; and
- (iv) in obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by § 240.15c3-3.

(2) If the broker or dealer is exempt from § 240.15c3-3, the independent public accountant shall ascertain that the con-

ditions of the exemption were being complied with as of the examination date and that no facts came to his attention to indicate that the exemption had not been complied with during the period since his last examination.

(3) A material inadequacy in the accounting system, internal accounting controls, procedures for safeguarding securities, and practices and procedures referred to above which is expected to be reported under these audit objectives includes any condition which has contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to (i) inhibit a broker or dealer from promptly completing securities transactions or promptly discharging his responsibilities to customers, other broker-dealers or creditors; (ii) result in material financial loss; (iii) result in material misstatements of the broker's or dealer's financial statements; or (iv) result in violations of the Commission's recordkeeping or financial responsibility rules to an extent that could reasonably be expected to result in the conditions described in parts (i), (ii), or (iii) of this subparagraph (3).

(h) *Extent and Timing of Audit Procedures.* (1) The extent and timing of audit procedures are matters for the independent public accountant to determine on the basis of his review and evaluation of existing internal controls and other audit procedures performed in accordance with generally accepted auditing standards and the audit objectives set forth in paragraph (g) above. In determining the extent of testing, consideration shall be given to the materiality of an area and the possible effect on the financial statements and schedules of a material misstatement in a related account. The performance of auditing procedures involves the proper synchronization of their application and thus comprehends the need to consider simultaneous performance of procedures in certain areas such as, for example, securities counts, transfer verification and customer and broker confirmation in connection with verification of securities positions.

(2) If, during the course of the audit or interim work, the independent public accountant determines that any material inadequacies exist in the accounting system, internal accounting control, procedures for safeguarding securities, or as otherwise defined in subparagraph (g)(3), then he shall call it to the attention of the chief financial officer of the broker or dealer, who shall have a responsibility to inform the Commission and the designated examining authority by telegraphic notice within 24 hours thereafter as set forth in paragraphs (d) and (f) of § 240.17a-11. The broker or dealer shall also furnish the accountant with a copy of said notice to the Commission by telegraphic communication within said 24 hour period. If the accountant fails to receive such notice from the broker or dealer within said 24 hour period, or if he disagrees with the statements contained in the notice of the broker or dealer, the accountant shall

have a responsibility to inform the Commission and the designated examining authority by report of material inadequacy within 24 hours thereafter as set forth in paragraph (f) of § 240.17a-11. Such report from the accountant shall, if the broker or dealer failed to file a notice, describe any material inadequacies found to exist. If the broker or dealer filed a notice, the accountant shall file a report detailing the aspects, if any, of the broker's or dealer's notice with which the accountant does not agree.

(i) *Accountant's reports, general provisions.*—(1) *Technical requirements.* The accountant's report shall: (i) be dated; (ii) be signed manually; (iii) indicate the city and state where issued; and (iv) identify without detailed enumeration the financial statements and schedules covered by the report.

(2) *Representations as to the audit.* The accountant's report shall: (i) state whether the audit was made in accordance with generally accepted auditing standards; (ii) state whether the accountant reviewed the procedures followed for safeguarding securities; and (iii) designate any auditing procedures deemed necessary by the accountant under the circumstances of the particular case which have been omitted, and the reason for their omission.

Nothing in this section shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required under this section.

(3) *Opinion to be expressed.* The accountant's report shall state clearly the opinion of the accountant: (i) in respect of the financial statements and schedules covered by the report and the accounting principles and practices reflected therein; and (ii) as to the consistency of the application of the accounting principles, or as to any changes in such principles which have a material effect on the financial statements.

(4) *Exceptions.* Any matters to which the accountant takes exception shall be clearly identified, the exception thereto specifically and clearly stated, and, to the extent practicable, the effect of each such exception on the related financial statements given.

(5) *Definitions.* For the purpose of this section, the terms "audit" (or "examination"), "accountant's report," and "certified" shall have the meanings given in § 210.1-02 of this chapter.

(j) *Accountant's report on material inadequacies.*

The broker or dealer shall file concurrently with the annual audit report a supplemental report by the accountant describing any material inadequacies found to exist or found to have existed since the date of the previous audit. The supplemental report shall indicate any corrective action taken or proposed by the broker or dealer in regard thereto. If the audit did not disclose any material inadequacies, the supplemental report shall so state.

