



AUDIT GUIDELINES RETAIL BRANCHES

April 2003

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.



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I. INTRODUCTION TO BRANCH AUDITING

General Background

The auditing of retail branch offices has become more specialized over the years as the composition of the retail branch has changed. From sales offices comprised mainly of commissioned brokers, the office has evolved into a many faceted revenue-producing center. In some cases the commission driven offices have been replaced by those with fixed annual fees, the assigned stockbroker replaced by “Client Relationship Managers,” the telephone replaced by the web and an ever-increasing number of new products replacing common stocks and bonds. In addition, outside events have placed additional responsibilities on branch personnel. Where once the retail branch office stood as a sales arm of the broker/dealer, today it is not only that, but is also the firm’s outpost protecting it from such illegal activities as money laundering (for additional information reference is made to the Audit Guideline on Anti-Money Laundering). This Audit Guideline document for Retail Branch Auditing is a tool designed to assist the internal auditor in assessing the potential risks associated with branch activities, the related controls that may be utilized to manage those risks and possible audit steps that can be performed by the auditor to assess the effectiveness of those controls.

The primary communication link between a broker/dealer and its retail customers is through the sales and operations personnel at the branch. Customers rely on quality service for their trading as well as for timely problem resolution. Therefore, a well-controlled and efficiently run retail branch system is critical towards retaining customers, growing the customer asset base and maximizing profits.

Risk and exposure relative to retail branch activities is increased because of the decentralized and geographically dispersed nature of a branch system. Consequently, it is important that branch controls be reviewed on a regular basis. Also, branch personnel must be adequately trained in the duties and responsibilities with which they are charged.

Retail Branch Activities

The focus of this Guideline is on retail branches, the most common type of branch business activity. The staffing composition of the branch is generally made up of the sales force, operations personnel and management. The sales force typically consists of account executives (also known as brokers, registered representatives, financial advisors or executives and financial or investment representatives) and their sales assistants. Operations personnel include the staff responsible for all non-sales activities, such as cashiering. Although generally discouraged by regulators, the branch manager and assistant branch manager might also have customer or sales responsibilities. The degree of automation available at the branch level and the number of trades normally determines the ratio of sales to support. This ratio is a good indication of how efficiently the branch is operating. The management group usually is made up of the branch manager (also, in some cases a regional branch manager), assistant branch manager and operations manager. Frequently, the management team will also include a branch compliance officer who should have an independent reporting line (including performance evaluation and compensation) to the main office.

Retail Branch Activities (Cont'd)

In larger branches, one may find sales teams, clusters of four or five sales persons with one of the group acting as their leader. This structure is usually found in branches that have inexperienced sales personnel or a high turnover rate of sales personnel. The role of the leader is to assist in generating sales as opposed to acting in a supervisory capacity. These “cluster” type arrangements should be examined closely to ensure that they are adequately supervised.

Account Executives (referred to in this Guideline as ‘reps’) may be commissioned per trade, commissioned based on total assets under management or salaried. Their method of compensation and the percentage of their payout can vary greatly. Most of the payout, especially with the more established producers, is negotiated. An understanding of the payout schedules per broker is helpful in reviewing their sales activity. For example, when a particular broker’s payout rate increases when certain levels of production are reached, the risk that unauthorized trading has occurred as the increased payout ratio nears becomes greater.

As stated above, products can vary from office to office. The use or misuse of a product can lead to regulatory, legal or reputation problems at a later date. Certain products representing higher degrees of risk, which the auditor should factor into their program, include options, low priced securities (i.e., penny stocks), illiquid securities, hedge funds, private equity funds, structured products (e.g., over the counter derivatives), high yield (junk) bonds and variable annuities. Sales practice activities for the handling of such products should be well established and understood by all sales personnel. Although the supervision of sales practice activities comes under the direct responsibility of the branch manager, most firms have centralized monitoring routines administered by the Compliance Department to identify potential violations of corporate sales practice policies. In addition, the branch must be subjected to an independent annual branch office inspection (NYSE Rule 342 and NASD Rule 3010).

Operations personnel are salaried employees paid to perform specific assignments and should not have any customer or sales responsibilities. Among other things, their functions include receiving securities and funds, as well as tending to inquiries emanating from the main office. They may also process client inquiries. Another important role for the operations staff is to ensure compliance with evolving rules and regulations dealing with anti money laundering (e.g., USA Patriot Act) and privacy laws and regulations (e.g., Gramm Leach Bliley Act). In many cases operations personnel are entitled to receive incentive compensation in addition to their salary. In these cases, the auditor should be cognizant of such pay structures and tailor their audit procedures to account for any inherent risks that might be present in such programs.

Although diminishing in most cases, retail branch offices still receive checks and securities from their clients. In rare cases, branches may also receive currency from their customers. Broker dealers have established procedures for the handling and processing of these items, including automated systems for establishing accounting control over transactions sometimes referred to as SOW and COW (Stock Over the Wire and Cash Over the Wire). The firm should have written procedures for processing funds and securities transactions including opening mail in a secured area, rendering the stock non-negotiable upon receipt and, restrictive endorsement and timely deposit of checks.

Retail Branch Activities (Cont'd)

Broker / dealers generally mail securities and checks directly from the main office to the clients. If the firm permits check processing or handling of securities through the branch, the auditor must ensure that proper controls are present.

While not considered to be a good control practice, in some cases branches may mail trade confirms and or periodic customer statements to the client. If so, the blank forms used must be adequately secured and access restricted only to appropriate (non-sales) personnel.

Order entry may be accomplished in a variety of ways depending upon the degree of automation the firm utilizes and its policies governing order processing. This could range from reps writing tickets and handing them to an order entry employee at the branch, to the reps entering the order directly from their workstation, to clients transmitting orders over the web.

Role of the Retail Branch Manager

Even with changes in structure and the operating methodology of the branch, the primary purpose of the retail branch office remains the generation of revenue and the profitability of the branch. This goal is achievable only when the branch office manager ensures that clients obtain quality services that are in their best interest, that applicable rules, regulations and firm policies are adhered to, that clients' personal information remains confidential and that their assets are properly safeguarded.

To properly discharge his or her responsibilities, the retail branch manager must have an effective means of supervising all rep activities as well as cashiering/operations and administrative functions of the branch. Typically, the branch manager will review daily reports of branch activities, sometimes utilizing a supervisory checklist to ensure and document compliance with firm policies. The branch manager may delegate certain supervisory functions to a qualified individual. However, responsibility for the delegated functions remains with the branch manager who must have an effective means of verifying performance of the delegated duties.

Regulations

Branch activities are subject to the rules and regulations of the Securities and Exchange Commission, applicable self-regulatory organizations, state regulators and, depending upon the firm's capacity and product offerings, various other regulations. Some of the more significant regulations include the following:

NYSE Rule 342 and NASD Rule 3010 – Supervision

- ♦ Each office must be under the supervision and control of the member organization.

