FINANCIAL INDUSTRY REGULATORY AUTHORITY[1]
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. NORTH WOODWARD FINANCIAL CORP. (CRD No. 104097), and DOUGLAS A. TROSZAK (CRD No. 2219763), Respondents.	Disciplinary Proceeding No. E8A2005014902 Hearing Officer – AWH **HEARING PANEL DECISION** November 30, 2007

Member firm and registered principal jointly and severally fined $10,000, and registered principal ordered to requalify by examination as a Financial and Operations Principal for failing to prepare a general ledger and a trial balance, in violation of SEC Rule 17a-3 and NASD Conduct Rules 2110 and 3110. Respondents also assessed costs.

Appearances:

Marcletta Kerr, Esq., and Pamela Shu, Esq., for the Department of Enforcement.

Douglas A. Troszak, *pro se* and for North Woodward Financial Corp..

DECISION

Background

On August 16, 2006, the Department of Enforcement filed the Complaint in this proceeding, alleging that North Woodward Financial Corp. and Douglas A. Troszak ("Respondents") failed to prepare a general ledger and a trial balance for the period ended

[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority (FINRA). References in this decision to FINRA include, where appropriate, NASD.

March 31, 2005, in violation of SEC Rule 17a-3 and NASD Conduct Rules 2110 and 3110. Because Respondents failed to file an Answer to the Complaint, an Order was issued directing the Department of Enforcement to file a Motion for Entry of Default Decision on or before December 4, 2006. However, before that motion was due, Respondents filed an Answer to the Complaint on November 30, 2006, admitting that they did not prepare a general ledger and trial balance for the period ended March 31, 2005, and asserting that all of the information which would have been evident on a general ledger and trial balance (of the type Enforcement alleges Respondents should have prepared) was evident and available in the Respondent firm's books and records for that period. Respondents denied that they violated SEC Rule 17a-3 and NASD Conduct Rules 2110 and 3110, and they requested a hearing.

Following an unsuccessful attempt by the parties to resolve this matter through negotiation of a settlement agreement, a hearing was held in Chicago, Illinois, on September 11, 2007, before a hearing panel composed of the Hearing Officer and two current members of the District 8 Committee. On October 23, 2007, North Woodward and Troszak filed their post-hearing submission.[2] On October 25, 2007, Enforcement filed its post-hearing brief.

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[2] Respondents attached to their submission two documents, marked as RX-2 and RX-3. RX-2 is a "Wells Submission" sent to Enforcement on July 22, 2006. Rx-3 is North Woodward's Annual Audited Report for calendar year 2005. Neither document was filed as a document to be introduced as an exhibit by the August 7, 2007, deadline for exchanging and filing such documents, nor were the documents presented by Respondents at the hearing. On November 6, 2007, Enforcement filed a motion to strike the documents as untimely and irrelevant to the issues in the Complaint. Moreover, Enforcement alleges that it is prejudiced by an inability to cross-examine on the documents at this stage of the proceeding. On November 15, 2007, Respondents replied to the motion to strike the documents, asserting that RX-2 shows their compliance with Enforcement's request for such a submission, and RX-3 shows that a general ledger is prepared at the end of the year to finalize the accounting process. Respondents do not explain why these documents were not exchanged prior to the hearing or why they were not introduced at the hearing. For good cause shown, RX-2 and RX-3 will be stricken, but shall remain in the record as rejected exhibits.

Findings of Fact[3]

Respondents

North Woodward Financial Corp. has been a registered broker-dealer and member of FINRA since November 2000. Douglas A. Troszak is the president of North Woodward. As a consequence of a special Financial and Operations Principal ("FINOP") examination in 2003, on January 6, 2005, FINRA issued an Order accepting an offer of settlement from North Woodward wherein, without admitting or denying the allegations, it consented to a fine of $5,000 on allegations that it engaged in securities related activities without employing a person who was registered as a FINOP.[4] The January 6, 2005, Order also noted that Troszak consented to the same sanction and entry of findings. Therefore, he was fined $5,000, jointly and severally with the firm.[5] Also as a result of the special FINOP investigation in 2003, the firm was issued a letter of caution for an inaccurate general ledger.[6]

Troszak first entered the securities industry in 1992, becoming registered as a General Securities Representative with member firm Gregory J. Schwartz and Co., Inc. He left that firm in 2000 to start his own firm, North Woodward. Troszak is also a Certified Public Accountant and has been President and owner of Troszak C.P.A. Group since 1985. He is registered through North Woodward as a General Securities Representative, a General Securities Principal, and, since July 2003, a FINOP.[7]

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[3] References to the Department of Enforcement's exhibits are designated as CX-; Respondents' exhibits, as RX-; and the transcript of the hearing, as Tr.-.
[4] CX-1.
[5] CX-2.
[6] Tr. 18-19.
[7] CX-2; Tr. 21.