RULES AND REGULATIONS

59717

(k) *Use of certain statements filed with the Securities and Exchange Commission.* At the request of any broker or dealer who is (i) an investment company registered under the Investment Company Act of 1940, or (ii) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept the financial statements filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 or Section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to paragraph (d) of this section. Such a filing shall be deemed to satisfy the requirements of this section for any calendar year in which such financial statements are filed, provided that the statements so filed meet the requirements of the other rules under which they are filed with respect to time of filing and content.

(1) *Extensions and Exemptions.* (1) (a) In the event any broker or dealer finds that it cannot file its report for any year within the time specified in paragraph (d) of this section without undue hardship, it may file with the Commission's principal office in Washington, D.C. and the appropriate regional office as specified in subparagraph (d) (6), an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. Notice of such application shall be sent to the designated examining authority. The application shall be made by the broker or dealer and shall:

(i) state the reasons for the requested extension;

(ii) indicate that the inability to make a timely filing is due to circumstances beyond the control of the broker or dealer if such is the case, and describe briefly the nature of such circumstance;

(iii) indicate if the broker or dealer is in violation of the net capital requirements specified in § 240.15c3-1 or the requirements of § 240.15c3-3, or has any significant financial or recordkeeping problems;

(iv) contain an agreement to file the report on or before the date specified by the broker or dealer in the application; and

(v) be received by the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the Commission's principal office in Washington, D.C. and the principal office of the designated examining authority prior to the date upon which the report is due.

(vi) be accompanied by a letter from the independent public accountant answering the following questions:

(A) What specifically are the reasons for the extension request?

(B) On the basis of that part of your audit to date, do you have an indication that may cause you to consider commenting on any material inadequacies in the accounting system, internal ac-

counting control and procedures for safeguarding securities?

(C) Do you have any indication from that part of your audit completed to date that would lead you to believe that the condition of the firm's records is endangering its ability to supervise its registered representatives and their handling of customer accounts.

(D) Do you have any indication from that part of your audit completed to date that would lead you to believe that the firm is in violation of the net capital requirements specified in § 240.15c3-1 or the requirements of § 240.15c3-3, or has any significant financial or recordkeeping problems?

(b) Within 10 calendar days after the request for extension of time has been received by the appropriate regional office as specified in subparagraph (d) (6), the regional office shall:

(i) notify the broker or dealer and its designated examining authority of the grant or denial of the requested extension; or

(ii) indicate to the broker or dealer that additional time is required to satisfactorily analyze the request, in which case the amount of time needed shall be specified.

(2) Any "bank" as defined in section 3 (a) (6) of the Act (48 Stat. 882; 15 U.S.C. 78c) and any "insurance company" as defined in Section 3(a) (19) of the Act (78 Stat. 565; 15 U.S.C. 78c) registered as a broker or dealer to sell variable contracts but exempt from § 240.15c3-1 shall be exempt from the provisions of this section.

(3) On written request of any national securities exchange, registered national securities association, broker or dealer, or on its own motion, the Commission may grant an extension of time or an exemption from any of the requirements of this section either unconditionally or on specified terms and conditions.

(m) *Notification of change of fiscal year.* In the event any broker or dealer finds it necessary to change its fiscal year it must file, with the Commission's principal office in Washington, D.C., the regional office of the Commission for the region in which the broker or dealer has its principal place of business, and the principal office of the designated examining authority for such broker or dealer, a notice of such change.

Such notice shall contain a detailed explanation of the reasons for the change, and indicate whether the filing of the annual audit report will be delayed as a result thereof. If the filing of the audit report will be delayed, the broker or dealer shall include in the notice the representations required by subparagraph (a) (1) of paragraph (1).

(n) *Filing Requirements.* For purposes of filing requirements as described in § 240.17a-5, such filing shall be deemed to have been accomplished upon receipt at the Commission's principal office in Washington, D.C., with duplicate originals simultaneously filed at the locations prescribed in the particular paragraph of § 240.17a-5 which is applicable.

3. Commission action: Pursuant to section 2, 6(e), 17(a) and 23 (a) and (b) of the Securities Exchange Act of 1934, the Securities and Exchange Commission amends § 240.17a-10 in Chapter II of Title 17 of the Code of Federal Regulations by revising paragraphs (a), (d) and (e) to read as follows:

§ 240.17a-10 Report of revenue and expenses.

(a) Every broker or dealer registered pursuant to Section 15 of the Act shall, not later than 45 days after the close of each calendar year (commencing with the calendar year 1975), file a report of his revenue and expenses, and related financial and other information for such calendar year on Form X-17A-10 (§ 249.618 of this chapter). Brokers or dealers required to complete Part III only or Schedules A through D shall file Form X-17A-10 (§ 249.618 of this chapter) not later than 60 days after the close of each calendar year.