Regulations (Cont'd)

NYSE Rule 342 and NASD Rule 3010 – Supervision

- ♦ Delegate to qualified individuals responsibility and authority for supervision and control of each office.
- ♦ Branch office managers who service customer accounts must be independently supervised.
- ♦ Establish procedures for independent verification and testing of branch activities that is separate and apart from the day to day supervision of the branch, normally achieved through an annual branch office inspection program.
- ♦ Report results of verification and testing and significant exceptions identified in the Annual Report to the chief executive officer on the organization's supervision and compliance effort.

NYSE Rule 401 – Business Conduct

- ♦ Requires that written policies and procedures be maintained governing the transmittal of customer funds and securities and changes in customer address or investment objectives.
- ♦ Policies and procedures must include a means/method of customer notification, identification or follow-up that can be documented.

NYSE Rule 405 – Diligence as to Accounts (“Know Your Customer”)

- ♦ Requires that due diligence be used to learn all essential facts about every customer, every order and every person holding power of attorney over an account.
- ♦ All customer accounts must be diligently supervised.
- ♦ New accounts must be approved prior to, or shortly after, the completion of the initial transaction in the account.

NYSE Rule 410 – Records of Orders

- ♦ Requires that a person designated to approve account name or designation changes must have passed a qualifying examination such as the Series 9/10 (Sales Supervision) or Series 14 (Compliance Official) or other sales supervisory examination.
- ♦ Clarifies that the rule applies to all account name and designation changes including related accounts and order errors (orders cancelled and moved into an error account).
- ♦ Requires documentation of the essential facts relied upon when approving an account name or designation change.

Regulations (Cont'd)

Section 326 of the USA Patriot Act – Customer Identification Programs

- ♦ Defines customer as any person who opens a new account at a broker/dealer or who is granted trading authority at a broker/dealer. Someone who has an account at a broker/dealer prior to the effective date of the regulation is not considered a customer. However, if such person opens another account with the broker/dealer after the effective date of the regulation, such person would then be considered a customer.
- ♦ Financial institutions must implement reasonable procedures to: verify the identity of anyone seeking to open an account; maintain records used to verify the person's identity, and; determine whether the person appears on any government agency list of known or suspected terrorists.
- ♦ Broker/dealers must develop and operate a Customer Identification Program and sets forth guidelines for verifying customer identity.

NYSE Rule 445 and NASD Rule 3011 – Anti Money Laundering Compliance Program

- ♦ Requires members to develop and implement a written anti money laundering program designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act.
- ♦ Member personnel or a qualified outside party must independently test the program for compliance. This may be accomplished through the use of audit, compliance or other qualified personnel.
- ♦ Requires the designation of a compliance officer with anti-money laundering responsibilities.
- ♦ Requires on-going training for appropriate personnel.

Graham – Leach – Bliley Act

- ♦ Among other things, requires financial institutions to disclose to customers their policies and practices for protecting the privacy of non – public personal information.
- ♦ Must make disclosure to customers at the time the account is opened and at least annually thereafter.

Bank Secrecy Act

- ♦ Broker/dealers must report currency transactions in excess of \$10,000 on a Currency Transaction Report.
- ♦ “Travel Rule” requires financial institutions to maintain certain information regarding funds transfers of \$3,000 or more and to include the required information in the transmittal of funds.

Risks

The nature of retail branch activities represents several significant risks to a broker/dealer that must be aggressively managed and monitored to avoid serious potential problems. Risk exposure is heightened because the branch is often the focal point of the customer/broker interaction. Risk management and monitoring is made more difficult because of the geographical dispersion of branch operations. Strong policies and procedures are necessary, but only effective to the extent of the understanding and diligence of the personnel responsible for adherence to those policies and procedures at each branch. A well devised, and regularly conducted branch review program is essential to ensuring that effective practices are being followed on a consistent basis throughout the organization. The branch review program may either be conducted by internal audit (utilizing the guidelines contained herein), by the compliance department or by other independent qualified groups. A practice that is often utilized to facilitate the branch audit process and assist the auditor in identifying potential areas requiring focus is the use of a detailed questionnaire to be completed by selected branch personnel prior to the actual branch visit.

Credit risk exists with respect to margin account activity, collateral valuation and coverage relative to non-standard securities transactions such as OTC equity derivatives, forward contracts and other credit related instruments, and partly secured and unsecured accounts. Branches play an important role in ensuring that credit exposure is minimized and accounts are adequately collateralized.

Financial/Operational risk is present in the areas of securities cashiering, funds cashiering and order processing. Securities and funds processing expose a firm to potential losses if they fail to process securities and funds transactions properly. Since branches may be responsible for processing customer orders, failure to do so properly might result in incurring the costs associated with trade errors and cancellations.

Regulatory/Legal risk is particularly present in branch-conducted business. Numerous rules and regulations overlay branch operations. Rules governing supervision, sales practices, margin, customer identification and anti money laundering must be strictly adhered to. Failure to do so exposes the organization to fines, sanctions and increased regulatory charges.

Reputation risk represents a serious concern relative to branch activities. Since the customer/firm interface is frequently defined in terms of the branch, failure to follow sound sales practice procedures or to process customer trades and other customer transactions effectively could result in serious damage to the broker/dealer's reputation and to their ability to maintain or grow its customer base.

Technology risk exists if access to firm or customer proprietary information is not adequately restricted to authorized personnel, either through physical safeguards or sound system access controls and if a sound business continuity plan is not in place.

Audit Guidelines

Retail branch audits are generally conducted in two distinct phases: the pre-visit review and the on-site portion of the review. During the pre-visit review the auditor will obtain an understanding of the policies and procedures followed with respect to branch operations, review exception and transaction records of branch activity and identify items for follow-up during the on-site visit. While on-site, the auditor will perform tests to determine that required policies and procedures are being followed, examine specific branch transactions and follow-up on items identified during the pre-visit review. The audit work steps included in the attached guidelines have been organized between those steps commonly performed during the pre-visit stage and the on-site stage of a branch audit.

The following guidelines are presented to assist the internal auditor in conducting a review of retail branch operations. It is important to note that these guidelines are general in nature and do not necessarily represent an exhaustive set of procedures for auditing all types of branch activities. Other procedures may have to be developed for reviewing certain accounts and products not specifically covered in this guideline. For example, branches that conduct investment banking and capital markets businesses (outside the scope of this Guideline) must be assessed in light of the controls that should be present to manage those types of activities. Judgment should be exercised when determining the specific procedures to be performed and those procedures should be tailored to the environment being reviewed. Certain activities covered in this Guideline may be addressed in a more comprehensive manner in other Guidelines dealing specifically with the subject activity. In that regard, specific reference is made to the Audit Guidelines for Credit Risk and Anti-Money Laundering.

