

BEFORE THE NATIONAL BUSINESS CONDUCT COMMITTEE

NASD REGULATION, INC.

In the Matter of

District Business Conduct Committee
For District No. 7,

Complainant,

vs.

James S. Pritula
Palm Beach Gardens, Florida,

and

Orlando, Florida,

Respondent.

DECISION

Complaint No. C07960009

District No. 7

Dated: January 23, 1998

James S. Pritula ("Pritula") has appealed the April 21, 1997 decision of the District Business Conduct Committee for District No. 7 ("DBCC") pursuant to Procedural Rule 9310.¹ After a review of the entire record in this matter, we hold that: Pritula permitted Fin-Atlantic Securities, Inc. ("FAS or the "Firm") to conduct a securities business on November 30 and December 16, 1994, while failing to maintain the minimum net capital required under Securities and Exchange Commission ("SEC") Rule 15c3-1; Pritula failed on behalf of FAS to give prompt notice to the SEC and NASD of its November 30 net capital deficiency as required by SEC Rule 17a-11; Pritula permitted FAS to fail to maintain a current and accurate general ledger trial balance and net capital computation as of November 30 and December 16, 1994, as required by SEC Rule 17a-3; and Pritula permitted FAS to file a materially inaccurate FOCUS Report Part I for the month of November 1994. We order that Pritula be censured, fined \$3,000, and required to requalify as a financial and operational principal ("FINOP") before again acting in that capacity.

¹ We cite here the Procedural Rules that were in effect at the time Pritula appealed. We will apply NASD's new procedural rules governing disciplinary proceedings to cases served on a respondent on or after August 7, 1997 and appealed or called for review. See Special Notice to Members 97-55 (August 1997).

Background. Pritula entered the securities industry in 1981 as a general securities representative. Pritula became a general securities principal in 1985, an options principal in 1986, and a FINOP in 1987. During the relevant time, Pritula was associated with FAS as a general securities sales representative, general securities principal, options principal, and FINOP. Pritula is not currently employed in the securities industry.

Facts. During the relevant time, FAS was wholly owned by Fin-Atlantic Corp. ("Fin-Atlantic") and had a \$50,000 minimum net capital requirement. Jerry E. Surman ("Surman") was FAS' president and compliance officer and one of FAS' and Fin-Atlantic's two stockholders.

FAS reported a net capital of \$64,779 on its November 30, 1994 FOCUS Report. FAS based its capital calculation, in part, on a \$20,000 capital infusion. Because this capital infusion enabled FAS to meet its \$50,000 minimum net capital requirement as of November 30, NASD Regulation District No. 7 staff ("staff") asked FAS to provide a copy of the \$20,000 check, the deposit slip, and the corporate minutes authorizing the capital infusion.

FAS provided a check dated November 15, 1994, written on the account of Surman and his wife, but the deposit slip indicated that the check was not deposited into FAS' account until December 12, 1994. A review of the Surmans' bank account established that the account did not have sufficient funds between November 15 and December 12 to cover the check. Moreover, when the check was deposited on December 12, it was returned for insufficient funds. The \$20,000 was not actually deposited into FAS' account until December 20, 1994. The DBCC found that the Firm had a net capital of \$48,193.66 on November 30 and \$38,842.29 on December 16.

November 30, 1994 net capital calculation. FAS reported a net capital of \$64,779 on November 30, 1994. The DBCC determined that FAS had a net capital of \$48,193.66 on that date. The DBCC added \$5,825.85 to the Firm's capital, comprised of \$118.40 (held at FAS' clearing firm); \$273.45 (a 15% additional haircut that the Firm unnecessarily took on its money market fund); and \$5,434 (resulting from the elimination of an undue concentration charge on mutual funds).

After subtracting the \$20,000 that was not deposited into the Firm's account until December 20, 1994, the DBCC subtracted an additional \$2,412.19 from the Firm's capital comprised of: \$2,163.48 (accounts payable not booked); \$213.20 (commissions payable not accrued); and \$35.51 (additional haircuts).

December 16, 1994 net capital calculation. FAS calculated its net capital at \$72,152 on December 16, 1994, on the basis of trade date reporting. Switching from settlement date to trade date reporting on December 16 enabled the Firm to add approximately \$10,100 to its capital. The DBCC, however, determined that FAS had impermissibly changed from settlement date to trade date reporting to calculate its net capital on December 16, and it recalculated the Firm's capital at \$38,842.29 using settlement date as the basis. The DBCC added \$61,229.41 (trades not settled by 12/16 that the Firm included) and subtracted \$71,289.76 from the Firm's capital comprised of \$29,055.71 (cash balance at FAS' clearing firm for trades not settled by December 16); \$1,657.30 (due from clearing balance for trades not settled by December 16); \$31,381.89 (increase in the Firm's

margin account balance for trades not settled by December 16); and \$9,194.86 (increase in haircuts for inventory positions that the Firm sold but did not settle prior to December 16).