Troszak started North Woodward primarily to service clients of his C.P.A. firm who wanted to invest money through an IRA account. His main business is the C.P.A. firm; North Woodward is a part-time business for him. At the time of the examination, Troszak was the only registered representative at North Woodward.[8]

The May 2005 Examination

In May 2005, FINRA Senior Compliance Examiner Thomas Shea conducted a routine examination of North Woodward. The examination consisted of a review of general compliance, focusing on, among other things, a net capital computation for March 31, 2005. Prior to the examination, Shea phoned the firm to announce the examination and to inform Troszak of the date the examination would open, the review period that would be covered, and some of the records that he would be requesting. Shea also sent the firm and Troszak a written records request to pull certain records which he wanted available at the time of the examination. Among the records he requested were a general ledger and a trial balance for the months of February through April 2005.[9]

When Shea arrived at North Woodward for the examination, he took an inventory of the records provided by Troszak and compared them to the records request he had sent to Troszak the prior week. Shea found bank statements, canceled checks, a check register, and brokerage and commission statements from North Woodward's clearing firm. However, there were no general ledgers or trial balances for February, March, or April 2005. Shea then asked Troszak for a general ledger and trial balance for February and March 2005. Troszak did not have a general ledger or trial balance for those two

[8] Tr. 68, 137, 169-70.
[9] CX-8; Tr. 9-12, 15-16.

months.[10] Troszak told Shea that he had given Shea sufficient records that would represent what would be contained within a general ledger. Troszak also informed Shea that the statement of financial condition from the firm's FOCUS report for March 2005 was the same as a trial balance, and his bank account statement for February, along with some handwritten notes that he had made on the statement, was the same thing as a trial balance.[11]

As Shea testified, a general ledger is a record that contains postings and a recording of the economic activity of a firm. It is used as a foundation document to prepare a trial balance, a balance sheet, an income statement, and a calculation of profit and loss. It is used to record assets and liabilities, income and expenses, profit and loss, and ownership equity. The general ledger also reflects accruals, such as accounts receivable and accounts payable, recognizing revenues or expenses when they are incurred rather than when they are actually received or paid.[12] FINRA requires that financial statements be prepared on an accrual, not on a cash basis.[13]

The trial balance is a document that is used to verify the accuracy of a general ledger. From the trial balance, a FINRA examiner will prepare an independent calculation of net capital which will be used to verify the accuracy of the net capital computation prepared by the firm.[14] While large firms may have to prepare net capital

[10] At the time of the examination, Shea did not specifically ask for a general ledger and trial balance for April 2005. Because Troszak did not have those documents for February and March, Shea assumed that he did not have one for April. Tr. 22-23, 27-28.
[11] *Id.*
[12] Tr. 26.
[13] Tr. 77.
[14] Tr. 27.

computations on a daily or moment-by-moment basis, other firms need prepare it only on a monthly basis.[15]

Because Shea did not have a general ledger or trial balance for March 2005, he made a best effort attempt to verify the net capital position of the firm as of the end of that month. He reviewed the bank statements, brokerage statements, clearing firm statement, canceled checks, and whatever bills Troszak provided to him. As a result, Shea found that, although the firm had sufficient net capital to be in regulatory compliance, its net capital computation of $18,547 was understated by $7,000, primarily due to the failure to accrue an account receivable from the clearing firm for commissions and the failure to accrue an account payable for a portion of the $5,000 fine assessed by FINRA in January 2005 as a result of the 2003 FINOP examination.[16] Because there was no general ledger, Shea could not determine whether there were any other accrued revenue or expense items.[17]

Troszak's Response to the Examination Findings

During the Exit Conference, and as confirmed by his hearing testimony, Troszak told Shea and Examiner David Wegner that SEC and FINRA accounting requirements, specifically with reference to SEC Rule 17a-3, were archaic and do not reflect what actually happens in the true accounting world.[18] At the hearing he testified that

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[15] Tr. 77.