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.



II A. RETAIL BRANCH AUDIT GUIDELINES

This guideline is intended to provide members of the Securities Industry Association, Internal Auditors Division with information for the purpose of developing or improving internal audit programs. The information is designed to provide guidance to member firms in the preparation of procedures tailored to the specific needs of their individual environment. Internal auditors should always use professional judgment in determining appropriate worksteps to complete specific audit steps.

The numbered references in the “Risks to be Managed” section of the following tables are a cross-reference to the “Retail Branch Office Operations Flowchart” included on page 33. These references are included for informational purposes and can be used to determine the potential areas of retail branch operations that may be affected.

Credit

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Margin</u> <ul style="list-style-type: none"> • Credit losses may be incurred as a result of the failure to properly manage margin account activity resulting in partly secured or unsecured accounts. <ul style="list-style-type: none"> ♦ Margin calls may not be issued timely or followed up on to ensure that they are met. ♦ Liquidations are not made when required or not made timely. ♦ Close out of positions in margin accounts to cover calls might result in partly secured or unsecured debit balances. ♦ Unsecured/ partly secured accounts (over-extension of credit) are not monitored and followed up for collection. 	<ul style="list-style-type: none"> • A margin lending agreement is on file and signed by the client. • Margin transactions exceeding pre-established risk levels (e.g., dollar levels, product and collateral types) require margin department and branch manager approval. • Margin call reports (i.e., Fed calls, maintenance calls) are distributed to the branch each day, and: <ul style="list-style-type: none"> ♦ The branch manager reviews the reports. ♦ Reps follow up with customers to inform them of calls and arrange for the submission of collateral sufficient to meet the calls. ♦ The rep and the branch manager approve requests for extensions. 	<u>Pre visit</u> <ul style="list-style-type: none"> • Review margin call reports for the branch and determine that: <ul style="list-style-type: none"> ♦ Calls were issued timely. ♦ Calls were met promptly. ♦ Follow up procedures are adequate. • Analyze call data by rep and by customer noting unusual call activity for follow up during the on site visit. • Gather and analyze data relative to liquidations for customers of the branch: <ul style="list-style-type: none"> ♦ Determine whether there have been an unusual number of liquidations by rep or by customer. ♦ Verify that liquidations were made on a timely basis. ♦ Note any questionable items for follow up during the on site visit.

Credit

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<ul style="list-style-type: none"> • Credit losses may be incurred if adequate collateral is not obtained or maintained in connection with non-standard transactions involving the extension of credit (e.g., OTC equity derivatives, forward contracts, etc.) <p>(11,12,13,14,15)</p>	<ul style="list-style-type: none"> • Liquidation notices are sent to the branch. <ul style="list-style-type: none"> ♦ The branch manager reviews all liquidation notices. ♦ Reps follow up with customers to inform them of possible liquidation. ♦ Requests not to liquidate are based on legitimate reasons and are approved by the branch manager and margin department. • Branch manager prohibits the extension of time or credit to IRA accounts in compliance with ERISA requirements. • Guarantee letters are signed by the client and the branch manager and are up to date. • Restrictions (e.g., cash up front) are enforced by the rep and communicated to the client. • Branch manager approves preferred margin interest rates. 	<ul style="list-style-type: none"> • Review reports of unsecured/partly secured accounts for the branch and determine the extent of: <ul style="list-style-type: none"> ♦ Credit losses for the branch. ♦ Credit losses by rep. ♦ Note items for follow up during the on site visit. • Assess the adequacy of prescribed branch follow up procedures with respect to partly secured/unsecured accounts. <p><u>On site visit</u></p> <ul style="list-style-type: none"> • Review and assess the adequacy of procedures for obtaining margin department and branch manager approval for margin transactions. <ul style="list-style-type: none"> ♦ Select a sample of margin transactions and verify that required approvals were obtained. ♦ Select a sample of margin accounts and determine that a signed margin lending agreement is on file. ♦ Select a sample of clients who received a preferred margin interest rate and determine whether branch manager approval was obtained. ♦ For a sample of guarantee letters determine whether such accounts have been approved by branch management and are up to date.

Credit

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Collateral valuations and margin calls for non-standard, credit related securities transactions are calculated and issued by non-branch personnel (e.g., margin department). • Reports of collateral deficiencies are sent to the branch daily: <ul style="list-style-type: none"> ♦ The branch manager reviews the reports. ♦ Reps follow up with customers to ensure that the calls for additional collateral are met. • Reports of partly secured/unsecured accounts are distributed to the branch on a periodic basis: <ul style="list-style-type: none"> ♦ The branch manager reviews the reports. ♦ Reps follow up with customers to obtain additional collateral or payment. ♦ When appropriate, decisions are made to turn over the accounts to a collection agency. 	<ul style="list-style-type: none"> • Discuss with branch manager and reps procedures followed with respect to margin calls. <ul style="list-style-type: none"> ♦ Examine a sample of branch margin call reports for evidence of branch manager review and rep follow up. ♦ Verify that the branch manager and the margin department have approved requests for extensions. ♦ Discuss with the branch manager and appropriate rep any unusual call activity noted during the pre visit analysis. • When non-standard, credit related securities are sold through the branch, ensure that: <ul style="list-style-type: none"> ♦ The collateral obtained meets the requirements of the firm's margin collateral policy. ♦ Non-branch personnel determine collateral valuation and margin calls. ♦ The branch manager receives and reviews collateral deficiency reports. ♦ The reps perform sufficient follow-up procedures to collect the required collateral. ♦ Reference is made to the Audit Guidelines for Credit Risk for further information.

