

Interpretation Memo

Member Firm Regulation

Number 86-10

December 24, 1986

NYSE

New York
Stock Exchange, Inc.
20 Broad Street
New York, NY 10005

PLEASE ROUTE TO CHIEF EXECUTIVE, FINANCIAL AND
OPERATIONS OFFICERS/PARTNERS AND COMPLIANCE DIRECTORS

TO: MEMBERS, MEMBER ORGANIZATIONS AND HANDBOOK SUBSCRIBERS

SUBJECT: INTERPRETATIONS AND AMENDMENTS TO SEC RULE 15c3-1

Trade Date Accounting Under Rules 15c3-1, 15c3-3, 15c3-3a, 17a-3
and 17a-5

The American Institute of Certified Public Accountants (AICPA) issued a revised edition of its guide "Audits of Brokers and Dealers in Securities" in January 1985 which in effect stated that generally accepted accounting principles normally require brokers and dealers to account for transactions on a trade date basis. Subsequently on November 11, 1985 the Chairman of the Stock Brokerage Auditing Subcommittee of the AICPA inquired of the SEC as to the effect this would have on recordkeeping, capital and reporting requirements of broker-dealers under SEC Rules. SEC response (copy attached) on April 23, 1986 addresses treatment of this requirement under SEC Rules 15c3-1, 15c3-3, 15c3-3a and 17a-5.

The Handbook Interpretation 15c3-1(c)(3)/01 Generally Accepted Accounting Principles (GAAP) on page 155 has been amended to reflect the SEC position. Subsequent amendments will be added as experience indicates.

Adoption of Amendments to Rule 15c3-1(c)(2)(vi)(F)

The Securities Haircuts required on Nonconvertible Debt Securities have been revised (attached) with an effective date of December 15, 1986.

Appendix C - Consolidations

A new interpretation relative to required counsel opinions is being substituted for a recent one which, based on inquiries, was not well understood by the membership. See Rule 15c3-1 (App. C)(b)(2)/03 attached.

Please remove:

pages 155-156 and add new pages 155-156-1
pages 224-227 and add new pages 224-227-1
pages 455-459 and add new pages 455-460

Attachments



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

April 23, 1986

Mr. Michael Helmick
Chairman, Stockbrokerage
Auditing Subcommittee
American Institute of Certified
Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Mr. Helmick:

This is in response to your letter dated November 11, 1985 concerning the effects of a broker-dealer's use of trade date or settlement date accounting for its financials.

The Stockbrokerage Auditing Subcommittee of the American Institute of Certified Public Accountants issued a revised edition of its guide "Audits of Brokers and Dealers in Securities" in January 1985.

That guide states:

". . . brokers and dealers generally use settlement date accounting. However, generally accepted accounting principles normally require that financial effect be given to transactions at the time an event takes place - that is, the time an entity acquires a resource from or incurs an obligation to others-which would make the use of trade date accounting appropriate. Thus, consideration should be given to the possible effect on the financial statements of unsettled transactions. The area of most concern is the income statement, which should include the effect of all transactions on a trade date basis. For example, accruals should be made for realized or unrealized gains and losses in securities purchased or sold for the broker's or dealer's account but not yet settled, and for commissions, net of related salesman's share, on unrecorded agency transactions. Other than for the commission accrued, gross receivables or payables related to unsettled agency transaction ordinarily are not shown on the statement of financial condition. However, accruals should be made in the statement of financial condition for the broker's or dealer's inventory positions that are expected

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to settle in the regular-way and for any other transactions with delayed settlements that are expected to be settled for cash in the future and that are not contingent (such as a when-issued or stand-by transaction). Because of the practical difficulty in identifying the offsetting entry to each such inventory position, a net receivable or payable may be accrued." Page 36

You state in your letter:

"The principal effect of a change to trade date is on firm inventory positions, and we see no problem with such a change from either a financial statement or net capital computation viewpoint. In fact, with the constant introduction of new types of securities with varying settlement dates combined with complex trading strategies, trade date inventory is extremely preferable in that it always gives a fair presentation from a financial statement viewpoint as well as the most logical capital charge under SEC Rule 15c3-1. In addition, it is our view that switching to trade date will not present major operational problems although it will be more costly and time consuming for the larger firms than the smaller firms.

"Firms that use the trade date basis of recordkeeping are in compliance with the Guide (i.e. - generally accepted accounting principles) while firms that use the settlement date basis of recordkeeping are in compliance with the Guide only if the difference between trade date and settlement date accounting is not material. Therefore, FOCUS Reports can be prepared on a settlement date basis and still be in compliance with the Guide if the difference between trade date and settlement date is not material. However, if the difference is material, the adjustment to trade date must be made in the financial statements as well as being included in the net capital computation." [emphasis added]

It is the view of the Division that for purposes of Rules 15c3-1, 15c3-3, 17a-3 and 17a-5,

1. If a broker or dealer uses settlement date accounting as contemplated by the Guide, it must compute its net capital including haircuts on a settlement date basis.
2. If a broker or dealer uses trade date accounting as contemplated by the Guide, it must compute its net capital including haircuts on a trade date basis.
3. If a broker or dealer must use the trade date basis of accounting because, as you state above, "the difference between trade date and settlement date accounting is . . . material," it must compute its net capital, including haircuts on a trade date

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basis.

4. If a broker or dealer uses settlement date accounting, as contemplated by the Guide, it must continue to adhere to that method of accounting unless a change is required because of a "material difference" between trade date and settlement date accounting or unless the broker or dealer advises its designated examining authority of a change to trade date.

5. If a broker or dealer must use trade date accounting because of a material difference between trade date and settlement date accounting on more than on an occasional basis, (i.e. twice in a 6 month period), it should probably use trade date accounting on a consistent basis.

6. If a broker or dealer uses trade date accounting on a consistent basis, it must continue to adhere to that method of accounting, unless a change is approved by its designated examining authority.

7. In any event, the broker or dealer must maintain the securities record required by Rule 17a-3(a)(5) on a settlement date basis. Additionally, the broker or dealer must compute the formula set forth in Rule 15c3-3a (17 CFR 240.15c3-3a) on a settlement date basis.

You further state that a firm's recording firm security positions that have not yet settled will result in a net payable or net receivable on its books. Finally, you note that customer transactions would in any event continue to be recorded on a settlement date basis, except for commissions which would be on a trade date basis.

Based on your statements, the Division will raise no question nor recommend any action if; for purposes of Rule 15c3-1,

1. any net receivable resulting from this accounting treatment is not deducted from net worth in computing net capital;

2. any net payable resulting from this accounting treatment is not included in aggregate indebtedness.

Sincerely,



Michael A. Macchiaroli
Assistant Director