iad INTERNAL AUDITORS DIVISION
SECURITIES INDUSTRY ASSOCIATION
SIA

Corporate Debt / Preferred Stock

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SECURITIES INDUSTRY ASSOCIATION
INTERNAL AUDITORS DIVISION
AUDIT GUIDELINES COMMITTEE

I. Background

Corporate bonds and preferred stock are two tools used by corporations to raise capital. Corporate bonds appeal to investors who are looking for current income with reasonable principal protection. These investors can be individuals or institutions. Preferred stock with dividend preferences appeal primarily to institutional customers who are eligible for dividend exclusion tax treatment. For purposes of this guide, preferred stock is considered to be a preferred which is not convertible as convertibles trade like equities and this guide is oriented towards fixed income. Detailed fact sheets describing general information, transaction terms and factors affecting prices of corporate bonds and preferred stocks are included as Exhibits I and II to this guide.

Corporate bond and preferred stock sales and trading desks can be oriented towards institutional business, retail business or both depending upon the size of the brokerage house. This guide assumes the desks to be institutional. The major difference between retail and institutional desks is that in a retail environment, the sales force is located in a branch system which would be audited separately. For information concerning branch audit procedures reference is made to the IAD Retail Branch Audit Guideline, dated April 2003.

Institutional Corporate Bond and Preferred Stock (ICBPS) trading desks exist to facilitate the execution of institutional customer orders and to hold selected securities for short periods to serve distribution needs and to generate proprietary trading income. The staffing of these desks typically consists of a head trader and, depending upon size, a group of traders divided along industry and product lines (i.e., bond trading groups for utilities, industrials, and banks and finance companies as well as separate traders for preferred stock). These individual traders are usually assisted by a number of trading assistants who perform many of the desk's record keeping and trade balancing functions. The head trader is responsible for monitoring the activities of each of his traders. Examples of reports he/she would use to monitor daily activities include fail reports, marked position reports, position vs. limit reports, profit and loss analyses and aged positions. These reports should be reviewed for each individual trader as well as for the desk as a whole. The head trader should also review correction statistics (e.g., errors and "as of" trades) on a weekly basis to determine if his desk is creating an excessive number of corrections and thus causing operational inefficiencies.

Institutional corporate bond and preferred stock sales desks exist to service institutional clients by transmitting their buy and sell orders to the trading desk. These sales desks also serve as conduits for the distribution of new bond and preferred stock issues to institutional customers. The staffing of these desks typically consists of a head salesman, a group of salesmen and a number of sales assistants. The head salesman is responsible for monitoring the activities of each of his salesmen. Examples of information and reports he would use to monitor these activities include daily fail reports and sales activity runs by salesman. Examples of weekly information he would use are reports of new account documentation deficiencies, desk correction statistics, unsecured debits and unregistered business.

II. Risks

There are a variety of risks associated with sales and trading desk activities, each of which can directly or indirectly expose a firm financially. For this reason, these risks must be controlled on a daily basis. These risks can be broken down into those that apply to both sales and trading activities or those that relate to only sales or trading. The following are examples of common risks and typical controls associated with sales and trading desk activities:

Risks common to both sales and trading:

Inaccurate Trade Processing -
Inaccurate trade processing will result in inaccurate firm records, inaccurate trade confirmations and an increased Purchase & Sales (P&S) workload due to an increase in the number of comparison breaks. Typical controls to reduce this risk include having some type of playback function to verify trade input at the point of entry and daily balancing of trade processing system and desk blotter positions to identify out of balance conditions.

Improper use of "as of" trades and trade corrections -
Frequent processing of "as of" trades and trade corrections can be indicative of trade execution/ processing problems or improper trading. A common control in this area is to have head traders or head salesmen sign and approve each "as of" or as a correction trade ticket prior to processing.

Inaccurate net interest calculations -
Accrued interest on bond transactions will either be calculated manually by the trader or automatically by the trade processing system depending upon the level of sophistication of the system. Inaccurately calculated net interest can cause P & S breaks on dealer to dealer trades or possible unsecured debits or customer dissatisfaction on transactions. A typical control in an automated system is to ensure all glossary information for each bond is verified prior to input. The risk of improper interest calculation will probably not be controlled beyond the initial calculation in a non-automated system. Over or underpayment of customer interest will ultimately result in either P & S breaks on dealer trades or Bond Interest Department debits or credits on customer trades.

