

# **Webinar: PCAOB Standards for Small Firm Broker-Dealer Auditors**

January 14, 2015

# Introductory Remarks

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Mary Sjoquist, Director  
Office of Outreach and Small Business Liaison

## Caveat

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The views we express today are our own and do not necessarily reflect the views of the Board, individual Board members, or other members of the Board's staff.

# Implementing Rule 17a-5 and the PCAOB Audit and Attestation Standards



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# Agenda

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- ❑ Coordinating the Audit and Audit Procedures on the Supporting Schedules and the Attestation Engagements
- ❑ Performing Audit Procedures on Supporting Schedules
- ❑ Examination Engagements
- ❑ Review Engagements
- ❑ Other PCAOB Standards and Rules
- ❑ Conforming Amendments

# Polling Question #1

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How many audits of broker-dealers does your firm perform?

- A. 1
- B. 2-20
- C. 21-50
- D. 51-100
- E. More than 100

# Polling Question #1

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Responses



# *PCAOB Webcast on Auditing Smaller Broker-Dealers*

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***January 14, 2015***



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# *Agenda*

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## ❖ **Broker-Dealer Rulemaking**

- **Broker-Dealer Annual Reporting Requirements Prior to July 30, 2013 Amendments to Exchange Act Rule 17a-5**
- **July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)**
  - **Compliance Report (and related Examination)**
  - **Exemption Report (and related Review)**
  - **Other Requirements**
  - **Frequently Asked Questions**
  - **Implementation Observations**

## ❖ **Applicability of Auditor Independence Rules to Broker-Dealer Audits**



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# *Broker-Dealer Rulemaking*

# *Broker Dealer Annual Reporting Requirements Prior to July 30, 2013 Amendments to Rule 17a-5*

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- ❖ **Generally broker-dealers must file an annual report with the SEC and the broker-dealer's designated examining authority pursuant to Rule 17a-5**
  - **Annual report was required to contain audited financial statements and certain supporting schedules and supplemental reports, as applicable**
  - **The audit was required to be conducted in accordance with GAAS (i.e., not PCAOB standards)**
- ❖ **Report on Internal controls**
  - **Study of practices and procedures followed, including consideration of control activities for safeguarding securities (if applicable)**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ In addition to existing requirements to file audited financial statements and certain supporting schedules (“Financial Report”), the amended Rule 17a-5 also requires the following new reports:
  - **Carrying broker-dealer** (as defined in SEC Release No. 34-70073) that has custody of customer assets to file a new Compliance Report, that will be examined by its independent public accountant
  - **Non-carrying broker-dealer** (as defined in SEC Release No. 34-70073) that does not have custody of customer assets to file a new Exemption Report, that will be reviewed by its independent public accountant

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Audits of the Financial Report, the examination of the Compliance Report and the review of the Exemption Report are to be conducted in accordance with PCAOB standards, instead of GAAS**
  - **The PCAOB has developed new attestation standards (AT Nos. 1 & 2) specifically tailored to the examination of the Compliance Report and the review of the Exemption Report, as well as a new auditing standard (AS No. 17) for supplemental information accompanying the financial statements**
- ❖ **Effective date:**
  - **The requirement to file a Compliance Report and Exemption Report and the related auditor reports is effective for fiscal years ending on or after June 1, 2014**

# Applicability of New PCAOB Standards\*

	Broker-Dealer	Related Auditor Requirement
<b>Carrying broker</b> (custody of customer assets)	<u>Financial Report:</u> <ul style="list-style-type: none"> <li>Financial statements</li> <li>Supporting Schedules</li> </ul> <u>Compliance Report</u> (new)	Audit Standards Audit procedures: <u>AS 17</u> Examination: <u>AT 1</u>
<b>Non-carrying broker</b> (no custody of customer assets)	<u>Financial Report:</u> <ul style="list-style-type: none"> <li>Financial statements</li> <li>Supporting Schedules</li> </ul> <u>Exemption Report</u> (new)	Audit Standards Audit procedures: <u>AS 17</u> Review: <u>AT 2</u>

\* Effective for all broker-dealers with fiscal years ending on or after June 1, 2014.