(d) In the event any broker or dealer finds that he cannot file his report for any year within the time specified in paragraph (a) of this section without undue hardship, he may file with the Commission's principal office in Washington, D.C. an application for an extension of time to a specified date which shall not be later than 105 days after the close of the calendar year for which the report is to be made. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date.

(e) Notwithstanding the time limits for filing established by paragraph (a) of this section any broker or dealer who is subject to said paragraph (a) of this section shall file a report of his revenue and expenses and related financial and other information on Form X-17A-10 (§ 249.618 of this chapter) for calendar year 1975 not later than 60 days after the close of the calendar year.

4. Commission action: Pursuant to Sections 2, 10, 15, 17(a) and 23(a) of the Securities Exchange Act of 1934, the Securities and Exchange Commission revises § 240.17a-11 in Chapter II of Title 17 of the Code of Federal Regulations to read as follows:

§ 240.17a-11 Supplemental current financial and operational reports to be made by certain brokers and dealers.

(a) Every broker or dealer subject to § 240.15c3-1, whose net capital at any time is less than the minimum required by any capital rule to which such person is subject, shall:

(1) Give telegraphic notice as set forth in paragraph (f) of this section that such person's net capital is less than is required by any such capital rule, identifying the applicable net capital rule or rules. The notice shall be given on the same day that such person's capital becomes less than required by any of the aforesaid rules to which such person is subject; and

(2) Within 24 hours thereafter file Part II of Form X-17A-5 (§ 249.617 of this chapter) and such supplementary information as may be required.

(b)(1) If a computation made by a broker or dealer pursuant to the requirements of § 240.15c3-1(c) shows, at any point during the month, that his aggregate indebtedness is in excess of 1,200 per centum of his net capital, or that his total net capital is less than 120 per centum of the minimum net capital required of him, such person shall file a report on Part II of Form X-17A-5 (§ 249.617 of this chapter) within 15 calendar days after the end of the month for which such computation was required to be made, and within 15 calendar days after the end of each month thereafter until 3 successive months shall have elapsed during which his aggregate indebtedness does not exceed 1,200 per centum of his net capital, and his total net capital does not fall below 120 per centum of the minimum net capital required of him.

(2) If a computation made by a broker or dealer pursuant to § 240.15c3-1(f) shows, at any point during the month, that his net capital is less than 6 percent of aggregate debit items computed in accordance with § 240.15c3-3 Exhibit A: Formula for the Determination of Reserve Requirements, or that his total net capital is less than 120 per centum of the minimum net capital required of him, such broker or dealer shall file a report on Part II of Form X-17A-5 (§ 249.617 of this chapter) within 15 calendar days after the end of the month for which such computation is made, and within 15 days after the end of each month thereafter until three successive months shall have elapsed during which his net capital is not less than six percent of aggregate debit items computed in accordance with § 240.15c3-3 Exhibit A, and his total net capital does not fall below

120 per centum of the minimum net capital required of him.

(c) At any time when a broker or dealer subject to § 240.17a-3 fails to make and keep current the books and records specified therein, he shall immediately give telegraphic notice of such fact, specifying the books and records which have not been made or which are not current, and within 48 hours of the telegraphic notice file a report stating what steps have been and are being taken to correct the situation.

(d) Whenever any broker or dealer discovers, or is notified by an independent public accountant, pursuant to paragraph (h)(2) of § 240.17a-5 of the existence of any material inadequacy as defined in paragraph (g) of § 240.17a-5, said broker or dealer shall give telegraphic notice of such material inadequacy within 24 hours, and within 48 hours of the telegraphic notice file a report stating what steps have been and are being taken to correct the situation.

(e) Whenever any national securities exchange or national securities association learns that a member broker or dealer has failed to file a notice or file a report as required by paragraph (a), (b), (c) or (d) of this section, such organization shall immediately report such failure as provided in paragraph (f) of this section.

(f) Every notice and report required to be given or filed by this section shall be given to or filed with the principal office of the Commission in Washington, D.C., with the regional office of the Commission for the region in which the broker or dealer has its principal place of business, with the designated examining authority of which such broker or dealer is a member, and with the Commodity Futures Trading Commission if such broker or dealer is a member of such Commission.

5. Commission action: Pursuant to Sections 2, 6(e), 17(a) and 23(a) and (b) of the Securities Exchange Act of 1934, the Securities and Exchange Commission amends § 240.17a-20 in Chapter II of Title 17 of the Code of Federal Regulations by revising paragraphs (a)(1) and (a)(2) to read as follows:

§ 240.17a-20 Monitoring effect of competitive commission rates.