Credit

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
		<ul style="list-style-type: none"> • Discuss with the branch manager and reps procedures followed with respect to liquidations. <ul style="list-style-type: none"> ♦ Examine a sample of liquidation notices for evidence of branch manager review and rep follow up. ♦ Determine that positions were liquidated timely. ♦ In instances where positions were not liquidated, verify that there was a legitimate reason and that the branch manager and the margin department approved non-liquidation. ♦ Identify accounts that have had an excessive number of liquidations and determine that the accounts have been restricted to cash up front transactions. ♦ Follow up with the branch manager and applicable rep any items noted during the pre visit analysis. • Discuss with the branch manager and reps the procedures followed with respect to the over extension of credit (e.g., partly secured and unsecured accounts). Determine that they comply with established policies and procedures. <ul style="list-style-type: none"> ♦ Verify branch manager review of reports of partly secured/unsecured accounts. ♦ For a sample of accounts determine that reps have performed adequate follow up to resolve the condition. ♦ For accounts that have been in deficit for an extended period of time ascertain whether the account has been turned over to a collection agency.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<p><u>Funds Processing</u></p> <ul style="list-style-type: none"> Improper or inadequate processing of funds transactions could result in financial losses. Types of transactions include the following: <ul style="list-style-type: none"> Check receipts Check disbursements Wire transfers Transfers between accounts Cash or cash equivalents <p>(16,17,18,19,20)</p>	<ul style="list-style-type: none"> Check receipts <ul style="list-style-type: none"> Firm policy prohibits acceptance of currency. Checks are restrictively endorsed upon receipt. Checks are deposited timely. Accounting control established by entering transactions into a funds processing system such as Cash Over the Wire (COW). Someone independent of check receipt functions reconciles deposits to accounting records. Undeposited checks are safeguarded overnight. If cash or cash equivalents are accepted at the branch: <ul style="list-style-type: none"> Pre-numbered receipts are utilized and access to blank receipts is restricted. Accounting control is established by entering transactions into a funds processing system such as Cash Over the Wire (COW). Deposits are reconciled to accounting records by someone independent of cash receipt functions. Cash deposits over \$10,000 are properly reported to the IRS. 	<p><u>Pre visit</u></p> <ul style="list-style-type: none"> Obtain an understanding of branch funds transaction procedures. Prepare a summary of funds receipts and funds disbursements for the branch in order to understand the magnitude of funds transactions. Review the bank reconciliation for the branch bank account. <ul style="list-style-type: none"> Determine that the account has been reconciled on a timely basis. Review reconciling items and note any unusual or aged items (including outstanding checks) for follow up during the on site visit. Determine that reconciling items have been resolved on a timely basis. Compare branch receipts from transmittal system to deposits per bank statement. <p><u>On site visit</u></p> <ul style="list-style-type: none"> Review and test procedures followed at the branch for processing funds received. <ul style="list-style-type: none"> Verify that, if prohibited, currency is not accepted at the branch. For a sample of check receipts determine that checks have been restrictively endorsed, deposited timely and entered into the firm's books and records (e.g., COW system).

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Check disbursements <ul style="list-style-type: none"> ♦ Check stock is restricted to appropriate personnel and physically safeguarded. ♦ Someone independent of check disbursement functions periodically examines check stock for numerical sequence. ♦ Check requests for disbursements are prepared and approved by supervisory personnel. ♦ Dual signatures are required for checks over specified amounts. ♦ Dollar limits are established for authorized signers. ♦ Authorized signers have no customer responsibilities. ♦ Customer ID is required when picking up checks. ♦ A customer call back procedure is employed to confirm that the customer received the check. 	<ul style="list-style-type: none"> ♦ Determine that checks not deposited have been restrictively endorsed and have been adequately safeguarded until deposit. Ascertain that there is a valid reason for not depositing the checks. ♦ Determine that branch procedures comply with the understanding obtained during the pre visit review. ♦ If cash receipts are accepted at the branch verify that: pre-numbered receipts are utilized and controlled; receipts are deposited and recorded timely; deposits are reconciled to receipts and accounting records by someone independent of cash receipt functions. ♦ Determine that appropriate filings have been made for receipts in excess of \$10,000. • Review and test procedures followed at the branch for processing funds disbursements. <ul style="list-style-type: none"> ♦ For a sample of check disbursements verify that check requests have been prepared, an appropriate supervisory official has approved the requests, and individuals with the proper authority have signed the checks. ♦ Determine that the dollar limits for check signers is appropriate.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> ♦ Letters of Authorization (LOA's) for third party checks, wires and transfers between accounts are required. ♦ Checks are not given to employees/ reps for delivery to customers. ♦ Returned checks are physically controlled and recorded. • Wire transfers <ul style="list-style-type: none"> ♦ Branch management and, when required, the margin department properly authorize wire transfer requests. ♦ Wire transfers are reconciled to authorized requests. ♦ A customer call back procedure is employed to confirm that the customer received the funds. • Bank accounts <ul style="list-style-type: none"> ♦ Bank accounts are reconciled by personnel independent of those processing funds transactions (preferably by home office personnel). 	<ul style="list-style-type: none"> ♦ Verify that customers are required to present proper identification when picking up checks by examining documentation noting the ID that was used. ♦ Ascertain that check stock is safeguarded and restricted only to authorized personnel. Verify the numerical sequence of the check stock. ♦ Determine that branch procedures comply with the understanding obtained during the pre visit review, including customer call back. • Test procedures for requesting and processing wire transfers. <ul style="list-style-type: none"> ♦ For a sample of wire transfers examine request forms and note approval. ♦ When required, margin department approval has also been obtained. ♦ Determine that approval authorities for wire transfers are appropriate. ♦ Verify that wire transfers have been reconciled to wire transfer requests by someone independent of the preparation or approval of wire transfers. • Determine that customer call back procedures are being followed. • For a sample of check disbursements with third party payees and transfers of funds between accounts verify that a signed letter of authorization (LOA) is on file. • Follow up on items noted during pre visit review.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Securities Processing</u> <ul style="list-style-type: none"> Improper or inadequate processing of securities could result in: <ul style="list-style-type: none"> Lost or stolen securities. Securities accepted in non-negotiable form. Delays in recording securities into customer accounts. Inaccurate recording and/or collection of dividends and interest. <p>(21,22,23,24)</p>	<ul style="list-style-type: none"> Procedures require same day processing and transmittal of securities received (with provision for safeguarding late receipts overnight). Securities received are reconciled to accounting records each day. Accounting control established by entering securities received into a securities processing system such as Securities Over the Wire (SOW). Incoming securities are reviewed for description, endorsement, powers and other legal papers. Proof of ownership is required for street name or bearer securities. Securities are restrictively endorsed upon receipt. LOA's are required for the transfer of securities between accounts. Securities on hand are properly safeguarded. Adequate insurance exists for lost or stolen securities. Cashiering activity areas are physically segregated from non-cashiering areas and secured from unauthorized access. 	<u>Pre visit</u> <ul style="list-style-type: none"> Obtain an understanding of securities processing procedures to be followed by the branches. Obtain or prepare a summary of securities received at the branch to assess the magnitude of such activity. Obtain information on the occurrence and magnitude of securities lost in transit from the branch. Analyze activity in the branch in transit account noting the length of time securities remain in transit. Note items that take an unusual length of time to clear transit for follow up during the on site visit. Determine the adequacy of insurance coverage for lost securities. Discuss with operations personnel any issues they have experienced with incoming securities from the branch. Note for follow up during the on site visit. <u>On site visit</u> <ul style="list-style-type: none"> Review and test procedures followed by the branch for processing securities received. <ul style="list-style-type: none"> For a sample of securities receipts verify that securities are examined for 'good form' (e.g., security description, endorsement, power of attorney, legal papers). Determine that securities receipts were entered into securities processing system.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
		<ul style="list-style-type: none">♦ For a sample of securities transferred between accounts verify that signed LOA's are on file.• Review reconciliations of securities received to the accounting records.• Ascertain that securities held overnight are adequately safeguarded.• Ascertain that the securities processing area is physically segregated from other areas and that access is restricted to authorized personnel.• Follow up on items noted during pre visit review (in transit items, lost securities, operations issues).