# Coordinating the Audit and Audit Procedures on the Supporting Schedules and the Attestation Engagements

# Coordinating

PCAOB standards require coordination among the audit, the audit procedures on the supporting schedules, and the examination engagement or review engagement

- Financial statement audit
  - The auditor should take into account evidence obtained from the results of the auditing procedures on the supporting schedules and the examination engagement or review engagement when evaluating the results of the audit and forming an opinion on the financial statements
- Supporting schedules
  - The auditor should take into account relevant evidence from the audit of the financial statements and the examination or review in planning and performing audit procedures related to the supporting schedules and in evaluating the results of the audit procedures to form the opinion on the supporting schedules

# Coordinating

PCAOB standards require coordination among the audit, the audit procedures on the supporting schedules, and the examination engagement or review engagement (cont.)

- ❑ Examination or review engagement
  - In planning and performing procedures for, and evaluating the results of the procedures performed in, the examination or review engagement, the auditor should take into account relevant evidence from the audit of the financial statements and the audit procedures performed on the supporting schedules
- ❑ The objectives of the audit and the examination or review are not the same, however, so the auditor must plan and perform the work to meet the objectives of both the audit and the attestation engagement



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# Supporting Schedules: Auditing Standard No. 17

## Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*

- Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*, applies when the auditor of the financial statements is engaged to audit and report on supplemental information that accompanies audited financial statements.
- Examples of supplemental information include the supporting schedules required by SEC Rule 17a-5 for broker-dealers.

# Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*

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- Objective of the auditor
  - To obtain sufficient appropriate audit evidence to express an opinion (reasonable assurance) on whether the SI is fairly stated, in all material respects, in relation to the financial statements as a whole
  
- Materiality
  - Generally the same materiality considerations as those used in planning and performing the audit of the financial statements

## *Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements*

- Requires the auditor to perform certain audit procedures to test and evaluate the supplemental information including
  - Obtain an understanding of the methods of preparing the SI, evaluate the appropriateness of those methods, and determine whether those methods have changed from the methods used in the prior period and, if the methods have changed, determine the reasons for and evaluate the appropriateness of such changes
  - Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the SI
  - Determine that the SI reconciles to the underlying accounts and other records or to the financial statements, as applicable

## *Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements*

- Requires the auditor to perform certain audit procedures to test and evaluate the supplemental information including (cont.)
  - Perform procedures to test the completeness and accuracy of supplemental information to the extent that it was not tested as part of the audit of financial statements
  - Evaluate whether the supplemental information, including its form and content, complies with relevant regulatory requirements or other applicable criteria, if any

# Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*

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- Reporting
  - Report is different from report in AU sec. 551
  - Opinion (reasonable assurance)

## Polling Question #2

Paragraph 4 of Auditing Standard No. 17 includes procedures the auditor should perform on the supplemental information. Which of the following is not one of those procedures?

- a. Determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements, as applicable.
- b. Perform procedures to test the completeness and accuracy of the information presented in the supplemental information irrespective of whether it was tested as part of the audit of financial statements.
- c. Inquire of management about any significant assumptions or interpretations underlying the measurement or presentation of the supplemental information.
- d. Perform procedures to test the completeness and accuracy of the information presented in the supplemental information to the extent that it was not tested as part of the audit of financial statements.

## Polling Question #2

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### Answer

b. Perform procedures to test the completeness and accuracy of the information presented in the supplemental information irrespective of whether it was tested as part of the audit of financial statements.

