



ORDER

Making Findings, and Imposing Sanctions ("Order") as set forth below.¹

III.

On the basis of Respondent's Offer, the Board finds that:

A. Respondent

1. DDAF is a registered public accounting firm with offices in Lexington and Louisville, Kentucky. It is a member firm of the McGladrey Alliance. At all relevant times, the Firm was licensed by the Kentucky State Board of Accountancy (license nos. 56, B 56). The Firm, formed in 1982, is registered with the Board pursuant to Section 102 of the Act and Board rules.

B. Summary

2. DDAF prepared the financial statements for a broker-dealer audit client ("Broker-Dealer") for the year ended December 31, 2012. As a result, the Firm was not independent of the Broker-Dealer under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.² The Firm nevertheless audited the financial statements and issued an audit report that the Broker-Dealer included with the financial statements it filed with the Commission. In the audit report, the Firm represented that the audit had been performed in accordance with Generally Accepted Auditing Standards ("GAAS"). Because GAAS requires independence, however, that representation violated Rule 17a-5(i), which required the audit report to state whether the audit was made in accordance with GAAS.

¹ The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

² Exchange Act Rule 17a-5, referenced throughout this Order as "Rule 17a-5," is found at 17 C.F.R. § 240.17a-5. The rule provisions set out herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. See Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with PCAOB standards, effective for audits of fiscal years ending on or after June 1, 2014. In addition, Rule 17a-5 provides that the auditor must be independent in accordance with Rule 2-01 of Commission Regulation S-X. At the time of the relevant conduct, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

ORDER

C. Respondent Violated a Commission Rule

3. Rule 17a-5(d)(1) requires, among other things, that "[e]very broker or dealer registered pursuant to section 15 of the [Securities Exchange] Act [of 1934] shall file annually, on a calendar or fiscal year basis, a report which shall be audited by an independent public accountant." Rule 17a-5(d)(2) states that "[t]he annual audited report" filed by a registered broker or dealer, among other things, "shall contain a Statement of Financial Condition . . . , a Statement of Income, a Statement of Cash Flows, a Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and [a] Statement of Changes in Liabilities Subordinated to Claims of General Creditors."

4. Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d)" Rule 17a-5(f)(3) states: "An accountant shall be independent in accordance with the provisions of § 210.2-01(b) and (c) of this chapter."

5. Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards." Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards."

6. GAAS requires auditors to maintain strict independence from their audit clients.³ "[I]f an auditor's report states that its audit was in accordance with GAAS when the auditor was not independent, then it has violated Rule 17a-5(i)."⁴

7. Pursuant to Rule 17a-5(f)(3), certain of the Commission's auditor independence criteria described in Rules 2-01(b) and (c) of Regulation S-X apply to

³ AU-C Section 200.15-.16, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*. References herein to GAAS are to the versions of the auditing standards that were applicable to audits of brokers and dealers at the time of the audit at issue here.

⁴ *Rosenberg Rich Baker Berman & Company*, Exchange Act Release No. 69765, 2013 WL 2898032, at *4 (June 14, 2013).



ORDER

audits of brokers and dealers.⁵ The applicable provisions include Rule 2-01(c)(4), which states in part:

An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client:

(i) *Bookkeeping or other services related to the accounting records or financial statements of the audit client.* Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:

. . .

(B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission

8. The Firm served as the auditor of the Broker-Dealer's December 31, 2012 financial statements. At all relevant times, the Broker-Dealer was a "broker" and "dealer," as defined in Section 110 of the Act and PCAOB Rules 1001(b)(iii) and 1001(d)(iii), and was not an "issuer," as defined in Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

9. In February 2013, the Broker-Dealer filed with the Commission a Form X-17A-5 Part III for the year ended December 31, 2012. Included in that filing was an audit report signed by the Firm dated January 25, 2013. That report stated, among other things, that the Firm audited the Broker-Dealer's financial statements "in accordance with auditing standards generally accepted in the United States of America."

⁵ Not all independence criteria described in Rule 2-01(c) apply to audits of brokers and dealers. As the Commission has explained, those audits "are not subject to the partner rotation requirements or the compensation requirements of the Commission's independence rules [Rules 2-01(c)(6) and (c)(8)] because the statute mandating those requirements is limited to issuers," and they "are not subject to the audit committee pre-approval requirements or the cooling-off period requirements for employment [Rules 2-01(c)(7) and (c)(2)(iii)(B)] because those requirements only reference issuers." See Exchange Act Release No. 34-70073 at II.E.



ORDER

10. The Firm's engagement letter with the Broker-Dealer for the audit of the Broker-Dealer's December 31, 2012 financial statements acknowledged that the Broker-Dealer might request that the Firm "perform accounting services necessary for the preparation of the financial statements," including "drafting the financial statements."