Fails to deliver not offset by fails to receive –
Fails to deliver cost the delivering firm money because the seller will receive interest only through settlement date and thereby lose the opportunity to earn interest on their capital. This risk can be controlled through the traders and head trader reviewing fail reports and trying to either borrow the bonds to deliver against the fail or cover the short sale.

Inaccurate management reporting -
Inaccurate management reporting of Trading and Sales results can cause breakdowns in various ways too obvious and numerous to mention. This should be a key focus of the audit.

Improperly or unregistered personnel –
Many desk employees must pass certain registration exams to be legally qualified for their job functions. An auditor should consult his firm's Registration or Compliance Department to identify applicable requirements at the time of the audit. Failure to comply with these requirements could lead to regulatory sanctions or poor legal standing in the event of a client lawsuit.

Misuse of non-public information -
Information barriers between the corporate finance, research, trading and sales areas of the organization may not be sufficient to prevent the misuse of non-public information. This could result in regulatory and legal exposure. Corporate policy should clearly prohibit the exchange of non-public information between specified areas of the organization and physical barriers between those areas should exist.

Risks unique to the sales aspect:

Failure to properly supervise salesmen -
A head salesman is required to perform certain supervisory functions to supervise his salesmen. The most common of these activities is a daily trade ticket or sales activity review. Failure to perform these functions could create a lax control environment and could also lead to regulatory sanction.

Failure to obtain, prepare and/or approve new account documentation -
Salesmen are required to prepare and head salesmen are required to approve new account forms for new customers. Firms should also maintain up to date corporate resolutions and trading authorizations for all accounts, indicating the type of trading that can be done in that account and who is authorized to initiate such trades. Failure to obtain these documents can impair a firm's ability to prove it "knew" its customer in the event of a lawsuit or regulatory review.

Failure to apply sufficient due diligence on customer accounts –
Anti-money laundering laws and regulations require the existence of a formalized customer identification program to identify accounts that may be likely to engage in money laundering activities. An effective customer identification program should be in place and conform to the regulatory requirements. For more detailed information concerning these requirements and the related audit implications reference is made to the IAD Anti-Money Laundering Audit Guidelines, dated April 2002.

Over-extension of business to customers –
Failure to manage the amount of business with customers within acceptable limits could result in excessive credit exposure. A process should exist for developing and monitoring approved risk limits for each customer which can only be exceeded with the prior approval of a risk monitoring group or executive who is independent of sales and trading.

Failure to resolve DVP account balances –
DVP account balances should be zero if all transactions have been properly calculated and posted (e. g., interest payments on bonds). Balances in these accounts usually indicate errors. Debit balances which go unaddressed for a period of time can tend to result in unsecured debits which may eventually have to be written-off. To control this risk, salesmen and sales assistants should periodically review all customer accounts to identify and research non-zero balances.

Excessive Markups/Markdowns
The NASD has issued markup guidelines for preferred stock sales. These guidelines generally allow for markups and markdowns up to a certain percentage of the trade value. Compliance with these guidelines should be monitored during the head salesman's trade ticket or activity review. This issue is particularly important for sales desks that service retail customers.

Risks unique to trading aspect:

Improper marking -
Each firm should have a policy that requires all positions to be marked to the market daily. Failure to properly mark positions will misstate management's profit and loss reports and can be indicative of a trader in trouble. Optimum control in this area would be to have the responsibility for marking positions done by a group independent from the trading function. Alternatively, if the trading area is responsible for pricing positions, those prices should be independently reviewed.

Market exposure –

Approved policies and procedures should be in place to measure, monitor and mitigate excessive exposure to changing market prices. Methods used to manage market risk include: (1) establishment of concentration limits (e.g., issuer and industry segment) to avoid over exposure to a single issuer or industry segment; (2) use of quantitative tools designed to measure and monitor market exposure, and; (3) procedures to inform appropriate trading areas when market exposure exceeds acceptable levels, along with clear policies regarding the steps to be taken in such conditions.

Trading limit averages -
Each product area should be assigned a gross, net and risk position limit by upper management. A head trader can consider further subdividing the desk's limit into individual trader limits. Failure to comply with trading limits can expose the firm to unwanted market risk. Compliance with limits should be monitored daily and the desk should be required to request permission to exceed their limit prior to doing so. Limit calculations should also be independently reviewed on a periodic basis.

Unbalanced blotter and processing system/general ledger positions -
Trading blotter and processing system positions should be balanced on a daily basis. This will ensure all trades have been recorded on both systems, avoid the possibility of a trader losing track of his position and reduce P & S comparison breaks.