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Compliance Report to include statements as to whether:**
  - **The broker-dealer has established and maintained Internal Control over Compliance;**
  - **Internal Control over Compliance was effective during the most recent fiscal year;**
  - **Internal Control over Compliance was effective as of the end of the most recent fiscal year;**
  - **The broker-dealer was in compliance with Rule 15c3-1 and Rule 15c3-3(e) as of its fiscal year-end;**
  - **The information used to state whether it was in compliance was derived from the books and records of the broker-dealer.**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **If applicable, a carrying broker-dealer would be required to include:**
  - **A description of each material weakness in Internal Control Over Compliance during the most recent fiscal year**
  - **A description of each instance of non-compliance with Rules 15c3-1 or 15c3-3(e) as of the end of the most recent fiscal year**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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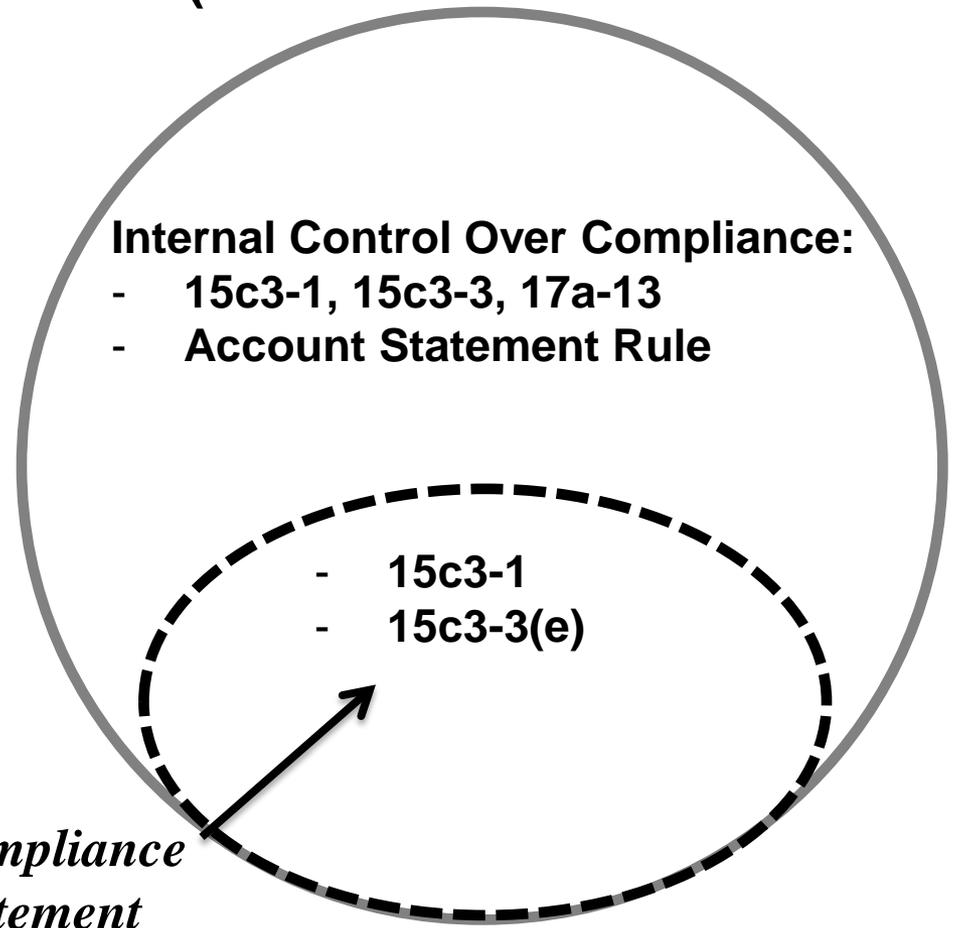
- ❖ **Internal Control Over Compliance (“ICOC”)**
  - **Internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with Rules 15c3-1, 15c3-3, 17a-13, or any rule of the designated examining authority (“DEA”) of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer (an “Account Statement Rule”) will be prevented or detected on a timely basis**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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❖ The rules covered by ICOC are broader than those covered by the compliance statement (statement #4 in the Compliance Report)

❖ Additionally, the statements in the Compliance Report on ICOC cover the entire year and year end, where the compliance statement is as of year end only



# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **ICOC is intended to focus on a broker-dealer's oversight of custody arrangements and protection of customer assets.**
  - **ICOC differs from Internal Control over Financial Reporting ("ICFR"), which focuses on the reliability of financial reporting and the preparation of financial statements.**
  - **The recently amended rule does not require that the effectiveness of ICFR be included as one of the statements made by the broker-dealer in the compliance report, or opined on by the auditor**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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## ❖ **Material Weakness**

- **A deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with Rule 15c3-1 or Rule 15c3-3(e) will not be prevented or detected on a timely basis or that non-compliance to a material extent with Rule 15c3-3, except for paragraph (e), Rule 17a-13, or any Account Statement Rule will not be prevented or detected on a timely basis**

- ❖ **Term “material inadequacy” no longer appears in Rule 17a-5**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Carrying broker-dealer is not permitted to conclude that its ICOC was effective**
  - **During the fiscal year if there were one or more material weaknesses in ICOC during the fiscal year**
  - **As of the end of the fiscal year if there were one or more material weaknesses in ICOC as of the end the fiscal year**
  
- ❖ **Carrying broker-dealer required to engage an independent public accountant to:**
  - **Prepare a report based on an examination of certain of the broker-dealer's statements contained in the Compliance Report**

# Examination Engagements: Attestation Standard No. 1

# Examination Engagement: Attestation Standard No. 1

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- The auditor's objective in the examination is to express an opinion regarding whether the assertions made by the broker-dealer in its compliance report are fairly stated, in all material respects.
  