[16] Tr. 28-29, 39-41; CX-9, p. 27. The only evidence in the firm's books and records of the FINOP fine was a check, dated April 4, 2005, payable to the order of NASD Regulation for $500. CX-9. Shea's specific finding on the Exit Conference form states that: "net capital was understated by $7,046 due to the improper allowable treatment of $1,000 of property, furniture and equipment, not reporting an allowable commission receivable of $8,072, overstating cash balance by $500, and not reporting an account payable of $155." CX-10, p. 2.

[17] Tr. 42.

[18] Tr. 31, 127.

Rule 17a-3 makes no mention of a "general" ledger, and that a small firm like his should not have to maintain a general ledger on a daily, weekly, or monthly basis.[19] In an on-the-record interview ("OTR"), Troszak explained that, at the time of the examination:

> . . . we're down to six or four checks a month. It doesn't make sense to continue to use this computer and its expense every month to generate a general ledger which is the same as the bank statement for all practical purposes. So we stopped doing it because it was of no use. It was an additional step that wasn't necessary.[20]

During the OTR, Troszak was asked whether, during the examination, he presented a list of the assets and liabilities of the firm to the Staff. He answered, "There are no liabilities. There have never been any liabilities. So, I couldn't produce something that doesn't exist."[21] At the hearing, he testified that he doesn't consider the money he receives from his clearing firm to be his until it is in his bank account.[22] However, after Shea made a number of requests for an update of open items addressed in the Exit Conference, in December 2005, the firm sent Shea a March 2005 general ledger and trial balance that showed a balance for accounts receivable (assets earned, but not yet received from his clearing firm), and a balance for accounts payable (a liability incurred, but not yet paid to Troszak).[23]

Troszak first testified that because the firm is small, he did not prepare a general ledger until tax time. He later testified that he currently prepares a general ledger quarterly, explaining that he no longer writes checks and makes payments by utilizing a debit card. He stated that the only record he is required to prepare within a prescribed

[19] Tr. 129, 143.
[20] CX-17, p. 15. There were six checks for the period ending March 31, 2005. Tr. 36.
[21] CX-17, p. 12.
[22] Tr. 128.
[23] Tr. 35-36; CX-14, p. 3, CX-15, pp. 5-7, 11-13.

time frame is the monthly net capital computation.[24] He acknowledged that a net capital computation is to be done on an accrual basis, and he understood that a bank statement does not take into account any accruals.[25]

Respondents' Past Accounting Practice

Prior to March 2005, Respondents knew that FINRA required their books and records to be kept on an accrual basis. They also were aware that they were required to prepare a general ledger and trial balance on a monthly basis, regardless of the number of checks that were written during any month.

As part of its application for new membership in FINRA, North Woodward was required to supply FINRA with, among other things, (1) a description of the Applicant's proposed recordkeeping system; (2) a trial balance, balance sheet, supporting schedules, and computation of net capital for the month ending March 31, 2000; and (3) sample books and records to be utilized. In response, North Woodward provided a General Ledger, a Trial Balance, and a Chart of Accounts that included those for accounts receivable and accounts payable, as well as those for accrued taxes.[26] In response to an additional request for information, North Woodward informed FINRA that:

> Books and records will be maintained utilizing an electronic checkbook (with hard copy back-up) cash receipts (deposits) as revenue and cash disbursements as expenses, with corresponding month-end adjustments (via journal entries) to bring the books and records to an accrual basis and thus in conformity with GAAP.
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> All cash receipts from clearing firm or mutual fund will be deposited into bank account and classified as revenue, and subject to adjustment at month-end. Cash disbursements are classified as an expense or equipment purchase when

[24] Tr. 127, 152, 166-67.
[25] Tr. 149-50.
[26] CX-4.