III. Audit Objectives

While the objectives of any sales and trading desk audit will most likely include objectives that are unique to that audit, there are objectives which are common to all ICBPS audits. These objectives can be broken down into those that apply to both the sales and trading portions of the audit and those that apply to only one of the two portions. Typical objectives of an ICBPS audit are as follows:

Objectives that apply to both the sales and trading portions:

- to determine that controls are in place to ensure trades are booked promptly, accurately and completely;
- to ensure all "as of" trades and trade corrections are approved by the head salesman or head trader;
- to ensure net interest for each bond trade is being accurately calculated;
- to ensure all fails to deliver and fails to receive are being continuously monitored and rectified on a timely basis;
- to verify the accuracy and completeness of management reporting (inventory reports, fail reports, aging reports, and profit and loss reports);
- to ensure all desk employees are properly registered;
- to ensure that corporate policy clearly prohibits the misuse of non-public information and that effective physical barriers deter the likelihood of improper exchanges of information; and,
- to ensure all personal trading accounts of employees are being reviewed by each employee's supervisor.

0bjectives that apply to the sales portion of the audit:

- to ensure that daily activity of each salesman is reviewed by the head salesman;
- to ensure that new account forms have been prepared and approved and trading authorizations have been obtained for all active accounts;
- to ensure that an effective customer identification and Know-Your-Client programs is in place and is being followed in compliance with anti-money laundering regulations;
- to ensure that appropriate credit risk limits have been established and are monitored for each customer;
- to ensure customer mark-ups are reasonable relative to NASD mark-up rules; and
- to ensure unsecured debits in customer accounts are being promptly collected.

Objectives that apply to the trading portion of the audit:

- to ensure that inventory is being accurately marked to market on a continuing basis;
- to ensure that inventory per the general ledger agrees to inventory per the desk's trading blotters and that such inventory is being included in firmwide capital computations;
- to ensure that market exposure is being measured and monitored and that appropriate action is taken when market exposure exceeds acceptable levels;
- to ensure that all traders are complying with position limits on a continuous basis;
- to ensure procedures address P & S dealer to dealer break notices are adequate and that such procedures include making the head trader aware of such breaks; and

- to ensure desk trading patterns are not unusual and are not indicative of any questionable relationships.

IV. Audit Procedures

A. Transactional Testing

1. Verify that the head trader or designee reviews all additions and corrections to security descriptions on the security master file prior to entry.
2. Verify that traders are receiving accurate and timely trade information, on available inventory for automatically executed trades.

3.a. Select a sample of trades and verify that the tickets are complete and accurate. These tickets should be approved by the traders prior to input and execution.

3.b. Verify that all tickets are time-stamped when entered and executed.

4. Verify that each trade and related interest was accurately input and reflected on the firm's inventory system.
5. Verify that all trade corrections are documented on the desk's records in a timely manner and approved by the appropriate trader/supervisor prior to entry.
6. Verify that desk personnel are ensuring that all corrections and cancellations are accurately entered and processed.
7. Where batch systems are utilized, verify through discussions with traders that their slates are adjusted timely and accurately for each trade executed.
8. Verify the accuracy of the trader's slate and General Ledger (G/L) system reconciliation for a sample of days in the period under review.
9. Verify that all breaks between the desk and the G/L system generated reports are documented and resolved in a timely manner.
10. Verify that the traders are not receiving or sending trade comparisons or confirmations. The comparison function should be performed by P & S personnel. Verify that all external trade discrepancies are researched and resolved promptly.

11a. Verify that sales credits offered adhere to department guidelines.

11b. For credits which exceed the guidelines, determine if a reasonable explanation exists and if a pattern of trader, account executive or customer involvement exists.

11c. Verify that the trading system will not allow sales credits to be overridden by unauthorized personnel (e.g., account executives).

B. Exception Testing

1. Discuss with the Purchase and Sale Department and determine if a review of un-compared trades is necessary. If a review of the P & S cycle is necessary perform the following steps:
2. Select a sample of Don't Know (DKs) and failed trades and verify that:
   - the discrepancy was documented and resolved in a timely manner.
   - a pattern of DK trades does not exist by customer, by salesperson or trader.
3. Select a sample of "as of" trades and determine if:
   - the trade was executed at the "as of" date price.
   - there is an adequate explanation for the trade and evidence of head trader approval.
   - there is a pattern of trader, AE or customer involvement.