The DBCC also added \$64.81 (money market shares that the Firm understated) and subtracted \$23,314.17, comprised of the \$20,000 check not yet deposited into Firm's account; \$2,019.09 in unbooked accounts payable; and \$1,295.08 in commissions payable not accrued.

Discussion

We find that Pritula allowed FAS to operate without sufficient capital on November 30 and December 16, 1994, failed to report those deficiencies, and also failed to maintain a current and accurate general ledger trial balance and net capital computation on those dates.² As to December 16, 1994, we find that FAS overstated its capital by \$23,249.65 (instead of \$33,310 as alleged). We also find that Pritula permitted FAS to file a materially inaccurate FOCUS Report Part I for the month of November 1994 as alleged in cause three. As discussed below, we affirm each of the DBCC's recalculations except for those calculations involving trade versus settlement date reporting.

\$20,000 check. We find that FAS improperly included the \$20,000 check as capital on November 30 and December 16. Notwithstanding any other recalculations, FAS' failure to infuse \$20,000 between November 15 and December 19 caused the Firm to operate below its required \$50,000 minimum net capital on November 15 and December 16, 1994, as alleged.

On November 15, 1994, Surman showed Pritula the corporate minutes authorizing a \$20,000 capital infusion, and he also showed Pritula a check for \$20,000 written on the account of himself and his wife at Bank South. Surman told Pritula that he would deposit the check. On the basis of Surman's representation, Pritula included the \$20,000 as FAS assets in his net capital computation as of that date. Pritula filed FAS' November 1994 FOCUS Report on December 14, 1994. The FOCUS Report indicated that the Firm had net capital of \$64,780, including the \$20,000 capital infusion.

When Pritula examined the firm's November bank statement from Barnett Bank on December 12, he saw that the check had not, in fact, been deposited on November 15, and asked Surman about it. Surman claimed that he had given the check to a temporary employee, who had failed to deposit it. Surman searched the office for the check, found the check and deposit slip in a manila folder in a drawer, and deposited the check on December 12. On December 15, the bank sent FAS notice that the check was "returned unpaid."³ On December 19, 1994, Surman liquidated a certificate of deposit ("CD") in the name of his mother, Shirley Lee Surman,⁴ wired \$25,000.70 into his account at Bank

² The record shows that FAS conducted a securities business on November 30 and December 16, 1994.

³ Pritula testified that he did not see the notice. He stated that it was not until he reviewed FAS' December 1994 bank statement on January 10 or 11, 1995, that he learned that the \$20,000 check had not been deposited.

⁴ It is not disputed that Surman was a signatory on that account.

South, and transferred \$20,000 into FAS' account at Barnett Bank on December 20. The DBCC determined that the \$20,000 could not be considered a Firm asset until December 20.

We reject Pritula's contention that the \$20,000 was a good asset between November 15 and December 14, the date on which he submitted FAS' November 30 FOCUS Report. Pritula contended that under Rule 15c3-1, the \$20,000 check was a "receivable" that was allowable as a good asset for 30 days. Thus, he argued, the \$20,000 was appropriately included in the Firm's capital as of November 30.⁵ A check, however, that has not been deposited into the Firm's account cannot be considered an asset in anticipation of its deposit. It is irrelevant that Surman controlled sufficient funds to meet FAS' capital requirements. These funds were not in the Firm's account on November 30 and December 16. In re Wallace G. Conley, 51 S.E.C. 300 (1993) (potential availability of funds not deposited in firm's account are neither assets nor receivables).

Accounts payable. Pritula did not book certain accounts payable as of November 30 and December 16 on the basis of an agreement between the Firm and its parent company, whereby the parent company agreed to pay such items as rent, utilities, administrative expenses, and salaries of non-licensed employees. We find that FAS should have booked these accounts payable as liabilities on the basis that notwithstanding the agreement, FAS booked the bills as expenses and paid them. Further, the record indicated that FAS had a history of paying such expenses notwithstanding the agreement.