- Reasonable assurance
  - A high level of assurance
  - Express an "opinion" on each of the broker-dealer's assertions

# Examination Engagement: Attestation Standard No. 1

- Planning the engagement
  - Establishing an overall strategy for the examination and developing a plan which includes, the nature, timing and extent of procedures necessary to obtain reasonable assurance
  - Coordinating with the audit of the financial statements and audit procedures performed on the supporting schedules
  - Performing planning procedures
  - Assessing the risk of fraud, including the risk of misappropriation of customer assets

# Examination Engagement: Attestation Standard No. 1

Testing Internal Controls Over Compliance both throughout the year and as of year end

- Obtain an understanding of the broker's or dealer's processes, including relevant controls, regarding compliance with the financial responsibility rules
- ICOC – Internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with SEC Rules 15c3-1, 15c3-3, 17a-3, or any rule of the DEA of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer, will be prevented or detected on a timely basis

# Examination Engagement: Attestation Standard No. 1

Testing Internal Controls Over Compliance both throughout the year and as of year end (cont.)

- Test controls
  - Evidence depends upon the risk associated with the control
  - As the risk associated with the control being tested increases, the persuasiveness of the evidence that the auditor should obtain also increases

# Examination Engagement: Attestation Standard No. 1

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Testing Internal Controls Over Compliance both throughout the year and as of year end (cont.)

- Design effectiveness
  - Testing design effectiveness includes determining whether the broker's or dealer's controls, if they are operating as prescribed by persons possessing the necessary authority and competence to perform the control effectively, can effectively prevent or detect instances of non-compliance with the financial responsibility rules on a timely basis.

# Examination Engagement: Attestation Standard No. 1

Testing Internal Controls Over Compliance both throughout the year and as of year end (cont.)

- Operating effectiveness
  - Obtain evidence throughout the year *and* as of year end
  - Methods of testing include a mix of inquiry, observation, inspection, and reperformance
  - Understanding changes in controls and testing new and superseded controls

# Examination Engagement: Attestation Standard No. 1

## Testing Internal Controls Over Compliance both throughout the year and as of year end (cont.)

- Evaluate deficiencies in ICOC to determine whether the deficiencies individually or in combination, are Material Weaknesses in ICOC
- The auditor cannot assume that an identified deficiency in ICOC is an isolated occurrence
- The auditor should evaluate the effect of any identified control deficiency on the auditor's assessment of risks associated with the controls and non-compliance
- The auditor should evaluate the effect Material Weaknesses on the audit of the financial statements and audit procedures performed on supplemental information

## Polling Question #3

Paragraph 13 of Attestation Standard No. 1 includes factors that affect the risk associated with a control. Which of the following factors are included in Attestation Standard No. 1?

- a. The nature of the financial responsibility rule.
- b. The existence and effectiveness of controls that monitor other controls.
- c. The risk of management override of controls over compliance.
- d. Answers b., and c.
- e. Answers a., b., and c.

## Polling Question #3

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Answer:

e. Answers a., b., and c.

# Examination Engagement: Attestation Standard No. 1

## Testing Compliance with SEC Rule 15c3-1 and SEC Rule 15c3-3(e)

- Evaluate whether the amounts in the schedules were determined in accordance with SEC rules
- Test the accuracy and completeness of information in schedules
- Determine whether the broker or dealer maintained the required level of net capital
- Determine whether the broker or dealer maintained a special reserve bank account for the exclusive benefit of customers and deposited funds in at least the required amount in accordance with paragraph (e) of SEC Rule 15c3-3