> checks are recorded into the accounting system, with monthly adjustments to bring the Books and Records to an accrual basis and thus in conformity with GAAP.[27]

In both 2001 and 2003, FINRA staff conducted examinations of North Woodward, and, as part of those examinations, requested a general ledger. In response, North Woodward provided a general ledger for the period of March 2001, and, in the second examination, a general ledger for March 1, 2003, through May 31, 2003. Among the listed assets on the general ledger for March 2001 was an amount for accounts receivable, and among the liabilities was an amount for accounts payable. The general ledger showed that six checks had been written by the firm in that month. The 2003 general ledger showed balances for, among other accounts, accounts receivable, an accrued commission receivable, and accounts payable. The general ledger also showed that seven checks were written in the month of March 2003.[28]

Discussion

NASD Rule 3110 requires member firms to keep books and records as prescribed by SEC Rule 17a-3. As pertinent to this case, SEC Rule 17a-3(a)(2) requires members to make and keep current "[l]edgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts." Rule 17a-3(a)(11) requires members to make and keep current a "record of the proof of money balances of all ledger accounts in the form of trial balances" to be prepared currently at least once a month.

[27] CX-5, p. 4.
[28] CX-6, CX-7.

SEC Clarification of Rule 17a-3(a)

In 1974, the SEC issued a Statement in response to inquiries requesting clarification of the requirements of Rule 17a-3(a).[29] The Statement makes clear that a general ledger and a trial balance are required by the Rule. One section of that statement is entitled "General Ledgers," and provides, in pertinent part that the general ledger should be posted as frequently as necessary, but not less than once a month, to ascertain compliance with the net capital rule.[30]

Another section of the SEC Statement is entitled "Trial Balances and Capital Computation." That section requires the monthly preparation of a trial balance of all ledger accounts.[31]

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[29] *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, Exchange Act Release No. 10,756, 1974 SEC LEXIS 3290 (April 26, 1974).

[30] *Id.* at **4-5:

> The ledgers prescribed in subparagraph (2) of Rule 17a-3 are the general records reflecting all asset, liability and capital accounts and all income and expense accounts and include control accounts for subsidiary ledgers. The blotters and other records of original entry should be maintained not only on a daily basis . . ., but in a form which will facilitate posting of the genera (sic) ledger as frequently as necessary . . . to ascertain . . . compliance with the net capital rule . . . .
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> A broker-dealer is required to be in compliance with the net capital rule at all times and the general ledger must be posted as frequently as may be necessary to make that determination. . . . If a broker-dealer effects only a limited number of transactions during an accounting period and it is clear from the nature of the business conducted that such transactions would have no material adverse effect on the broker-dealer's financial and operational condition, net capital or customer's protection requirements during the period it may be appropriate to post the general ledger on a monthly basis.

[31] *Id* at **8-9:

> Subparagraph (11) requires the monthly preparation of a trial balance of all ledger accounts and a computation of aggregate indebtedness and net capital as of the trial balance date. These records should be prepared no later than 10 business days after the end of the accounting period, except in those instances where the records must be prepared in a lesser period to satisfy any reporting requirements established by any self-regulatory authority of which the broker-dealer is a member.

Memorandum of the Board of Governors

In 1996, the FINRA Board of Governors issued a Memorandum interpreting the requirements of SEC Rule 17a-3 as mandating general ledgers and trial balances, without exception.[32]

Responsibility for Preparation of the Firm's Books and Records

Troszak, as North Woodward's FINOP, was responsible for making and keeping current North Woodward's books and records. As FINOP, he could not shift his responsibility for compliance with applicable requirements to FINRA.[33] His assertion that the necessary information was available in other records he maintained is unavailing. For more than 40 years, legal precedent has held that, even if his assertion were true, it would not relieve him of the need for full compliance with SEC and FINRA requirements.[34] As noted above, neither SEC Rule 17a-3 nor NASD Rule 3110 exempts from its purview any broker-dealer because of size or number of transactions. As the 1974 SEC Statement noted, one of the regulatory purposes of Rule 17a-3(a) is to enable a

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[32] *Memorandum of the Board of Governors,* FINRA MANUAL, p. 8135 (2006 ed.). The section entitled "Firm's general ledgers" provides:

> **Paragraph 2** requires that ledgers or other records be maintained reflecting all of the firm's assets and liabilities, and its income and expense and capital accounts. This refers to what is usually known as the general ledger in which a record of all asset, liability and nominal accounts are (sic) kept and from which a trial balance can be abstracted in order to prepare financial statements showing the broker's or dealer's financial condition. Under present day double entry systems, this record requires but little explanation.

