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There is a general impression amongst accountants that the brokerage audit is a weird, mysterious something outside the realm of ordinary auditing procedure, and is therefore avoided and sometimes feared by them.

The fact remains, however, that the principles involved in a brokerage audit are no different from the principles involved in any commercial audit. The theory of accounts certainly is the same, for a debit is a debit, whether it appears on the books of a shoe manufacturer or a stock-brokerage house. All that is different in the case of a brokerage house is the method of doing business, and that difference exists in the audit of books of concerns engaged in one industry as against another. If the auditor acquaints himself with the method of doing business, the terms employed, and the purpose of the various books, etc., the auditing procedure can be just as readily mastered as in the case of the ordinary commercial audit.

It is not the purpose of this paper to describe the method in which stock brokers carry on their business. It is assumed that that is already known. There will be discussed the auditing procedure that should be followed when an audit is desired for surety-bond purposes by a stock-brokerage house. An audit for surety-bond purposes is practically equivalent to what is generally known as a "balance-sheet audit." That is, the auditor is called upon to verify the securities, cash and customers' balances and other assets and liabilities. Concretely, it includes the following:

> Count and verify the securities on hand, cash and revenue stamps with the books, reconcile and confirm domestic and foreign bank accounts, money borrowed and collateral deposited to secure the loans, securities borrowed and loaned, securities failed to receive and to deliver, securities in transfer; verify customers' and partners' accounts as to money and security-balances; verify the correctness of the security record; ascertain that all securities are properly accounted for; verify the trial balances of all ledgers; reconcile accounts current from foreign correspondence; reconcile statements from other brokers; and such other work necessary to verify other assets and liabilities.

The surety-bond audit, however, does not necessitate the submission of a balance-sheet, so that the auditor is not called upon to certify the financial condition. All that is required is the verification of the assets and liabilities in a manner similar to what has already been mentioned.

When an accountant is called in on a brokerage audit, long before the audit itself is to be begun, arrangements should be made with the client as to several matters. For instance, an understanding should be had as to who is to write up the verification forms, whether the auditor or the client's staff. This is very important, because writing up verifications is a considerable time-consuming factor. It is also necessary to determine in advance to what extent firm and partners' accounts are to be verified; also joint and trio accounts. Also, arrangements should be made to have some member of the firm present when the securities are to be counted. This is extremely advisable for the protection both of the client and the accountant.

In this connection, however, mention must be made that it is advisable that the client's office force should not know that an audit is to be made, or when the auditors will begin, in order that, if any irregularity does exist, the perpetrator may be caught unawares.

It is also important that the auditor familiarize himself with the books kept by the client, their purpose, rulings, etc., in order that when the audit itself is begun, he may have at his command a practical working knowledge of just how the books are run. In this connection, however, the auditor will find that there is more standardization in the form of the books kept by brokerage houses than there is in many other enterprises.

Assuming that all these preliminary matters have been properly disposed of, we now come to the time when the audit is to be begun. In order to make a proper audit, it is necessary that the auditor be equipped with the proper working tools for that particular audit. In a brokerage house, where the office force is usually "head in heels" with work, the auditor becomes a pest when he has to interrupt any member of the force to request stationery or other similar things with which he should have been properly equipped in the first place. A well-rounded set of equipment will include various colored pencils, indelible pencils, a ruler, metal clips, ink, blotters, a stamp pad, date stamp, journal paper, and analysis paper. This will make the auditor properly supplied as to his working tools. With respect to the equipment necessary for the audit itself, he should have before he begins the audit a card showing the abbreviations of stock-exchange houses, a booklet containing the transfer agents for the various stocks listed on the exchanges, all his confirmation forms, including forms for customers, bank loans, stocks loaned and borrowed, in transfer, failed to receive, failed to deliver, open contracts.

He should have available security-record forms, envelopes of his own firm, small and large, self-addressed envelopes, small and large, and letterheads.

With respect to the auditing procedure, almost everyone will agree that the first thing to do is to count the securities. However, there are certain things that must be disposed of long before the time for the count. If accounts are kept with foreign banks, request should be made several weeks before the date as of which the audit is made, for statements of the client's account as of the date of the audit. In this way, foreign statements will be coming in shortly after the commencement of the audit.

Furthermore, the security-record forms should be written up with respect to the names of the securities before the audit itself begins. The security record will be described subsequently. Suffice it at this time to mention that in order that the securities as independently accounted for by the auditor be reconciled to the records kept by the client, it is advisable that the same names of the various securities as recorded by the client and their alphabetical order be also maintained in the auditor's security records. Thus, Republic of France 8's may be listed by the client under "F," while the auditor might deem it advisable to list the security under "R." By first going to the security record, however, and setting up the auditor's security-record sheets in the same manner in which the client's are kept, a great deal of time will be subsequently saved in checking out the one to the other.

With these operations out of the way, the audit itself can be begun. The first thing to do, of course, is to count the securities, and in counting the securities it is necessary to distinguish between active and inactive boxes, the inactive box showing the names of the customers to whom the securities belong. One auditor should count the securities and the other should list them, and in this connection, it is important that certain standard features in connection with the securities be recorded. For instance, on a bond it is necessary to list the number of bonds, the name of the debtor, the interest rate, the year of maturity, and also the last coupon, whether it is for a date either prior or subsequent to the interest date next preceding the date of the count.