# Examination Engagement: Attestation Standard No. 1

## Testing Compliance with SEC Rule 15c3-1 and SEC Rule 15c3-3(e) (cont.)

- Determine whether the information in the schedules was derived from the books and records of the broker or dealer
- Determine whether the broker or dealer made the notifications, if any, required by the net capital rule and reserve requirements rule as of the end of the most recent fiscal year
- Plan and perform compliance tests that are responsive to the risks, including fraud risks, associated with non-compliance with 15c3-1 and 15c3-3(e)
- Perform procedures to obtain evidence about the existence of customer funds or securities held for customers

# Examination Engagement: Attestation Standard No. 1

## Testing Compliance with SEC Rule 15c3-1 and SEC Rule 15c3-3(e) (cont.)

- Evaluate identified instances of non-compliance with the net capital rule and the reserve requirements rule to determine whether any instance of non-compliance existed as of the end of the most recent fiscal year
- The auditor cannot assume that an identified instance of non-compliance is an isolated occurrence
- Instances of non-compliance might indicate the existence of one or more Deficiencies in ICOC
- The auditor should evaluate the effect of any instance of non-compliance on the auditor's assessment of risks associated with the controls and non-compliance

# Examination Engagement: Attestation Standard No. 1

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## Testing Compliance with SEC Rule 15c3-1 and SEC Rule 15c3-3(e) (cont.)

- The auditor should evaluate the effect on the audit of the financial statements and audit procedures performed on supplemental information

# Examination Engagement: Attestation Standard No. 1

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Testing that the information used to assert compliance was derived from the books and records of the broker-dealer

- Consider work performed on 15c3-1 and 15c3-3 supporting schedules
- Consider compliance work performed
- Evaluate identified instances in which the information used to assert compliance with the 15c3-1 or paragraph (e) of 15c3-3 was not derived from the broker's or dealer's books and records to determine whether material, individually or in combination

## Polling Question #4

Paragraph 21 of Attestation Standard No. 1 describes performing compliance tests. Which of the following is not a procedure described in paragraph 21?

- a. Determine whether the broker or dealer maintained the required level of net capital in accordance with the net capital rule.
- b. Test compliance with SEC Rule 17a-13.
- c. Test the accuracy and completeness of the information in the schedules.
- d. Evaluate whether the amounts in the schedules were determined in accordance with the net capital rule or reserve requirements rule, as applicable.

# Polling Question #4

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Answer:

- b. Test compliance with SEC Rule 17a-13.

# Examination Engagement: Attestation Standard No. 1

- Evaluating the results
  - Evaluate all evidence obtained
  - Evaluate whether sufficient appropriate evidence has been obtained to support the conclusions to be presented in the examination report taking into account
    - the risks associated with controls and non-compliance
    - the results of the examination procedures performed
    - The appropriateness (i.e., the relevance and reliability) of the evidence obtained

# Examination Engagement: Attestation Standard No. 1

## □ Communications

- In an examination engagement, the auditor should communicate:
  - To management; all identified deficiencies in Internal Control Over Compliance
  - To management and the audit committee; instances of identified noncompliance with the financial responsibility rules, identified Material Weaknesses, and identified instances in which information used to determine compliance with the SEC Rule 15c3-1 or paragraph (e) of SEC Rule 15c3-3 was not derived, in all material respects, from the broker's or dealer's books and records

# Examination Engagement: Attestation Standard No. 1

## □ Reporting

- Reporting on the assertions (not the process)
- Opine on each assertion
- Adverse opinion must express an opinion on the subject matter rather than on the assertion.
- Modified or adverse report
  - Can have clean opinion on one or more of the assertions along with an adverse opinion on one of more of the assertions
  - For example, BD was in compliance as of year end and compliance was determined from the books and records, however, a material weakness exists in internal controls over compliance with the specified financial responsibility rules

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Non-carrying broker-dealer required to state the following in its Exemption Report:**
  - **The provisions in Rule 15c3-3(k) under which the broker-dealer claimed an exemption from Rule 15c3-3**
  - **Either:**
    - **The broker-dealer met the identified exemption provisions in Rule 15c3-3(k) throughout the most recent fiscal year without exception, or**
    - **The broker-dealer met the identified exemption provisions except as described in the Exemption Report**
  - **If applicable, an identification of each exception, a description of the nature of each exception, and the approximate date(s) on which the exception existed**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Non-carrying broker-dealer required to engage an independent public accountant to:**
  - **Prepare a report based on a review of the broker-dealer's statements contained in the Exemption Report**
- ❖ **Note that a broker-dealer must file an Exemption Report if it claimed that it was exempt from Rule 15c3-3 throughout the most recent fiscal year, even in situations in which the broker-dealer had exceptions to meeting the exemption provisions in 15c3-3(k).**