The other relevant section is one entitled "Monthly trial balances and net capital computation." That section provides:

> **Paragraph 11** requires the preparation of a record of the proof of money balances in all ledger accounts in the form of trial balances currently at least once a month, and the preparation of a record of the computation of aggregate indebtedness and net capital as of the trial balance date currently at least once a month. Such trial balances and computations will serve as a check upon the current status and accuracy of the ledger accounts which members are required to maintain and keep current and will also help to keep members currently informed of their capital positions.

[33] *Joseph S. Barbera*, Exchange Act Release No. 43,528, 200 SEC LEXIS 2396 (Nov. 7, 2000) (firm, acting through its FINOP, failed to maintain an accurate general ledger and failed to evidence creation of trial balances).

[34] *J.B. Howard*, Exchange Act Release No. 7,318, 1964 SEC LEXIS 505 at *3 (May 19, 1964) (citations omitted).

broker-dealer to be aware of the extent of its compliance with various rules and requirements, and to "be able to demonstrate compliance to the Commission and the self-regulatory authorities *without the burden of bringing books and records up-to-date being placed upon the regulatory authorities*." (emphasis added).[35]

North Woodward, acting through Troszak, failed to prepare and maintain a general ledger and a trial balance for the period ended March 31, 2005, as alleged in the Complaint. As a result, North Woodward and Troszak failed to prepare and maintain accurate books and records, in violation of SEC Rule 17a-3 and NASD Conduct Rules 3110 and 2110.[36]

Sanctions

For recordkeeping violations, FINRA Sanction Guidelines recommend a fine of $1,000 to $10,000. The Guidelines also call for consideration of suspending the firm with respect to any and all activities or functions for up to 30 business days and suspending the FINOP for up to 30 business days. The principal consideration in determining sanctions for this violation is the nature and materiality of the missing information.[37]

The general ledger and trial balance are fundamental documents that are key to preparation of the firm's other financial reports and computations, without which a firm's management cannot be certain as to its net capital position. The Hearing Panel concludes that the nature and materiality of those missing documents make this a serious case. The Hearing Panel also takes into consideration the small size of the firm, its single registered

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[35] *Statement Regarding the Maintenance of Current Books and Records by Brokers and Dealers*, 1974 SEC LEXIS 3290 at *2.
[36] Violations of SEC Rules and other NASD Rules are violations of NASD Rule 2110. *See Davrey Financial Services*, Exchange Act Release No. 51,780, 2005 SEC LEXIS 1288 (2005).
[37] FINRA SANCTION GUIDELINES, p. 30 (2007 ed.).

representative, and the fact that the firm had well above its minimum net capital.[38] On the other hand, Troszak is a Certified Public Accountant who concedes that a net capital computation must be done on an accrual basis, and a bank statement does not take into account any accruals. His decision not to prepare a general ledger and a trial balance was an intentional act, based on his unilateral assessment of whether the size of his firm warranted the preparation of those documents. Finally, the Hearing Panel considers Troszak's and the firm's disciplinary history of similar misconduct.

Enforcement requests that North Woodward be fined $500, and Troszak fined $5,000, suspended for ten business days as a FINOP, and required to requalify by examination as a FINOP. The Hearing Panel has weighed the factors noted above with a view toward ensuring that the sanctions imposed are not punitive, but are sufficiently remedial to achieve deterrence. Given Respondents' disciplinary history, the fact that Troszak is the firm's only registered representative, and the need for a sanction that will impress upon Troszak the need to conform his recordkeeping to strict regulatory requirements, North Woodward and Troszak will be fined $10,000, jointly and severally, and Troszak will be required to requalify by examination as a FINOP. In addition, North Woodward and Troszak will be assessed costs in the total amount of $1,950.42, consisting of a $750 administrative fee and a $1,200.42 transcript fee.

Conclusion

For failure to prepare and maintain accurate books and records, in violation of SEC Rule 17a-3 and NASD Conduct Rules 3110 and 2110, North Woodward Financial Corp. and Douglas A. Troszak are fined $10,000, jointly and severally, and assessed costs in the total amount of $1,950.42, jointly and severally. Douglas A. Troszak is also

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[38] *Notice to Members* 06-55.

required to requalify by examination as a Financial and Operational Principal before again serving as a Financial and Operational Principal.

These sanctions shall become effective on a date set by FINRA, but not earlier than 30 days after this decision becomes FINRA's final disciplinary action in this matter.

SO ORDERED.

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Alan W. Heifetz
Hearing Officer
For the Hearing Panel

Copies to:
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