C. Trading Activity Monitoring

1. Verify that individual trader, desk, and issuer positions are within limits established by trading administration. If the limits were exceeded, verify that approval was obtained from trading management and that senior management was notified.
2. Verify that each trader is executing trades only in securities/product line in which he/she has been assigned.
3. Select a sample of traders and review their positions and trading for the period under review. Be alert for unusual patterns such as:
   - trader/desk purchasing and selling the same quantity for one security with the same counterparty in a short period.
   - trader/desk offering favorable prices to select clients.
4. Determine if the system provides an aged inventory report for slow moving or possibly overvalued inventory. Evaluate management's procedures including the timing of reviews.
5. Select a sample of aged and concentrated inventory positions and determine that the head trader is aware and has approved these positions.
6. Select a sample of trader transactions in the period under review and verify that:

a) transaction was entered into by an authorized individual (properly registered and authorized to trade in security),

b) the trade was executed at a reasonableness basis, and

c) there is no pattern of customers receiving a price that is not reasonable when compared to the security's price during the day.

7. Review the activity in the suspense/error accounts and determine that all items are cleared in a timely manner.

   a) Ascertain the validity of all clean-up activity against employee related accounts.

   b) Obtain month-end reconciliations of error account balances to positions on hand. Verify that reconciling items have been addressed and resolved.

   c) Determine that the head trader has approved the resolution of all trading errors.

8. Review hedge trading activity versus desk exposure. Determine if exposure is properly hedged and that the desk is not speculating in futures without trading administration approval.

9. Review the process for measuring and monitoring market exposure and ascertain that appropriate action is taken to reduce exposure when it exceeds acceptable levels.

D. Trading Profit and Loss (P/L)

1. Select a sample of the traders' daily realized/ unrealized P/L estimates and determine if they are complete and accurate.

2. Determine if an independent party (e.g., Firm Trading Accounting) is responsible for pricing positions or, alternatively, reviews the trader inventory valuations.

3. Evaluate the adequacy of procedures employed in the independent review process.

4. Perform compliance and substantive testwork to determine the reasonableness of inventory valuations. Substantive testwork would involve obtaining comparative price estimates from the following:

   - independent published sources (Wall Street Journal, New York Times, Barrons Magazine, Standard & Poor's Guides, Moody's Bond Survey),

   - telephoning other market-makers (broker/ dealers listed in NASDAQ's pink and yellow sheets), or

   - reviewing prior and subsequent trading activity with independent parties.

5. Select sample of month-ends and verify that the mark to market is posted to the general ledger accurately.

6. Analyze the overall profitability of each trader by comparing the cost of inventory carry and the daily profit/loss for a sample period. Ensure that trading administration's management reports reflect accurate information regarding desk/trader profitability.

E. Joint Trading Account Review

1. Verify that all joint trading accounts are supported with executed agreements clearly establishing profit/loss responsibility.

2. Verify that Firm Trading Accounting is accurately recording profit and loss for all parties.

3. Verify that the head trader is reviewing joint trading account activity.

4. Verify accounts are being closed out on a timely basis in accordance with agreement.

F. Regulatory Review

Note: The following procedures can be performed as part of a comprehensive review of the desk's activities or may be performed as part of a review of the Net Capital Computation.

1. Evaluate the adequacy of procedures employed in calculating the capital charges on inventory positions.

2. Reconcile the Firm Trading inventory to Regulatory Reporting inventory to ensure that all positions are included in the haircut calculation.

3. Select a sample of positions and test to ensure that the capital charge taken is in compliance with the Net Capital Rule (l5c3-1) Regulation 240.l5c3-1a paragraphs A-J.

4. Review the sample and determine if any additional haircut charges are required (e.g., Regulation 240.l5c3-1a paragraphs K-M securities with a limited market or undue concentration). Evaluate whether sufficient evidence was compiled for Regulatory Accounting to support charge taken.

5. Trace and agree inventory balances to FOCUS report and financial statements and trace capital charges on inventory to the Net Capital Computation.

G. New Accounts

1. Select a sample of new account forms and review the completeness of the document as a

function of NYSE Rule 409 ("Know your customer rule").

2. Determine if the form has been approved by a duly qualified individual.
3. Review the form and evaluate if other approvals are required (i.e., Legal Department approval of accounts of subsidiaries of clients).
4. Determine if the required documents have been obtained by the firm prior to the commencement of trading (i.e., corporate resolutions/charters, partnership agreements, margin agreements, option agreements).
8. Based upon discussion with the sales manager or his/her designee and review of aged document listing analyze whether the firm is conducting business with clients prior to obtaining all required documents.
9. Ascertain that a formal customer identification program exists, is being followed and complies with anti-money laundering regulations (see IAD Anti-Money Laundering Guidelines for more specific information).