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# Review Engagements: Attestation Standard No. 2

## Review Engagement: Attestation Standard No. 2

- The auditor's objective is to state a conclusion regarding whether, based upon the results of the review procedures, the auditor is aware of any material modifications that should be made to the broker-dealer's assertions for the assertions to be fairly stated in all material respects.
- Moderate assurance
  - Obtained by performing with due professional care the inquiries and other procedures required by AT No. 2 in order to reach a conclusion about whether there is a need to modify the broker's or dealer's assertions for the assertions to be fairly stated

## Review Engagement: Attestation Standard No. 2

- Assertions would not be fairly stated, in all material respects when:
  - Assertion that identifies the provisions in paragraph (k) of SEC Rule 15c3-3 under which the broker or dealer claimed an exemption is inaccurate;
  - The broker or dealer asserts that it met the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 without exception when the auditor is aware of exceptions
  - The broker's or dealer's assertion that identifies and describes each exception during the most recent fiscal year in meeting the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 is inaccurate or incomplete

# Review Engagement: Attestation Standard No. 2

- Planning the review
  - Should be coordinated with the audit of the financial statements and the audit procedures performed on the supporting schedules
    - Includes taking into account the results of the procedures from the audit and the auditing procedures on the supporting schedules
    - Plan and perform the work to meet the objectives of both engagements

## Polling Question #5

What condition would not cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects in a review report?

- a. The broker's or dealer's assertion that identifies the provisions in paragraph (k) of SEC Rule 15c3-3 under which the broker or dealer claimed an exemption for SEC Rule 15c3-3 is inaccurate.
- b. The broker or dealer asserts that it met the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 without exception when the auditor is aware of exceptions in meeting the exemption provisions.
- c. The broker's or dealer's assertion that identifies and describes each exception during the most recent fiscal year in meeting the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 is inaccurate or incomplete.
- d. The broker's or dealer's assertion that identifies and describes each exception during the most recent fiscal year in meeting the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 includes a large number of exceptions to the identified exemption provisions.

# Polling Question #5

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Answer:

- d. The broker's or dealer's assertion that identifies and describes each exception during the most recent fiscal year in meeting the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 includes a large number of exceptions to the identified exemption provisions.

## Review Engagement: Attestation Standard No. 2

- Nature, timing, and extent of procedures depends on, among other things:
  - History of instances of noncompliance with the exemption provisions
  - Changes in procedures, controls, or the environment in which the controls operate since the prior year
  - The risk of fraud, including the risk of misappropriation of customer assets, relevant to the exemption provisions
  - Evidence about the broker's or dealer's compliance with the exemption provisions or about the effectiveness of controls over compliance with the exemption provisions obtained from the audit of the financial statements and the audit procedures performed on supplemental information

# Review Engagement: Attestation Standard No. 2

- Performing the review engagement
  - Read documentation regarding the broker's or dealer's identified exceptions and compare it to the information included in the exemption report
  - Other review procedures
    - Reading correspondence with SEC and DEA
    - Reading reports of internal auditors, others who perform an equivalent function and compliance functions that are relevant to compliance
    - Reading regulatory filings that are relevant to compliance with the exemption conditions

# Review Engagement: Attestation Standard No. 2

- Performing the review engagement (cont.)
  - Inquiries regarding
    - Compliance with the exemption provisions
    - Regulatory examinations and correspondence
    - Subsequent events
    - Known instances of non-compliance
    - Nature and frequency of customer complaints that are relevant to compliance
    - Controls in place to maintain compliance
    - Nature and frequency of monitoring activities

# Review Engagement: Attestation Standard No. 2

- Performing the review engagement (cont.)
  - Examples of audit procedures that may provide evidence for review engagement (will vary based on type of exemption claimed)
    - Testing of transactions related to customer trades
    - Testing of specially designated cash accounts or other audit procedures regarding cash
    - Testing investment inventory or transactions related to the broker-dealer's proprietary trading
    - Audit procedures performed on the clearing agreement, test of commission revenue, or clearing expense

