

## **Nature of Operations and Significant Accounting Policies**

**Nature of operations:** Lakeshore Securities L.P. (The Partnership) is a registered broker-dealer and a member of the Chicago Board Options Exchange, Inc. and the Options Clearing Corporation. The Partnership is also registered as an introducing broker with the Commodity Futures Trading Commission (CFTC), and is a member of the National Futures Association (NFA) and the Chicago Futures Exchange. The Partnership provides brokerage and clearing services to customers, primarily broker-dealers, on a national basis.

Although the Partnership is not exempt from SEC Rule 15c3-3, it does not transact business in securities with, or for, customers other than members of a national securities exchange and does not carry margin accounts, credit balances or securities for any person defined as a "customer" pursuant to Rule 17a-5(c)(4).

The following is a summary of the Partnership's significant accounting policies:

**Accounting policies:** The Partnership follows Generally Accepted Accounting Principles (GAAP), as established by the Financial Accounting Standards Board (FASB), to ensure consistent reporting of financial condition, results of operations, and cash flows.

**Use of estimates:** The preparation of financial statements in conformity with GAAP requires the Partnership's management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Cash equivalents:** Cash equivalents are highly liquid investments with original maturities of less than three months at the date of acquisition that are not held for sale in the ordinary course of business.

**Revenue recognition and receivable from broker-dealers and others:** Brokerage commissions, order flow income, and clearing fee income are recorded on a trade date basis as securities transactions occur. Receivable from broker-dealers and others includes amounts due from these services. Uncollectible amounts are written off at the time the individual receivable is determined to be uncollectible. Allowances for uncollectible receivables are based primarily on historical collection experience. As of December 31, 2015, no allowance has been recorded.

**Securities transactions:** Securities transactions and related revenues and expenses are recorded at fair value on a trade-date basis as if they had settled. The resulting realized gains and losses and change in unrealized gains and losses are reflected in principal transactions in the statement of income.

Dividends are recorded on an ex-dividend date.

**Income taxes:** The financial statements do not reflect any income taxes since the taxable income of the Partnership is includable in the income tax returns of the partners.

FASB guidance requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Partnership's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained "when challenged" or "when examined" by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense and liability in the current year. Management has determined that there are no material uncertain income tax positions through December 31, 2015. The Partnership is generally not subject to U.S. federal and state tax examinations for tax years before 2012.

## **Fair Value of Financial Instruments**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Partnership utilizes valuation techniques to maximize the use of observable inputs and minimize the use of unobservable inputs. Assets and liabilities recorded at fair value are categorized within the fair value hierarchy based upon the level of judgment associated with the inputs used to measure their value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Inputs are broadly defined as assumptions market participants would use in pricing an asset or liability. The three levels of the fair value hierarchy are described below:

Level 1. Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2. Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly and the fair value is determined through the use of models or other valuation methodologies. A significant adjustment to a Level 2 input could result in the Level 2 measurement becoming a Level 3 measurement.

Level 3. Inputs are unobservable for the asset or liability and include situations where there is little, if any, market activity for the asset or liability. The inputs into the determination of fair value are based upon the best information in the circumstances and may require significant management judgment or estimation.

The availability of observable inputs can vary from security to security and is affected by a wide variety of factors, including, for example, the type of security, whether the security is new and not yet established in the marketplace, the liquidity of markets, and other characteristics particular to the security. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in level 3.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Partnership's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

A description of the valuation techniques applied to the Partnership's major categories of assets and liabilities measured at fair value on a recurring basis follows.

**Common stock:** Fair value of securities traded on a national securities exchange are based upon the last reported sales price on the day of valuation. These financial instruments are classified as Level 1 in the fair value hierarchy.

**Note 2. Fair Value of Financial Instruments (Continued)**

The following table presents the Partnership's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2015:

Description	Fair Value Measurements			Total
	Level 1	Level 2	Level 3	
Securities owned:				
Common stock:				
Stock in exchange	\$ 690,795	\$ -	\$ -	\$ 690,795
Other	11	-	-	11
Total	\$ 690,806	\$ -	\$ -	\$ 690,806

The Partnership assesses the levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Partnership's accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. There were no transfers among Levels 1, 2, and 3 during the year.

**Deposit with Clearing Organization**

The Partnership has cash on deposit with a clearing organization in the amount of \$400,004 at December 31, 2015, as a guarantee deposit.

**Receivable from Broker-Dealers and Others**

Receivable from broker-dealers and others at December 31, 2015 consists of the following:

Brokerage commissions receivable	\$ 2,187,135
Cash on deposit at clearing broker	2,222,974
	<u>\$ 4,410,109</u>

Cash and equity securities held by the clearing broker collateralize amounts due to the clearing broker, if any, and may serve to satisfy margin and regulatory requirements.