H. Sales Activity Review

1. Discuss the head salesman's or designee's procedures for conducting his daily trade ticket or sales activity review.
2. Select a sample of daily tickets and determine if there is evidence of the sales manager's review.
3. Verify that risk limits for customer accounts have been established and are monitored. Obtain a sample of exception reports where accounts have exceeded their limits and ascertain that:
    - ♦ Prior approval was received
    - ♦ Accounts were bought into compliance with their limits within a reasonable period of time.

I. Customer Account Review

1. Discuss customer account review procedures with the sales manager or designee.

   Determine if all accounts are being reviewed by a qualified individual on a quarterly basis.
2. Select a sample of accounts and verify that the sales manager has documented the review.
3. Discuss with the sales manager the procedures for identifying and monitoring unsecured debits. Determine if these procedures include interfaces with Cashiering to monitor the performance of accounts on a settlement date basis.
4. Select a sample of accounts with the unsecured debit balances and determine if the sales manager is complying with their procedures. Be alert for RVP/DVP accounts with debit/credit balances. The balances in these accounts should be zero if all transactions have been properly calculated and posted.
5. Discuss the unsecured debit with appropriate management. Determine if reserves have been set up for receivables and what the likelihood for collection is.
6. Review accounts where collection of debits is unlikely. Determine what the controls are to limit further business with contra-party. Discuss exceptions with sales managers.
7. Review aging of reserves and test to determine that they are written off in a timely manner.

J. Monitoring Employee Accounts

1.a. Verify that all trading and sales employee trading accounts are duplicated for senior department management's review. Sales manager and head trader account's should be reviewed by Trading Administration.

b. Ensure that senior department management's review is documented and occurs on a regular basis (i.e., monthly).

2. Select a sample of employee accounts and review activity to determine if any trading pattern (prices not reflective of market, large dollar trades) are evident.
3. Select a sample of trade corrections/cancellations in employee accounts and determine if change occurred in conjunction with an unfavorable price movement.
4. Determine that a formal policy exists governing the personal trading of employees and that the employees have signed an acknowledgement that they have read and understand the policy.

K. Compliance Testing

1. Reconcile employee listing obtained from personnel and payroll to identify all trading and sales employees.
2. Using final employee roster obtained above and the most current Registration Department run verify that:
    - all applicable employees are properly registered (securities and commodities),
    - applicable supervisory personnel are registered as securities principals.
3. Verify that none of the traders/salesmen are currently barred or suspended from being associated with an exchange or association. If

they are, verify that they are not conducting business.

4. Discuss the desk's procedures for complying with the NASD's trade reporting and mark-up on principal trade requirements.
5. Select a sample of days in the period under review for testing.
6. Obtain the preferred stock trade tickets and NASD trade report information and determine that:
   - all required trades were reported within 90 seconds of execution, and
   - that the NASD's mark-up guideline was not exceeded.
7. Verify that the mark-up (principal trades) or the commission (agency trades) was reflected in the customer confirm.
8. Verify that the desk is in compliance with the applicable record retention requirements.
9. Ascertain that a formal policy exists concerning the exchange of non-public information between specified areas of the organization and that effective physical barriers have been established between those areas.

L. Fail to Receive/Deliver

1. Review the procedures employed by the receive/deliver section of operations.
2. Review operation's procedures to determine if timely action is taken to research and resolve the fails.
3. Determine if aged fails to receive/deliver detail and summary information is communicated to Regulatory Accounting for inclusion in the Net Capital Computation.
4. Determine the manner in which fail information is communicated to management (i.e., fail reports by customer, large dollar).
5. Discuss the desk's procedures for reviewing the fail to deliver report and evaluate whether their procedures include trying to borrow the bonds when they are in a net fail to deliver position.

EXHIBIT I

CORPORATE BOND FACT SHEET

General Information

Denomination:	Usually $1,000
Maturity Date:	Stated on bond; can be up to 30 years
Interest Rate and Payment Dates:	Interest usually paid semi-annually at one half of stated interest rate on bond.
Form:	Can be either bearer or registered although all bonds issued after July 1, 1983 are in registered form
Market Place	Exchanges or OTC
Common Issuers:	Large, publicly held companies generally classified in one of three categories: utilities, industrials, or bank and finance companies.
Common Investors:	Those looking for current income with reasonable principal protection: individuals, financial institutions, banks, pension funds, corporations and professional money managers.