It is very advantageous to have the active securities in alphabetical order and the inactive securities called off alphabetically, according to customers. This will prove valuable for the subsequent posting to the stock record.

Too much emphasis cannot be placed upon the importance of being extremely careful in making the count. Fractional shares should not be mistaken for whole shares, and dividend scripts should not be mistaken for common stock. Securities, of course, should be counted on the day as of which the audit is to be made. The count of the active securities must be completed before the next business day. On the inactive securities, there is no serious loss in completing the count on a subsequent day, provided that the boxes are sealed when out of the control of the auditor, and further provided that strict record is kept of all securities withdrawn from or added to the box subsequent to the date as of which the audit is made and prior to the completion of the count.

It is of course important to make sure that the auditor has all the security boxes. Sometimes it develops later on in the course of the audit that a box has been overlooked and the value of the audit is immediately undermined.

Another operation that should be performed on the day as of which the audit is to be made is the verification of bank loans. The reason that this must be done on the date of the audit is that the securities in the loans are constantly changing and in order that the security balances on the date of the audit may be determined from the loan register, and in order that the bank may be able to verify that balance without difficulty, it is obvious that reference to the client's books as of the date of the audit and to the bank's records the next day will enable all concerned to obtain the necessary information promptly. The information for the detail as to the date and amount of the loan and security behind it is obtained from the bank-loan register, which is a sort of subsidiary ledger, of which the bank-loan account in the general ledger is the controlling account.

The verification form should be drawn up in duplicate, the original to go to the bank and the duplicate to remain with the auditor, in order to build up the security record.

Before the verification forms are mailed, the total money balances should be computed and their correctness checked to the controlling account. Likewise, the verifications should be made of stocks loaned and borrowed, which are run on practically the same manner as bank loans, as are stocks failed to receive and stocks failed to deliver. Stocks in transfer can be obtained from the transfer sheets and verification should be made to the transfer agents.

On the date of the audit, it is also necessary to count the petty cash and reconcile the balance, as well as make a count of revenue stamps, both federal and state.

From the foregoing, it will be observed why brokerage auditing entails so much night work, in spite of the fact that many auditors may be sent out on the one engagement.

After all this verification, etc., security records should then be built up. The security record is merely a perpetual inventory record, and the auditor should build up the record as of the date of the audit. Some auditing firms do not build up their own security record, but check the record of the clients. In the writer's opinion this is a most unsafe procedure, in view of the fact that changes can be made overnight by the office clerks, or spurious items ticked off by them as having been checked, whereas, as a matter of fact, they have not been, and in both cases the auditors would be at a loss to detect them. The writer has therefore always felt that it is necessary for the auditor to build up his own security records.

A security record should show for each security the number to be accounted for, and how they are accounted for. In other words, the theory of debit and credit still prevails. Accountability for securities may arise through either a customer being long, firm investments, stocks borrowed or failed to deliver. The securities may be accounted for by either being in the box, active or inactive, being out on loan with banks, stocks loaned, in transfer, failed to receive, or customers short. In any event, however, the total of the amount to be accounted for must, of course, equal the amount accounted for; and these totals should agree with the client's security record.

The way the security record is built up, is to take copies of all verification forms containing security positions as well as the security count, and to post each item to the security sheet, and particularly to that column on the security-record sheet that is set aside to indicate in what category that security falls; thus, the securities with banks pledged to secure loans would be posted in the loan column on the side of the security record devoted to securities accounted for.

By the time the security records are partially written up, the customers' accounts as of the date of the audit will undoubtedly have been posted and ruled off, and statements prepared, so that the verification can then be made to the customers' accounts through the use of the auditor's verification form. By this time verifications should have been sent for all asset or liability accounts with dollar or security balances, and of course, in all these cases it is important to observe that request should be made that the verification be returned to the auditor. The way to determine whether verifications have been made for all asset and liability accounts is to obtain copies of trial balances of all the ledgers and to scan each asset and liability account. The security record can then be completed and checked out to the client's security record, and differences noted and adjusted. By that time most of the verifications will have undoubtedly come in.

In those cases where customers do not confirm their position, it is necessary, under the terms of the surety bond, that a second request be sent to them by registered mail ten days after the mailing of the first request for confirmation.

Bank balances should, of course, be reconciled, as well as foreign balances. By this time all asset and liability accounts should have been verified, and the report can then be submitted to the client. The report should contain merely a caption for each asset and liability, and a brief statement as to what was done to verify it and what the confirmations disclose. A list should be included of customers from whom no reply was received, and it is also advisable to include a schedule showing differences that were found in the security record. A letter should also be prepared that the client can submit to the surety company in order to show that the terms of the bond were complied with.

A word should be mentioned about the arrangement of the working papers. Because of the mass of papers that will be accumulated during the course of the audit, it is imperative that some systematic arrangement of the working papers be made or else the auditor will soon find that his papers are in a state of confusion. To begin with, each sheet for the different operations should be successively numbered. Incidentally, it is advisable to show the initials of the individual who prepared the sheet. Manila folders should be used for the papers of each operation, or of such items as can be properly grouped. Thus, a folder should be had for the securities-count and the papers in this connection placed in that folder. A folder should also be made for bank loans, stocks loaned and borrowed, etc. It is also advisable to have a folder for items to be attended to, in order that these may be separated from the others. The important thing to bear in mind is that the papers should be so arranged that any particular information that is desired can be easily traced.