

MEMORANDUM

To: All Member, Member Organizations and Participants and Participant Organizations

From: Joseph Cusick, Vice President - Regulatory Programs

Re: Annual Audit Requirement: Designation of Accountant under 17a-5(f)(2)

Date: December 7, 2004

This memorandum is intended to inform Philadelphia Stock Exchange ("Phlx" or the "Exchange") Members, Member Organizations, Participants and Participant Organizations (collectively "Member Organizations") that pursuant to Rule 17a-5(f) promulgated under the Securities Exchange Act of 1934 ("the Act") all registered broker-dealers required to file annually audited financial statements ("Annual Audit") with the Designated Examining Authority ("DEA"), and the Securities and Exchange Commission ("SEC") must submit "Notice pursuant to Rule 17a-5(f)(2)" by December 10th of each year.

Every broker or dealer which is required by paragraph (d) of Rule 17a-5 to file an annual report of financial statements shall file, no later than December 10th of each year, a statement with the Commission's principal office in Washington, D.C., the regional or district office of the Commission for the region or district in which its principal place of business is located and the principal office of the designated examining authority for such broker or dealer. Such statement shall indicate the existence of an agreement dated no later than December 1st, with an independent public accountant covering a contractual commitment to conduct the broker's or dealer's annual audit during the following calendar year.

The agreement may be of a continuing nature, providing for successive yearly audits, in which case no further filing is required. If the agreement is for a single audit, or if the continuing agreement previously filed has been terminated or amended, a new statement must be filed by the required date.

The statement shall be headed "Notice pursuant to Rule 17a-5(f)(2)" and shall contain the following information:

- (A) Name, address, telephone number and registration number of the broker or dealer;
- (B) Name, address and telephone number of the accounting firm;
- (C) The audit date of the broker or dealer for the year covered by the agreement.

Please direct any questions regarding the Annual Audit requirement to William Bunting, Director Examinations Department at 215-496-5401.

Additionally, Member Organizations not meeting an exemption from Rule 17a-5(d) that report on a calendar year basis are reminded of the requirement to file an annual audit with their DEA no later than March 1, 2002. The applicable text of Membership Memorandum 2130-01, issued on November 30, 2001, which addressed the filing requirements and exemptions, for Membership Organizations for which the Phlx is the DEA is reprinted below for your convenience. Annual Audits filed with the Phlx should be directed to the Examinations Department.

Applicable Text of Phlx Memorandum No. 2130-01

Pursuant to Rule 17a-5(d), promulgated under the Act, all broker-dealers are required to file an Annual Audit with their Designated Examining Authority, and the SEC, no more than 60 days after the date of the year end financial statements. Member firms designated to the Phlx are reminded to file their Annual Audit with the Exchange's Examinations Department on a timely basis. Member firms requiring an extension must make a request, in writing, prior to the filing due date. Additionally, member firms are reminded of the requirement that they engage an independent and certified public accountant that is duly registered in good standing under the laws of the accountant's home state.

Exemption from Annual Audit Requirement

Pursuant to subsection (1)(iii) of Rule 17a-5(d) of the Act, broker-dealers that are members of a national securities exchange and have transacted a business in securities solely with or for other members of a national securities exchange and have not carried customer accounts, are exempt from Rule 17a-5(d).

Based on previous discussions between the Phlx and the SEC's Division of Market Regulation, the exemption will apply to a Phlx member firm that operates primarily as an on-floor specialist, market maker or a floor broker and executes 75% or more of its transactions directly relating to its primary business on the floor of the Exchange.

Therefore, member firms conducting 25% or more of their total transactions at any time, which are not directly related to its primary business as on-floor specialist, market maker or floor broker will be required to engage an independent public accountant and file an Annual Audit pursuant to Rule 17a-5. Transactions not directly related to a primary business on the floor include, but are not limited to: transactions occurring in a customer or investment account; proprietary trading and margin transactions resulting in the application of Regulation T.

Member firms claiming an exemption from Rule 17a-5(d) are reminded of the obligation to maintain evidence supporting their qualification for the exemption. During routine examinations the Examinations Department staff will review compliance with Rule 17a-5(d).