Transaction Terms

Transaction Price:	Stated as a percentage of par. Bonds also normally trade plus accrued interest based upon the number of days from (and including) the last payment date through the day before settlement divided by 360 multiplied by the bonds' stated interest rate. In such a calculation, all months are assumed to have 30 days.
Settlement Period:	Usually 3 business days ("regular way").
Price/Interest Rate Relationship:	Bond prices and interest rates generally move inversely (i.e., declining rates results in higher bond prices).

Factors Affecting Individual Bond Prices

Macro Economic:	General state of economy and perceived direction of future interest rates; Outlook for the issuer's industry
Micro Economic:	Current yield and yield to maturity of the individual bond;
	Length of time to maturity of the bond;
	Whether or not the bond has a sinking fund;
	The call or redemption date of the bond and call price;
	The rating of the issuer from either Standard and Poor's or Moody's and the prospect for changes in that rating;
	The company's cash flow and key ratios relative to the trends for that company and comparable companies within the industry.

EXHIBIT II

PREFERRED STOCK FACT SHEET

General Information

Denomination:	Shares
Maturity:	May have a stated maturity or may be perpetual.
Form:	Can be either bearer or registered.
Market Place:	Exchanges or OTC.
Preferences:	Features designed by issuers and investment bankers to make these issues more attractive to the public while providing certain benefits to the issuer. Such features can be:

- *Dividend preference* - the stock has a dividend rate, stated as a percentage of par or as a particular annual dollar amount. This dividend must be paid in full before any common stock dividend can be paid.
- *Cumulative dividend preference* - similar to a dividend preference, except in this case, if the issuer does not pay the preferred dividend for a particular period, all such missed preferred dividends must be paid in full before a common stock dividend can be paid.
- *Participating dividends preference* - holders of preferred stock with this preference are eligible to receive dividends above their stated dividend should the company's earnings improve and the issuer's board of directors see fit to declare additional dividends.
- *Conversion preference* - this preference allows holders to convert their preferred into common stock at a stated rate.
- *Call preference* - this preference allows the issuer to retire the preferred at its option at a predetermined price.

Preferred stock can be issued with a combination of any or all of these or other preferences. Preferred stock with a conversion preference is normally considered an equity and is, therefore, excluded from the remainder of this analysis as this guide is oriented towards Fixed Income products.

Common Issuers:	Electric utilities, banks and industrial companies. Electric utilities usually issue preferred with finite or perpetual lives and set dividend preferences. Banks and industrial companies usually issue preferred with dividend preferences which are adjustable on a quarterly basis based upon a set basis point differential above or below the highest yielding 10, 20 or 30 year Treasury security.
Common Investors:	Insurance companies, major corporations, banks and mutual funds are the primary investors in these securities although there is some retail interest.

Transaction Terms

Transaction Price:	Quoted as a dollar value per share. Transactions can appear to be priced away from listed market quotes as those quotes are for small lots and most transactions are larger and executed away from the market (i.e., dealer to dealer over the counter).
Settlement Period:	3 business days.

Factors Affecting Individual Preferred Prices

Macro Economic:	General state of economy and perceived direction of future interest rates; Outlook for the issuer's industry;
Micro Economic:	Yield; Length of time to retirement (if applicable); The call date and price (if applicable); The rating of the issuer from either Standard and Poor's or Moody's and the prospect for changes in that rating; The company's earnings, cash flow and key ratios relative to the trends for that company and comparable companies within the industry.

The Audit Guidelines (the “guidelines” are intended to provide members of the Securities Industry Association (“SIA”), Internal Auditors Division with information for the purpose of developing or improving their approach towards auditing certain functions or products typically conducted by a registered broker-dealer. These guidelines do not represent a comprehensive list of all work steps or procedures that can be followed during the course of an audit and do not purport to be the official position or approach of any one group or organization, including SIA or any of its divisions or affiliates. Neither SIA, nor any of its divisions or affiliates, assumes any liability for errors or omissions resulting from the execution of any work steps within these guidelines or any other procedures derived from the reader’s interpretation of such guidelines. In using these guidelines, member firms should consider the nature and context of their business and related risks to their organization and tailor the work steps accordingly. Internal auditors should always utilize professional judgment in determining appropriate work steps when executing an audit.