



DIVISION OF  
MARKET REGULATION

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

December 16, 2005

Ms. Kris Dailey, Managing Director  
Member Firm Regulation  
New York Stock Exchange, Inc.  
20 Broad Street  
New York, New York 10005

Ms. Susan DeMando, Associate Vice President  
Department of Member Regulation  
NASD Regulation, Inc.  
1735 K Street, NW  
Washington, D.C. 20006-1500

Re: Annual Audited Financial Statement Filing Requirements Under Rule 17a-5

Dear Ms. Dailey and Ms. DeMando:

Broker-dealers are required, pursuant to Rule 17a-5(d) of the Securities Exchange Act of 1934 ("Exchange Act"),<sup>1</sup> to file annually with the Commission, on a calendar or fiscal year basis, a report which shall be audited by an independent public accountant. The report must be as of the same fixed or determinable date each year, unless a change is approved in writing by the broker-dealer's designated examining authority ("DEA"). The audit report's scope includes, among other things, the broker-dealer's balance sheet, income statement, net capital computation,<sup>2</sup> and customer reserve computation.<sup>3</sup> The balance sheet and net capital computation are made available to the public, while the remainder of the audit report is kept confidential if the broker-dealer requests such treatment. The audit report provides the Commission with an independent confirmation of the broker-dealer's financial condition and compliance with the Commission's financial responsibility rules. It provides the firm's customers with a confirmation of the state of the firm's solvency.

Each year, the Division of Market Regulation ("Division") of the Securities and Exchange Commission ("Commission") receives requests from broker-dealers for no-action relief from the requirement to obtain an audit pursuant to Rule 17a-5(d) where the registration of the broker-dealer with the Commission became effective shortly before the

<sup>1</sup> 17 CFR 240.17a-5(d).

<sup>2</sup> The Commission's net capital rule requires a broker-dealer to maintain a minimum level of highly liquid assets as part of its net worth. 17 CFR 240.15c3-1.

<sup>3</sup> The Commission's customer protection rule requires a broker-dealer that carries customer securities and cash to set aside in a special bank account a reserve equal to the net amount of cash it owes its customers. 17 CFR 240.15c3-3.

end of the initial audit period. When the audit period is three months or less, these broker-dealers assert that the benefits associated with the Commission's audit requirement are minimal and do not outweigh the costs. As part of their request, the broker-dealers agree that their audited annual report for the next audit period will cover the entire period from the effective date of the broker-dealer's registration with the Commission.

Based on the foregoing, the Division will not recommend enforcement action to the Commission when a broker-dealer does not file the audited annual report of financial statements required by Rule 17a-5(d) for its initial audit period under the following circumstances:

- (a) the registration of the broker-dealer with the Commission became effective within three months of the end of its initial audit period;<sup>4</sup>
- (b) the broker-dealer does not clear transactions, does not carry customer accounts, and is not a broker-dealer that effectuates financial transactions with customers in accordance with Exchange Act Rule 15c3-3(k)(2)(i);<sup>5</sup>
- (c) the broker-dealer's audited annual report for the next audit period will cover the entire period from the effective date of the broker-dealer's registration with the Commission; and
- (d) the broker-dealer sends notice to the Commission and to its DEA before its audited annual report is due that it has met the above conditions.

This letter applies only to the filing of audited financial statements in accordance with Rule 17a-5(d). The DEA of a broker-dealer may have separate rules for other required filings of financial statements.

This letter expresses a staff position with respect to enforcement only and does not purport to state any legal conclusion on this matter. The Division's position is confined to the facts as described in this letter. Any material change in circumstances may warrant a different conclusion and should be brought immediately to the Division's attention.

Sincerely yours,



Thomas K. McGowan  
Assistant Director

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<sup>4</sup> A broker-dealer whose initial fiscal year ended before the issuance date of this letter but whose audit is due after the issuance date may rely on this letter, provided that all the conditions are met.  
<sup>5</sup> 17 CFR 240.15c3-3(k)(2)(i).