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Trade Processing</u> <ul style="list-style-type: none"> • Inaccurate or unauthorized trade processing could result in: <ul style="list-style-type: none"> ♦ Unauthorized trading in customer accounts. ♦ Costs associated with excessive trade errors, cancels and corrects and as of trades. ♦ Failure to execute open orders. ♦ Misdirection of customer confirmations. <p>(6,7,8,9,10)</p>	<ul style="list-style-type: none"> • Access to wire and order room is restricted to authorized personnel. • Orders are time stamped either manually or electronically. • Trade executions are matched to order tickets and trade blotters on T+1. • Open orders are reviewed periodically and reconciled to open order files. • The branch manager reviews and approves blotters and trade execution reports each day. • The branch manager reviews and approves error and suspense account activity and cancel/rebill trades, and: <ul style="list-style-type: none"> ♦ Open error positions are monitored by management until closed. ♦ Operations personnel obtain all required approvals prior to processing transactions to the error account. ♦ Errors are identified, positions are closed and losses are allocated in accordance with Firm procedures. ♦ Appropriate documentation is maintained to support error account activity. • The branch manager approves commission overrides. 	<u>Pre visit</u> <ul style="list-style-type: none"> • Obtain an understanding of trade processing procedures to be followed at the branch. • Obtain or prepare reports of branch trade volumes to assess the level of trading activity. • Compare confirmation addresses to customer name and address database and to rep home addresses. • Ascertain the extent of returned confirmations for the branch and investigate unusual levels and individual occurrences. • Analyze the extent of commission adjustments and override activity for the branch and note excessive or unusual activity for follow up during the on site visit. • Identify active accounts and accounts with high-risk trading and review activity. Note unusual activity for follow up during the on site visit. • Identify discretionary accounts and review activity. Note unusual activity for follow up during the on site visit. • Review activity in branch error and suspense accounts. Note excessive or questionable activity for follow up during the on site visit.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Branch manager approval and proper authorization is required for discretionary accounts. • Written customer authorization is required for time and price discretion lasting more than one day. • Confirmations are sent directly to customers from the home office. • If blank confirmations are kept at the branch, they are adequately safeguarded and restricted to authorized personnel. • Compliance department surveillance of accounts of active trading customers. 	<p><u>On site visit</u></p> <ul style="list-style-type: none"> • Ascertain that there is adequate physical security over the wire and order room and that access is restricted to authorized personnel. • Select a sample of trades and compare to order tickets and trade blotters, ensure order tickets were time stamped and that orders were executed within a reasonable period of time. • Examine and test reconciliation of orders to trade blotters and execution reports. • Verify that branch manager is reviewing and approving trade blotters, execution reports and open order files. • Ascertain that branch manager approves error and suspense account activity. • Select a sample of errors and determine that: <ul style="list-style-type: none"> ♦ The resolution of the error is supported by the documentation and approved by the branch manager. ♦ That open positions were closed out on a timely basis. ♦ That advices were sent to account owners and interested parties for any accounts impacted by the error resolution. • For a selection of commission overrides and adjustments determine that branch manager approval was obtained.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
		<ul style="list-style-type: none">• For a sample of orders with time and price discretion determine that unexecuted orders are cancelled after one day. If order is not cancelled verify that written customer authorization is on file.• If customer confirmations are mailed from the branch:<ul style="list-style-type: none">♦ Review procedures followed and verify that non-sales personnel perform process.♦ Ascertain that blank confirmations are physically safeguarded and restricted to authorized personnel.• Follow up on items noted during pre visit review:<ul style="list-style-type: none">♦ Comparison of confirmation addresses to name and address database and rep addresses.♦ Returned confirmations.♦ Commission adjustments and overrides.♦ Review of active accounts, high-risk trading accounts and discretionary accounts.♦ Review of error and suspense accounts.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<p><u>New Accounts</u></p> <ul style="list-style-type: none"> • Inadequate procedures and controls over the establishment of new accounts could result in the following: <ul style="list-style-type: none"> ♦ Accounts for persons not meeting firm criteria. ♦ Unauthorized accounts that can be used for improper or illegal purposes. ♦ Failure to properly restrict accounts. ♦ Non-compliance with “Know Your Customer” and USA PATRIOT Act requirements. ♦ Failure to verify customer address and investment objective changes. <p>(1,2,3,4,5)</p>	<ul style="list-style-type: none"> • New account forms are prepared for each account that is opened. The forms provide for the information necessary to comply with the ‘Know Your Customer’ requirements. • The branch manager must approve all new account forms. • Establishment of new customer accounts can only be done on the basis of an approved new account form and by individuals independent from sales personnel. • Customer accounts may be categorized according to pre-determined risk criteria (e.g., type of account, nature of activity, country of residence, etc.). Accounts deemed to be higher risk are subjected to more stringent surveillance activities. • Customers’ identities must be verified through documentary and non-documentary methods in accordance with the firm’s Customer Identification Program. • The customer’s identity, nationality and residence are compared to government agency lists of known or suspected terrorists or jurisdictions considered to be a primary money laundering concern. 	<p><u>Pre visit</u></p> <ul style="list-style-type: none"> • Obtain an understanding of the procedures followed for opening new accounts at the branch, including the procedures to be followed for verifying the customer’s identity. • Ascertain that the procedures ensure that reps and other branch personnel are prohibited from setting up new accounts on the firm’s books and records. • Select a sample of accounts and examine the new account documentation to determine that it has been properly completed and has been approved by the branch manager. • Review the procedures to be followed in accordance with the firm’s Customer Identification Program. • Select a sample of recently opened accounts and determine that appropriate documentation exists evidencing that the customers’ identities were verified and compared to lists of known or suspected terrorists in accordance with firm procedures. • Review the document tracking system and note branch accounts with missing documentation for follow up during the on site visit. Ascertain that accounts have been restricted as required.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> Records of the information used to verify customers' identities must be maintained in accordance with the requirements of the USA PATRIOT Act. A document tracking system monitors missing customer documentation. Follow up procedures exist for obtaining missing documentation. Accounts not providing required documentation are restricted from trading. Written procedures exist for verifying customer address and investment objective changes. Verification letters are sent to old and new addresses for any customer address change by individuals independent of branch personnel. Initial orders in new accounts are pre – approved by branch manager. Accounts having P.O. box addresses and accounts where statements are sent to parties different from the account beneficiary are reviewed and approved by the branch manager. 	<ul style="list-style-type: none"> Review procedures for verifying customer address and investment objective changes and ascertain that individuals independent from branch personnel perform the procedures. For a sample of customer address and investment objective changes ascertain that verification procedures were performed. Obtain a listing of accounts with a P.O. box address and where statements are sent to parties different from the account beneficiary. Determine that the branch manager reviewed and approved the account. <p><u>On site visit</u></p> <ul style="list-style-type: none"> Through discussion, observation and examination of documentation determine that branch personnel are following proper new account opening procedures, including verification of the customer's identities. Select a sample of new accounts and determine that the branch manager approved the account before trading and pre approved the first trade in the account. For accounts with missing documentation identified during the pre visit review, determine that branch personnel are following the required follow up procedures. Verify that procedures for preventing identity theft of customer information are being followed.