Commissions payable. Pritula did not book commissions payable on November 15 and December 16 as liabilities on the basis of agreements between the Firm and its salespersons that stated that the Firm would not pay out the commissions until it received the funds. We find that FAS should have booked these commissions payable as liabilities. The agreements pertained only to "new issue offerings, DPP's,⁶ single premium life insurance policies, real estate investment trusts and variable annuities," and not to commissions on equity trades. The record indicated that the commissions payable at issue were based on equity trades; therefore, they were not subject to these agreements.

Haircuts. We find that Pritula is responsible for the miscalculation of the Firm's haircuts on November 30 and December 16. Pritula testified that although he knew that haircut percentages varied based, among other things, on the activity level of a security, he did not try to determine the level of activity in the Firm's positions because FAS did not have the necessary "facilities or

⁵ Pritula testified that upon reviewing FAS' December bank statement, he and Surman spoke to Brad Miller ("Miller"), the Firm's certified public accountant, who told Pritula that receivables were good for 30 days, and that he should treat the check as a "deposit in transit," *i.e.*, a good receivable between November 15 and December 15. We find that it was Pritula's responsibility as the Firm's FINOP to make that determination, and he cannot shift this responsibility. It is the FINOP's responsibility to understand the net capital rule and to apply its provisions. In re Townsley Associates & Company, Inc., 50 S.E.C. 755 (1991) (FINOP cannot shift responsibility for compliance by virtue of having relied on the advice of a certified public accountant).

⁶ "DPP" is an abbreviation of "direct participation program."

computers." Broker/dealers are required under SEC Rule 15c3-1 to calculate the appropriate percentage to deduct from the market value of the firm's positions. We do not accept Pritula's excuse for his inaction.

Trade date versus settlement date reporting. Prior to December 16, FAS had calculated its net capital on a settlement date basis. Pritula calculated FAS' net capital on December 16 based on trade date. The DBCC found that FAS had impermissibly changed to trade date accounting on December 16. On that basis, the DBCC made five adjustments to the Firm's capital calculations, giving the Firm approximately \$10,100 less capital. The DBCC found that a broker/dealer must prepare its financials on a consistent basis and that it was improper for Pritula to switch to a trade date basis in order to improve its net capital position.

We reverse the DBCC's finding on this issue.⁷ Where the difference between trade date and settlement date reporting would be material, e.g., would cause a firm either to be in compliance or non-compliance with the net capital rule, a firm may switch from settlement to trade date reporting. This position is consistent with the position taken by the SEC's Division of Market Regulation in April 1986 in a letter to the American Institute of Certified Public Accountants ("Institute"). The Institute noted that a broker/dealer that used the settlement date basis of recordkeeping would be in compliance with the Institute's guide, "Audits of Brokers and Dealers in Securities," only if the difference between trade date and settlement date accounting were not material. The Division agreed that if the difference between trade date and settlement date account reporting were material, the firm must compute its net capital on a trade date basis. The Division stated, however, that if such a material difference required the firm to use trade date accounting on more than on an occasional basis, i.e., twice in a six-month period, the firm should probably use trade date accounting on a consistent basis.

In the instant matter, FAS switched from settlement date to trade date because the resulting difference to the Firm's capital was material. The record does not show that the Firm continued to switch from one method to the other. Therefore, we find that the Firm was not precluded from using trade date to calculate its net capital as of December 16, 1994. On that basis, we add \$10,060.35 to the Firm's capital on December 16 and find that FAS' capital was overstated on that date by \$23,249.65.

Pritula's responsibility. Pritula has denied all responsibility for the violations at issue. He contended that Surman, as the owner of the Firm, was responsible for FAS' net capital and reporting violations.⁸ Pritula contended that he had no reason to believe that Surman did not deposit the check

⁷ We note that recalculating FAS' capital on December 16 on the basis of settlement date reporting does not place the Firm in capital compliance on that date. It is the exclusion of the \$20,000 check on November 30 and December 16 that caused the Firm to be out of capital compliance on those dates.

⁸ On January 3, 1995, an NASD examiner asked Pritula for documentation that the \$20,000 were good funds from November 15 through November 30, 1994. The record shows that Surman did not have sufficient funds in his account to cover the check during that period.

on November 15. We find that Pritula had no basis to rely solely on Surman's word. If Pritula had examined the account on which Surman wrote the check, he would have discovered that the account did not have sufficient funds to cover the check on November 15. Additionally, Pritula could have asked for proof of deposit, such as a bank deposit slip, but he did not.

A FINOP is responsible for the "supervision of and responsibility for individuals who are involved in the actual maintenance of the member's books and records from which [the firm's] reports are derived" and the "supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the Act." Membership and Registration Rule 1022(b) (formerly Schedule C to the NASD By-Laws). In re Gilad J. Gevanyahu, 51 S.E.C. 700 (1993) (FINOP's argument that he should not be held responsible for firm's net capital violation because he was dependent upon firm's president for financial information rejected by SEC).