11. Firm staff prepared and included in the Firm's audit documentation an "MRAM [McGladrey Risk Assessment Model] Risk Assessment & Client Acceptance" form noting that the Broker-Dealer's management "prepares the entity's audited financial statements and related disclosures with significant assistance/revision necessary from the independent auditor" (emphasis added) and assigning a corresponding risk of "Medium" to this aspect of the engagement.

12. Firm staff also prepared and included in the Firm's audit documentation a form titled "0808 FSR Financial Statement Preparation." This form stated in pre-printed text that "[a]uditors of financial statements subject to SEC independence are prohibited from performing certain prohibited services, including bookkeeping and financial statement preparation services" and noted that the form was "used to document the engagement team's compliance with this prohibition." The text added to the form by Firm staff included: a list of items obtained from the Broker-Dealer, such as a trial balance, general ledger detail, and a FOCUS report, as well as schedules concerning cash flow, changes in members' equity, and changes in liabilities subordinated to claims of general creditors; a statement that Firm staff prepared the Broker-Dealer's financial statements based on this information and based on related inquiries to the Broker-Dealer, then provided those drafts to the Broker-Dealer, which the Broker-Dealer's management "review[ed] and approve[d]"; and the engagement team's conclusion that these activities by the Firm constituted only a "clerical task" and a "word processing function" that did "not impair our independence."

13. Firm staff used the trial balance obtained from the Broker-Dealer to prepare the Broker-Dealer's Statement of Financial Condition as of December 31, 2012 and Statement of Income for the year ended December 31, 2012 filed with the Commission. In preparing these two financial statements, Firm staff aggregated line items and changed line item descriptions as compared to corresponding information in the trial balance.

14. Firm staff used general ledger detail and information resulting from inquiries to the Broker-Dealer's management to prepare the Broker-Dealer's Statement of Changes in Stockholders' Equity and Statement of Cash Flows for the year ended December 31, 2012 filed with the Commission. In preparing these two financial statements, Firm staff aggregated line items, changed line item descriptions, and changed non-line-item text as compared to corresponding information in, and added

ORDER

text absent from, the general ledger detail and other documents obtained by the Firm from the Broker-Dealer.

15. Firm staff emailed the Broker-Dealer a set of draft financial statements on January 23, 2013 for management approval.

16. As a result of the Firm's conduct in preparing the financial statements, the Firm was not independent of the Broker-Dealer under the independence criteria established by the Commission in Rule 2-01(c)(4) of Regulation S-X, which Rule 17a-5 made applicable to the audit of the Broker-Dealer's financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client."⁶

17. The Firm violated Rule 17a-5(i) by representing in its audit report that it had performed the audit of the Broker-Dealer's December 31, 2012 financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audit had not been performed in accordance with GAAS. That violation constituted a violation of the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED that:

- A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), the Firm is censured.
- B. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty of \$2,500 is imposed upon the Firm. All funds

⁶ *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602 (November 21, 2000) at IV.D.4.b(i).

ORDER

collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. The Firm shall pay this civil money penalty within 10 days of the issuance of this Order by (a) wire transfer pursuant to instructions provided by Board staff; or (b) United States postal money order; (c) made payable to the Public Company Accounting Oversight Board; (d) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006; and (e) submitted under a cover letter, which identifies the Firm as a respondent in these proceedings, sets forth the title and PCAOB Release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

C. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), the Firm is required:

1. within ninety (90) days from the date of this Order, to establish policies and procedures, or revise and/or supplement existing policies and procedures, for the purpose of providing the Firm with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report—whether an audit report, an examination report, or a review report—required under paragraph (d)(1)(i)(C) of Rule 17a-5, as amended);

2. within ninety (90) days from the date of this Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

3. within ninety (90) days from the date of this Order and before the Firm's commencement of any SEC Registered Broker-Dealer Engagement (or, where the Firm by the date of this Order has already commenced but not completed such an engagement, before the Firm's

ORDER

release of its report), to ensure training pursuant to the policy described in paragraph C(2) above on at least one occasion;

4. to provide a copy of this Order—

a. within (30) days from the date of this Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), the Firm as of the date of this Order,

b. within (30) days from the date of this Order, to any client of the Firm as of the date of this Order for which the Firm has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement,

c. before the commencement of any SEC Registered Broker-Dealer Engagement, to any future client for which the Firm is engaged within three (3) years of the date of this Order to perform such an audit; and

5. to certify in writing to the Director of the Division of Enforcement and Investigations, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, the Firm's compliance with paragraphs C(1) through C(4)(b) above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Firm shall submit such certification within one hundred twenty (120) days from the date of this Order. The Firm shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement and Investigations may reasonably request.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

December 8, 2014