Financial/Operational

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Financial Management</u> <ul style="list-style-type: none"> • Failure to monitor branch financial results could result in: <ul style="list-style-type: none"> ♦ Misstatement of branch profit and loss. ♦ Inappropriate or excessive expenses not being detected. 	<ul style="list-style-type: none"> • Budgets are prepared for key elements of income and expense. • Variances between actual results and budgeted amounts are prepared, explained and reviewed. • Detailed profit and loss statements are received and reviewed by the branch manager on a frequent and regular basis (e.g., weekly). 	<u>Pre visit</u> <ul style="list-style-type: none"> • Obtain an understanding of the process followed for reporting and analyzing branch results. • Review a sample of branch profit and loss reports including variance explanations and note items for follow up during the on site visit. <u>On site visit</u> <ul style="list-style-type: none"> • Verify that the branch manager reviews and approves profit and loss reports on a frequent and regular basis. • Follow up on variance items and unusual expense items noted during the pre visit review.

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Regulatory and Legal</u> <ul style="list-style-type: none"> Branch activities are susceptible to regulatory sanctions for non-compliance with rules and regulations relating to: <ul style="list-style-type: none"> Supervision and control (NYSE Rule 342) Anti-Money Laundering and Customer Identification requirements of the USA PATRIOT Act Privacy of customer information Sales practices Employee accounts Customer complaints Registrations Continuing Education Books and records under revised SEC Rules 17a-3 and 17a-4 (effective May, 2003) Allocation of IPO shares <p>(Entire flow)</p>	<ul style="list-style-type: none"> Supervision <ul style="list-style-type: none"> Branch manager utilizes a compliance checklist to ensure that required supervisory activities are performed. Each day the branch manager reviews, among other things: trading activity for appropriateness; margin call and extension activity; new account forms; incoming and outgoing paper, facsimile and electronic correspondence; error and suspense account activity; securities and funds processing activity. Periodically the branch manager reviews customer statements to ensure that activity in customer accounts is appropriate and not excessive. Such review is documented. Delegated supervisory responsibilities are appropriate and branch manager has an effective means of monitoring the performance of the duties delegated. 	<u>Pre visit:</u> <ul style="list-style-type: none"> Review records of non-compliance with firm training requirements (USA PATRIOT Act, Continuing Education). Note exceptions for follow up during on site visit. Review customer complaint files and note unresolved or unusual items for follow up during the on site visit. Discuss with the compliance department their monitoring program over the branch's activities. Review results of the monitoring program and note any unusual items for follow up during the on site visit. Select a sample of discretionary accounts and review trading activity noting possible instances of excessive trading. Determine that the type of trading activity is consistent with the customer's investment objectives. Through discussion with personnel responsible for managing registration requirements and examination of applicable exception reports determine whether there have been any exceptions to registration requirements (Blue Sky violations) at the branch. Note items for follow up during the on site visit. Verify that customer accounts serviced by branch managers are subjected to independent supervision.

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> ♦ In situations where branch managers (or other branch supervisory personnel) service customer accounts, procedures exist that require the independent supervision of those accounts. • USA PATRIOT Act <ul style="list-style-type: none"> ♦ See New Accounts section concerning identification of customers. ♦ See Anti-Money Laundering Audit Guidelines for further information on risks, controls and audit work steps, including the identification, escalation and reporting of suspicious activity. ♦ Staff has received the required firm training and is familiar with their duties and responsibilities. ♦ Branch procedures comply with firm policies and procedures concerning the Act. 	<ul style="list-style-type: none"> • Discuss with compliance department results of the monitoring of branch employee trading activity. Note questionable activity for follow up during the on site visit. <p><u>On site:</u></p> <ul style="list-style-type: none"> • Interview the branch manager concerning their supervisory responsibilities. • Review branch management reports and assess their adequacy in enabling branch management in carrying out their supervisory responsibilities. • Determine that the branch manager has documented performance of their supervisory activities. Supervisory activities should include review of: <ul style="list-style-type: none"> ♦ Trading activity. ♦ Margin calls and extensions. ♦ Outgoing correspondence including e-mail. ♦ Error and suspense account activity. ♦ Securities and funds processing activity. ♦ Customer statements. ♦ Employee trading activity. • Verify that procedures for preventing identity theft of customer information are being followed.

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Privacy of customer information: <ul style="list-style-type: none"> ♦ Individuals requesting customer information are required to provide data known only to the customer (e.g., personal identification number), prior to the release of the requested information. ♦ Outgoing correspondence is reviewed to ensure that it does not contain any proprietary customer information. • Sales practices <ul style="list-style-type: none"> ♦ Sales personnel are knowledgeable concerning the firm's sales practices policies and procedures. ♦ The branch manager supervises the reps by reviewing daily trading reports, monthly customer statements and incoming and outgoing customer correspondence. The review is directed at the detection of inappropriate customer trading (e.g., churning, unsuitability, concentration, etc.). ♦ A centralized compliance program exists that monitors sales practice activities at the branch. 	<ul style="list-style-type: none"> • If supervisory responsibilities have been delegated, assess whether the person performing the duties is appropriate and determine that the branch manager has an effective means of monitoring performance of the duties delegated. • Interview reps concerning sales practice activities and assess their awareness and knowledge of firm policies and procedures. • Ascertain that books and records maintained at the branch meet the requirements of SEC Rules 17a-3 and 17a-4, including the requirement for promptly producing requests for records. • Review procedures for allocation of IPO shares to customers and ascertain that branch manager reviews and approves allocations. • Follow up on items noted in pre visit review (complaints, compliance monitoring, training, registrations, employee training, discretionary account trading).