**Commitments, Contingencies and Indemnifications**

The Partnership entered into a lease for office space expiring January 31, 2016. The minimum rental commitments under this agreement are as follows:

2016	\$ 4,954
	<u>\$ 4,954</u>

Rental expense for the year ended December 31, 2015 was \$59,303.

#### **Note 5. Commitments, Contingencies and Indemnifications (Continued)**

The partnership agreement provides, among other things, that the Partnership may, under certain circumstances and subject to minimum capital requirements, elect to purchase a partner's interest at a price, as defined.

In the normal course of business, the Partnership may be subject to various claims, litigation, regulatory and arbitration matters. The effect of such claims and matters, if any, cannot be determined and management of the Partnership believes that the resolution of these matters will not result in a material adverse effect on the Partnership's financial position, results of operations, or cash flows. The Partnership also indemnifies and guarantees certain service that provides against specified potential losses in connection with their acting as an agent of, or providing services to the Partnership. The maximum potential amount of future payments that the Partnership could be required to make under these indemnifications cannot be estimated. However, the Partnership believes that it is unlikely it will have to make material payments under these arrangements and has not recorded any contingent liability in the financial statements for these indemnifications.

#### **Partners' Capital**

Effective January 1, 2011, the Partnership created a Special Limited Partnership interest that participates only in a portion of the income and expenses from the Partnership's investment in shares of stock in exchange owned. The Special Limited Partner does not actively manage the operations of the Partnership.

During 2014 the general partners in the firm sold 36% interest in the firm to some of the limited partners. As a result and due to legal restructuring of the partnership, general partners became limited partners and certain limited partners became general partners. The equity of the partnership was unaffected by this restructuring.

#### **Employee Benefit Plan**

The Partnership participates in a 401(k) employee benefit plan covering substantially all of its employees and employees of related entities. Contributions to the plan are at the discretion of the Partnership. During the year ended December 31, 2015, the Partnership made no contribution to the plan.

#### **Customer Concentration and Concentration of Credit Risk**

For the year ended December 31, 2015, the Partnership had two major customers that represented 26 percent of total brokerage commission revenue. A customer is considered major when the customer represents more than 10 percent of total receivables from broker-dealers and others as of December 31, 2015, or more than 10 percent of total brokerage commission revenue for the year ended December 31, 2015.

The receivable from broker-dealers and others represents a concentration of credit risk resulting from the Partnership's brokerage activity. The cash in bank deposit accounts, at times may exceed federally insured limits. The Partnership has a policy of reviewing, as considered necessary, the creditworthiness of the counterparties with which it conducts business and does not anticipate nonperformance by these counterparties.

### Net Capital Requirements

The Partnership is subject to the minimum net capital requirements of the SEC Uniform Net Capital Rule (SEC Rule 15c3-1) and the CFTC Net Capital Requirements (Regulation 1.17) and has elected to compute its net capital requirements under the alternative method, as provided by the Rule. Under the SEC Rule 15c3-1, the Partnership is required to maintain "net capital" equal to the greater of 2 percent of combined "aggregate debits" or \$250,000, as these terms are defined. Under the Regulation 1.17, the Partnership is required to maintain "adjusted net capital" of \$45,000, as this term is defined.

Net capital and net capital requirements change from day to day, but as of December 31, 2015, under the most restrictive of these requirements, the Partnership had net capital and net capital requirements of \$4,796,217 and \$250,000 respectively. The net capital rule may effectively restrict partner withdrawals.

As a clearing member of the Options Clearing Corporation, the Partnership is required to maintain net capital of \$2,000,000 (Rule 302(a)).

### Subsequent Events

The Partnership has evaluated subsequent events for potential recognition and/or disclosure through the date these financial statements were issued. Subsequent to year-end, the Partnership exercised its option to extend the lease for office space. The minimum rental commitments under this agreement are as follows:

2016	\$ 61,082
2017	62,914
2018	64,801
2019	5,413
	<u>\$ 194,210</u>

### Recently Issued Accounting Pronouncements

The Partnership has reviewed the accounting standards updates issued by the FASB that were either newly issued or had effective implementation dates that would require these provisions to be reflected in the financial statements for the year ending December 31, 2045. Based upon this review, the Partnership has implemented the pronouncements that require adoption (if any). The Partnership has also concluded that the remaining pronouncements have either limited or no application to the Partnership and in all cases implementation would not have a material impact on the financial comments taken as a whole.