As FAS' FINOP, it was Pritula's responsibility to calculate the Firm's capital accurately. He was remiss in not demanding a copy of the actual deposit slip before including the \$20,000 as capital.

As FINOP, Pritula should have had access to incoming mail, bank statements, financial statements, and check deposits. He should not have assumed that Surman was entitled to control these functions.⁹

Sanctions. We affirm the censure, \$3,000 fine (\$1,000 for each of the three causes of complaint), and requirement to requalify as a FINOP by taking and passing the Series 27 qualification examination before again acting in the capacity of a FINOP. We also affirm the assessment of costs of the DBCC proceeding in the amount of \$1,343.65.¹⁰ The SEC has emphasized that net capital violations are serious offenses. A firm's failure to maintain its required net capital means that the firm does not have sufficient liquid assets to satisfy its indebtedness, particularly the claims of its customers. In re Wallace G. Conley, *supra*. Pritula permitted Surman to maintain control of bank statements, financial statements, and check deposits, leaving Pritula dependent upon Surman to show him relevant documents. Pritula was nonetheless responsible for the Firm's compliance with applicable financial reporting and net capital requirements. Pritula's apparent belief that because Surman was owner of the Firm, he was entitled to control the Firm's finances, did not excuse Pritula from carrying out his responsibilities as FINOP. See, e.g., In re George Lockwood Freeland, 51 S.E.C. 389 (1993); In re James Michael Brown, 50 S.E.C. 1322 (1992), aff'd without opinion, No. 92-9165 (11th Cir. April 19, 1994).¹¹

⁹ We have considered Pritula's contention that NASD Regulation has conducted a "personal vendetta" against him. We find no evidence in the record to support this contention.

¹⁰ The sanctions are consistent with the Guidelines for net capital violations, record keeping violations, and inaccurate FOCUS reports. See NASD Sanction Guidelines ("Guidelines") (1996 ed.) at 35, 40, and 23, respectively.

¹¹ We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Pursuant to NASD Procedural Rule 8320, any member who fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily

On the basis of the foregoing, we affirm the censure and \$3,000 fine, representing a fine of \$1,000 per cause. We also affirm the requirement to requalify as a FINOP by taking and passing the Series 27 qualification examination before again acting in the capacity of a FINOP and the assessment of costs of the DBCC proceeding in the amount of \$1,343.65.

On Behalf of the National Business Conduct Committee,

Joan C. Conley, Corporate Secretary

be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

Direct: (202) 728-8381
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Joan C. Conley
Corporate Secretary

January 23, 1998

VIA FIRST-CLASS/CERTIFIED
RETURN RECEIPT REQUESTED

James S. Pritula
Palm Beach Gardens, Florida

James S. Pritula
Orlando, Florida

Re: Complaint No. C07960009: James S. Pritula

Dear Mr. Pritula:

Enclosed herewith is the Decision of the National Business Conduct Committee in connection with the above-referenced matter. Any fine and costs assessed should be made payable and remitted to the National Association of Securities Dealers, Inc., Department #0651, Washington, D.C. 20073-0651.

You may appeal this decision to the U.S. Securities and Exchange Commission ("SEC"). To do so, you must file an application with the SEC within thirty days of your receipt of this decision. A copy of this application must be sent to the NASD Regulation, Inc. ("NASD Regulation") Office of General Counsel as must copies of all documents filed with the SEC. Any documents provided to the SEC via fax or overnight mail should also be provided to NASD Regulation by similar means.

Your application must identify the NASD Regulation case number, and set forth in summary form a brief statement of alleged errors in the determination and supporting reasons therefor. You must include an address where you may be served and phone number where you may be reached during business hours. If your address or phone number changes, you must advise the SEC and NASD Regulation. If you are represented by an attorney, he or she must file a notice of appearance.

The address of the SEC is:
Office of the Secretary
U.S. Securities and Exchange
Commission
450 Fifth Street, N.W., Stop 6-9
Washington, D.C. 20549

The address of NASD Regulation is:
Office of General Counsel
NASD Regulation, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

Questions regarding the appeal process may be directed to the Office of the Secretary at the SEC.
The phone number of that office is 202-942-7070.

Very truly yours,

Joan C. Conley
Corporate Secretary

Enclosure

cc: Gene E. Carasick, Esq. (NASD Regulation, Inc. - District No. 7)