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Employee accounts <ul style="list-style-type: none"> ♦ The branch manager reviews employee account statements to identify improper trading activity, such as front running. ♦ Employees are required to obtain compliance department pre approval for their trades. ♦ Compliance department monitors employee trading activity to ensure that employees have not traded in securities that are on the firm's restricted or gray lists. • Customer complaints <ul style="list-style-type: none"> ♦ The branch manager reviews all customer complaints and approves resolution of the complaints. • Registrations <ul style="list-style-type: none"> ♦ A centralized function manages the registration process throughout the firm. ♦ Reports are generated identifying reps not having the required registration or transacting business in states in which they are not registered. ♦ Exception reports are sent to the branch manager for resolution. 	

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none"> • Continuing Education <ul style="list-style-type: none"> ♦ A centralized function administers compliance with the continuing education requirements. ♦ The branch manager is notified of branch personnel who have not met the continuing education requirements. • Books and records <ul style="list-style-type: none"> ♦ Revised procedures have been implemented to comply with newly enacted requirements of SEC Rules 17a-3 and 17a-4 governing maintenance and retention of books and records. • IPO allocations <ul style="list-style-type: none"> ♦ Allocation of IPO shares to customers are subjected to compliance department surveillance routines designed to identify allocations: made on the basis of inducement for payment of excessive compensation for other services; made to an executive officer or director of a company on the condition of directed investment banking business; made on the condition of aftermarket orders. 	

Regulatory and Legal

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
	<ul style="list-style-type: none">♦ Compliance department identification and surveillance of allocations of “hot issues” to ensure compliance with free-riding and withholding prohibitions.♦ Branch manager reviews and approves allocation of IPO shares to customers.	

Reputation and Technology

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<u>Security</u> <ul style="list-style-type: none"> • Inadequate physical and system security could result in: <ul style="list-style-type: none"> ♦ Misappropriation of proprietary information. ♦ Loss of customer or firm assets. ♦ Loss of customer privacy. <u>Sales and Marketing</u> <p>Use of unauthorized marketing and sales materials and outside employee activities could result in:</p> <ul style="list-style-type: none"> • False or misleading statements being made under the name of the firm. • Regulatory sanctions. 	<u>Physical Security</u> <ul style="list-style-type: none"> • Cashiering areas are physically separated from non-cashiering areas and access is restricted to authorized personnel. • Use of facsimile machines is appropriately restricted. • Confidential hard copy reports are safeguarded and properly disposed. <u>System Security</u> <ul style="list-style-type: none"> • Establishment of individual access and authority is controlled by a designated individual at the branch who has no customer responsibility. The branch manager approves system access and authority for all branch personnel. • System access and authority is limited to individuals based upon their roles and responsibilities. • Firm policies and procedures place restrictions on the use of personal computers. <u>Sales and Marketing</u> <ul style="list-style-type: none"> • All sales and marketing materials used by the branch, other than firm-wide materials has been submitted to the Compliance Department for review and approval prior to use. • Employees are required to obtain branch manager and Compliance Department approval for outside business activities to include approval of any materials. 	<u>Pre visit</u> <ul style="list-style-type: none"> • Obtain an understanding of company policies concerning physical security, use of personal computers and disposal of confidential information. • Obtain system access reports for branch personnel and assess their level of access based upon their duties and responsibilities. <u>On site visit</u> <ul style="list-style-type: none"> • Ascertain that physical security over sensitive areas adequately restricts access to authorized personnel. • Discuss with the branch manager and reps the use of personal computers and determine that they are familiar with applicable policies and procedures. • Ascertain that the procedures for document disposal comply with the firm's policies. Verify that the process is followed. • Obtain materials used for branch sales and marketing activities and determine that compliance department approval was obtained. • Ascertain that branch manager and compliance department approval was obtained for any employee outside business activity.

Reputation and Technology

<i>Risks to be Managed</i>	<i>Types of Controls to Manage or Eliminate Risks</i>	<i>Potential Audit Work Step</i>
<p><u>Business Continuity</u></p> <p>Routine operations are disrupted by a disaster and cannot be restored timely.</p> <p>(Entire flow)</p>	<ul style="list-style-type: none">• Business continuity and disaster recovery plans exist and are approved by senior management.	<ul style="list-style-type: none">• Ensure the existence of a BCP and determine how the plan has been validated for practicability and effectiveness.



II B. SEGREGATION OF DUTIES CHECKLIST

Introduction

Adequate segregation of duties reduces the likelihood that errors (intentional or unintentional) will not be prevented and remain undetected. The basic idea underlying segregation of duties is that no one employee or group of employees should be in a position both to perpetrate and to conceal errors or irregularities in the normal course of their duties. Additionally, errors may occur due to inadequate supervision of employee activity. In general, the principal incompatible duties to be segregated are: authorization, custody of assets, and recording or reporting of transactions. In addition, the risk management function as well as other oversight functions (Controllers, Compliance, Legal, Credit) should be separated from the functions that are originating risk itself and the processing of a transaction.

A practical method for using this checklist is to list the names of individuals responsible for particular functions. Review the checklist for individuals whose names are listed more than once and then make a determination whether that represents a potential lack of segregation of duties. Also consider whether individuals are performing incompatible duties. Once an individual is identified as performing incompatible duties, all duties performed by that individual should be challenged as to whether the effectiveness of those duties is reduced or eliminated by the lack of segregation of duties identified. Larger organizations may find it sufficient to list only the department performing each of these duties or functional job titles, rather than the names of individuals. Those companies could then evaluate whether any departments were performing incompatible duties.

Keep in mind that not all instances where an individual performs more than one function represent a lack of segregation of duties. In addition, it is important to remember that there is a possibility of a lack of segregation of duties within the same category. Consequently, completion of this checklist is intended to highlight potentially conflicting duties, not to be the only method of identifying all such conflicting duties. The segregation of duties checklist is located on the following page.

SEGREGATION OF DUTIES CHECKLIST

Margin

- Who identifies margin calls?
- Who is responsible for issuing margin calls?
- Who approves requests for margin call extensions?
- Who identifies when account/position liquidations need to be made?
- Who approves requests not to liquidate?
- Who maintains records of margin calls, extensions and liquidations?

Funds Processing and Securities Processing

- Who processes funds receipts and disbursement transactions?
- Who records funds transactions?
- Who approves funds disbursements (check and wire)?
- Who distributes disbursements to customers?
- Who reconciles the branch bank account?
- Who reconciles wire transfers to approved transfer requests?
- Who has custody and access to blank checks?
- Who processes securities transactions?
- Who records securities transactions?
- Who maintains physical control and has access to securities on hand?

Trade Processing

- Who enters orders?
- Who has access to the order room?
- Who reconciles trade executions and open orders to order tickets and trade blotters?
- Who approves error and suspense account activity?
- Who has custody and access to blank confirmations?
- Who mails confirmations to customers?
- Who approves commission adjustments/overrides?

