

Joint Audit Committee

Regulatory Update

TO: Chief Financial Officers
Chief Compliance Officers

0102

DATE: April 12, 2001

SUBJECT: Recording Aged Reconciling Items

Recently we have received several inquiries concerning the proper recording of unresolved reconciling items on the segregation and secured amount statements. In addition, questions have been raised concerning the applicability of the capital charge for aged reconciling items as required under SEC Rule 17a-13.

As always, firms should strive to ensure that all reconciling items are researched, resolved, and recorded on a timely basis. This memo addresses those reconciling items which remain unresolved and/or not recorded in the general ledger and financial statements. Outlined below are the requirements for proper segregation and secured statement reporting as well as for computing and recording the aged reconciling item charge.

Reconciling Items - Segregation and Secured Statement Reporting

In recording balances on the segregation and secured amount statements, net unfavorable reconciling items which remain unresolved should not be included as segregated or secured, as applicable, assets. Unfavorable reconciling items increase the balance recorded of an asset (or decrease the balance recorded of a liability) in comparison to the balance reflected on the third party document. To properly reflect segregated and secured assets, net unfavorable reconciling items are determined **by entity, by origin**. Further, reconciling items which are resolved, but have not been recorded into the general ledger, should be properly reflected on the segregation and secured amount statements.

Aged Reconciling Item Capital Charge

SEC Rule 17a-13 requires a 100% charge to net capital for unfavorable reconciling items over 17 business days old for bank accounts and carrying broker accounts and reconciling items over 7 business days for clearing organizations and security depositories.

In computing the charge, the reconciling items of **all accounts of a single entity** (customer segregated, customer secured 30.7, and house) are netted. The age of the reconciling item is determined as of the statement date. An unresolved reconciling item is considered "aged" if it had originated on or prior to 17 business days or 7 business days, as applicable, of the statement date.

If the net of the aged reconciling items is increasing an asset or decreasing a liability as reported in the general ledger and financial statements (i.e. unfavorable), a net capital charge should be taken for that amount.

To avoid “double hitting” a firm’s capital, an assessment is required comparing the unfavorable reconciling items (decrease to assets, increase to liabilities) already reflected on the segregation and secured statements to the aged reconciling capital charge computed by entity across all origins. Note: The assets recorded on the balance sheet for segregated and secured assets should be identical to that recorded on the segregation and secured statements. That is, the segregated and secured balances recorded on the firm’s balance sheet should reflect the unfavorable reconciling items.

If the aged capital charge is greater than the unfavorable reconciling items reflected in the segregation and secured statements, then the capital charge shall equal the difference between the two. If the aged capital charge is less than the unfavorable reconciling items reflected in the segregation and secured statements, then a current asset (Other Assets FOCUS Report Line 15.D. and Form 1-FR Line 19) equal to the difference between the two should be recorded on the balance sheet.

For statement presentation, the capital charge for aged reconciling items should be reflected on FOCUS Report Line NC-6.F. Other Deductions and Charges and, until the Form 1-FR is re-formatted, for 1-FR purposes record the charge as a noncurrent asset on the appropriate cash, carrying broker, clearing organization, or security balance sheet line.

An example is detailed on the following page.

If you have any questions, please contact your DSRO or visit the JAC Web Site at www.wjammer.com/jac.

EXAMPLE

Account	Bank ABC Segregated	Bank ABC House	Bank XYZ 30.7 Secured	Bank XYZ House
G/L Balance	\$110,000	\$110,000	\$45 000	\$150,000
Bank Statement Balance	\$ 80,000	\$130,000	\$50 000	\$120,000
Aged Unreconciled Difference	\$ 30,000 unfavorable	\$ 20,000 favorable	\$ 5,000 favorable	\$ 30,000 unfavorable
Net By Bank	\$10,000 unfavorable		\$25,000 unfavorable	

Financial Statement Presentation

Segregation Statement: Segregated Assets at Banks: \$ 80,000

Secured Statement: Secured Assets at Banks: \$ 45,000

Balance Sheet: Segregated Cash: \$ 80,000
 Secured Cash: \$ 45,000
 House Cash: \$260,000
 Other Assets: Current \$ 20,000
 Other Assets: Non-current \$ 10,000

Net Capital: Aged Reconciling Item Charge: \$ 25,000

Explanation

On the segregation and secured statements the assets recorded from the general ledger do not include unfavorable reconciling items. Therefore, segregated assets at Bank ABC only reflect \$80,000 as the \$30,000 unfavorable reconciling item is not a good segregated asset. For secured assets at Bank XYZ, the \$45,000 general ledger balance is recorded as the \$5,000 reconciling item is favorable; that is, the balance per bank statement is greater than the general ledger.

The segregated and secured asset amounts flow directly into the balance sheet. To balance debits and credits on the balance sheet, an Other Asset: Non-current is established for segregated and secured general ledger amounts not yet recorded; that is, the unfavorable reconciling items excluded from segregated and secured assets. In the example above, an Other Asset: Non-current of \$30,000 for Bank ABC unfavorable reconciling items is recorded.

On the balance sheet, house cash is recorded at the general ledger amounts for a total of \$260,000.

To determine the capital impact and any charge for aged reconciling items, all accounts of a single entity are netted. Thus, for Bank ABC, a net \$10,000 unfavorable reconciling charge results. As a \$30,000 non-current other asset has already been recorded for Bank ABC, \$20,000 of the noncurrent other asset is reclassified as current. Thus the impact to the firm's capital from Bank ABC's aged reconciling items is a negative \$10,000 represented by the non-current asset.

For Bank XYZ, a net \$25,000 unfavorable reconciling charge results. As the firm's capital has not yet been impacted, a \$25,000 capital charge is recorded to reflect Bank XYZ's aged reconciling items.