(a)(1) Every broker or dealer with revenues as shown on line 6 of Statement A to Part III or line 11 of Statement AA to Part II of Form X-17A-10 (§ 249.618 of this chapter) of \$500,000 or more, of which at least 20 percent is derived from brokerage commission transactions effected on national securities exchanges as shown on Line 1(a) of Statement A to Part III, or Line 1(e) of Statement AA to Part II, respectively, of Form X-17A-10 (§ 249.618 of this chapter) during calendar year 1974 shall, not later than 17 business days after the close of each calendar quarter, file a report of his revenues and expenses and related financial and other information for each such calendar quarter on Form X-17A-20 (§ 249.636 of this chapter).

(2) Every broker or dealer required to file for calendar year 1975 Part II to Form X-17A-10 (§ 249.618 of this chapter), and whose commissions earned on transactions in listed equity securities executed on an exchange as shown on Line A(11) of Part II to Form X-17A-10 (§ 249.618 of this chapter), and who does not conduct a business with other than other members of an exchange, shall, not later than 17 business days after the close of each calendar quarter (commencing with the calendar quarter ending March 31, 1976), file a report of revenues and expenses and related financial and other information for each such calendar quarter on Form X-17A-20 (§ 249.636 of this chapter).

NASD

NOTICE TO MEMBERS: 76-5
Notices to Members ~~should be~~
retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

January 22, 1976

TO: All NASD Members

RE: Settlement Date Schedule Involving Lincoln's Birthday and
Washington's Birthday.*

Transactions made on Lincoln's Birthday, Thursday, February 12, 1976, and on the days immediately preceding that day, will be subject to the schedule of settlement dates below (for "regular-way" transactions). No settlements will be made on Thursday, February 12, since many banking institutions will be closed. Securities markets and the NASDAQ system, however, will be in operation for trading.

The schedule takes into account that securities markets and the NASDAQ system will be closed on Monday, February 16, 1976 in observance of Washington's Birthday.

Transactions made on February 12 will be combined with transactions made on the previous business day, February 11, for settlement on February 20.

February 12 shall not be considered as a business day in determining the day for settlement of a transaction, the day on which stock shall be quoted ex-dividend, or in computing interest on bonds.

Further, marks to the market, reclamations, buy-ins and sell-outs as provided for in the Uniform Practice Code, shall not be exercised on February 12.

Settlement dates for "regular-way" transactions

<u>Trade Date</u>	<u>Settlement Date</u>	<u>7th Business Day**</u>
February 3	February 10	February 12
4	11	13
5	13	17
6	17	18

Settlement dates for "regular-way" transactions

<u>Trade Date</u>	<u>Settlement Date</u>	<u>7th Business Day</u>
9	18	19
10	19	20
11 and 12 Lincoln's Birthday observance	20	23 & 24
13	23	25
16 Washington's Birthday no trade	--	--
17	24	26
18	25	27

Questions regarding this notice may be directed to the Uniform Practice Division of National Clearing Corporation, Two Broadway, 8th Floor, New York, New York 10004 - (212-) 952-4018.

* This notice, which applies to all NASD Members, has been issued by National Clearing Corporation. The Board of Directors of NCC interprets and enforces the provisions of the NASD's Uniform Practice Code.

** Date for determining the close out provisions under Section 4(c)(2) of Regulation T of the Federal Reserve Board. February 23 is the 7th Business Day for trades of February 11. February 24 is the 7th business day for trades of February 12.

NASD

NOTICE TO MEMBERS: 76-6
Notices to Members should be
retained for future reference.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D. C. 20006

January 30, 1976

TO: All NASD Members

RE: Prudhomme Investor Service, Inc.
10210 Sutherland Road
Silver Spring, Maryland 20901

ATTN: Operations Officer, Cashier, Fail-Control Department

On Friday, January 23, 1976, a temporary receiver was appointed for the above captioned firm. While not a member of the Association or the National Clearing Corporation, members are advised to direct any questions regarding this firm to the temporary receiver.*

Temporary Receiver

Mr. John H. Moelter
Suite 800, Farragut Building
900 Seventeenth Street, N.W.
Washington, D. C. 20006
Telephone (202) 223-8400

*This notice, which applies to all NASD Members, has been issued by National Clearing Corporation. The Board of Directors of NCC interprets and enforces the provisions of the NASD's Uniform Practice Code.