New Accounts

- Who approves new account forms?
- Who establishes new accounts on the books and records?
- Who verifies customer address and investment changes?

Financial Management

- Who approves expenses?
- Who records and approves journal entries?

Regulatory and Legal

- Who reviews activity of the branch manager who has sales responsibilities?
- Who is responsible for managing rep registration?
- Who reviews employee trading activity?
- Who is responsible for managing customer complaint resolution?

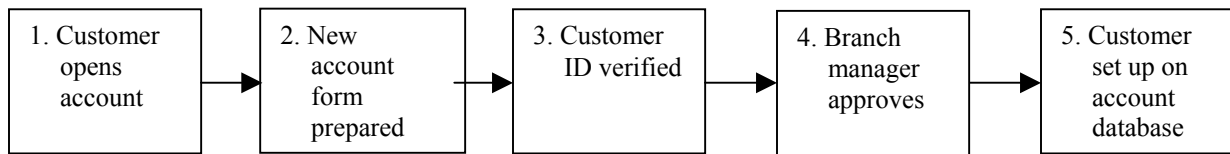


III. BRANCH OPERATIONS FLOWCHART

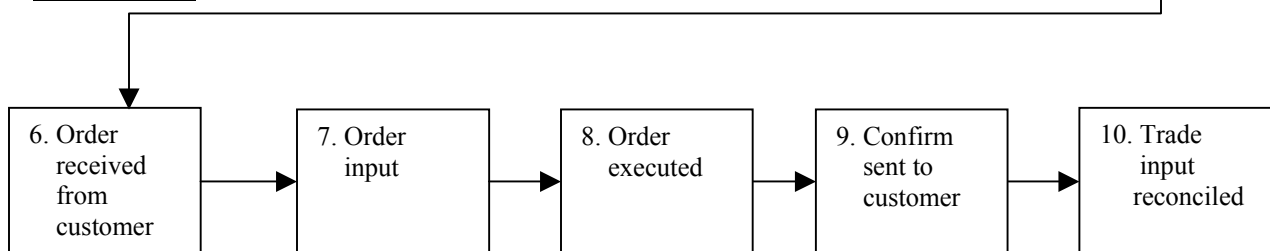
The following flowchart illustrates some of the typical activities that take place in a retail branch. Definitions for the individual process steps are included below. Such definitions are numbered in order to cross-reference with the appropriate process steps.

Branch Office Diagram Flowchart

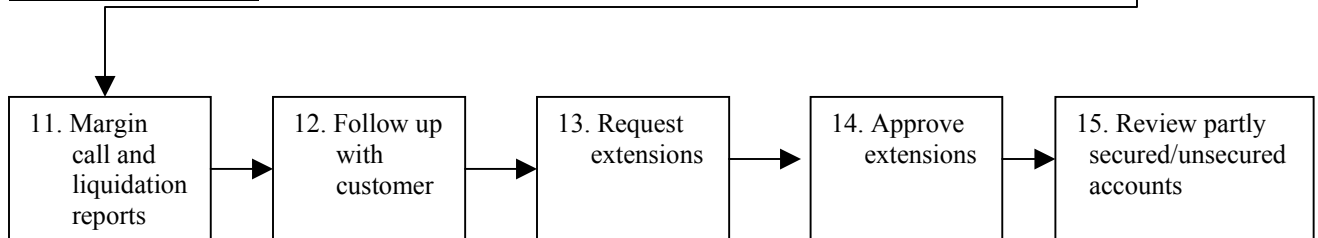
New Account Process



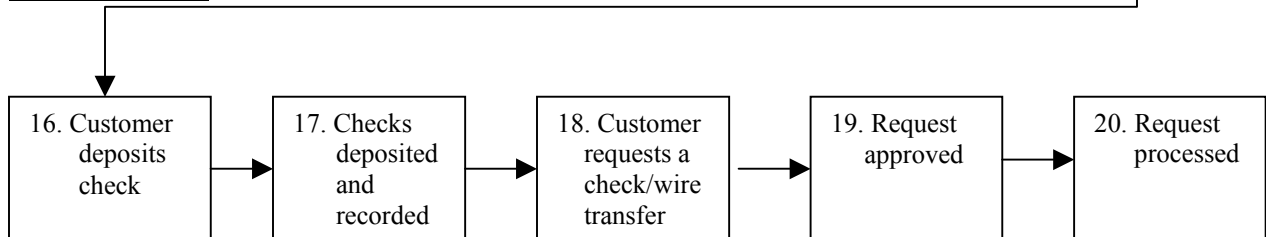
Trade Process



Margins/Liquidations



Funds Processing



Securities Processing



Definition of Process Steps

1. New account process initiated. Information necessary to comply with 'Know Your Customer' requirements is collected.
2. New Account form is prepared and signed. Different forms are utilized for cash accounts and margin accounts.
3. Customer identity is verified through either documentary or non-documentary means. Determination is made if customer appears on any government list of known or suspected terrorists or terrorist organizations.
4. Branch manager approves the New Account form.
5. Customer is set up on the customer account database. May be done either at the branch (by non-sales personnel) or the forms may be sent to the New Accounts Department for input.
6. Order may be received over the telephone or on line.
7. For orders received over the telephone, the rep will either enter the order directly on line or prepare an order ticket. Order tickets may be input by the Wire and Order room.
8. Order is either executed or is maintained in an open order file.
9. Confirmation is sent to customer on T+1. In those rare instances where confirmations are mailed from the branch, operations personnel will perform the mailing process.
10. On T+1 operations personnel will reconcile trade orders to execution reports, open order files and blotters.
11. Margin call reports and liquidation notices are sent to the branch each day and reviewed by the branch manager and rep.
12. The rep may follow up with the customer to ensure that the call will be met.
13. If there is a legitimate reason the rep may request an extension on behalf of the customer.
14. The rep, the branch manager and the Margin Department approve extension requests for margin calls.
15. Periodically, reports of partly secured/unsecured accounts are sent to the branch manager and rep. The rep will follow up with the customer to obtain additional collateral. After all reasonable steps have been taken, the account will be referred to a collection agency.
16. Customer deposits a check either in person or by mail.
17. All checks are restrictively endorsed and deposited each day. Receipts are recorded on the books and records. Deposits should be reconciled to amounts recorded by someone independent of funds processing.
18. Customer requests a check or wired funds. Check request or wire transfer request is prepared.
19. Branch manager approves funds request form.
20. Check is issued or funds wired by individuals independent from sales personnel. Checks should be mailed to or picked up by customer and not given to any employee to deliver.
21. Customer deposits securities.
22. Securities are examined for proper form and legal paperwork.
23. Security receipts are recorded on the books and records.
24. Securities are packaged and transmitted in accordance with firm procedures.