# Review Engagement: Attestation Standard No. 2

- Evaluating the results
  - If information comes to the auditor's attention indicating that one or more undisclosed exceptions might exist, other than the exceptions disclosed in the exemption report or if the audit has substantial doubt about one or more of the assertions the auditor should perform additional procedures as necessary to address the matter

# Review Engagement: Attestation Standard No. 2

- Evaluating the results (cont.)
  - Evaluate whether information has come to the auditor's attention that causes the auditor to believe that one or more of the assertions are not fairly stated in all material respects.
  - If the assertion is not fairly stated in all material respects:
    - Modify the review report (see reporting)
    - Evaluate the effect of the matter on the audit and the audit procedures on the supporting schedules

## Polling Question #6

Which of the following procedures should the auditor perform to identify exceptions to the exemption provisions (paragraph 10 of Attestation Standard No. 2)

- a. If the broker or dealer identified exceptions to the exemption provisions during the year under review, the auditor should read the broker's or dealer's documentation regarding the exceptions to the exemption provisions and compare it to the information included in the report.
- b. Read regulatory filings of the broker or dealer that are relevant to the broker's or dealer's compliance with the exemption provisions.
- c. Read reports of internal auditors, other who perform an equivalent function, compliance functions, and other auditors that are relevant to the broker's or dealer's compliance with the exemption provisions.
- d. All of the above.

# Polling Question #6

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Answer:

- d. All of the above.

# Review Engagement: Attestation Standard No. 2

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## □ Communications

- The auditor should communicate to management and to the audit committee; any exceptions to the exemption provisions identified by the auditor and information that causes the broker's or dealer's assertions about the exemption provisions not to be fairly stated in all material respects

# Review Engagement: Attestation Standard No. 2

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## □ Reporting

- If assertion(s) are not fairly stated, in all material respects, the auditor must modify the report to describe the reasons
- If one or more exceptions was omitted, the auditor's report should disclose each omitted exception

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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## ❖ **Notification requirements**

- **An auditor must immediately notify the CFO of the broker-dealer if**
  - **The auditor determines, in the course of preparing its reports, that the broker-dealer was not in compliance with Rule 15c3-1, 15c3-3, 17a-13 or its DEA's Account Statement Rule, or**
  - **In the performance of an examination of the Compliance Report, the accountant determines that any material weakness existed in the broker-dealer's ICOC**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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## ❖ **Notification requirements (cont'd)**

- **The broker-dealer must file a notification with the Commission, its DEA and the Commodity Futures Trading Commission (“CFTC”) (if the broker-dealer is registered as a futures commission merchant) if the auditor’s notice relates to an instance of non-compliance that would trigger notification, and provide a copy of the notification to the auditor**
- **If the auditor does not receive a copy of the notification within 1 business day, or if the auditor does not agree with the statements in the notification, the auditor must notify the SEC and DEA within one business day**
- **Amendments to the notification requirements are effective for fiscal years ending on or after June 1, 2014**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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## ❖ **Access to audit documentation**

- **Clearing and Carrying broker-dealers to consent to permitting their independent public accountants to:**
  - **Make available to the Commission and DEA examiners the audit documentation associated with its annual reports required under Rule 17a-5**
  - **Discuss findings relating to the audit reports with the Commission and DEA examiners**
- **Consent required to be included in the independent public accountant designation letter that all broker-dealers are required to file with the Commission and their DEA**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Securities Investor Protection Corporation (SIPC) Reporting**
  - **Broker-Dealer that is a SIPC member must file the annual report with SIPC. Requirement is effective for fiscal years ending on or after December 31, 2013**
  - **The independent public accountant report on applying agreed-upon procedures will continue to be conducted in accordance with AICPA attestation standards**
  - **Broker-Dealer required to file the SIPC supplemental report with SIPC until the earlier of the Commission approving a rule adopted by SIPC or two years**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Interaction with the Investment Advisers Custody Rule 206(4)-2:**
  - **Broker-dealers that must also comply with the Investment Adviser Custody Rule are required to obtain annually an auditor's written internal control report**
  - **The Commission has determined that the independent public accountant's report based on an examination of the Compliance Report will satisfy this requirement**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **Division of Trading and Markets issued Frequently Asked Questions (FAQs) on April 4, 2014 that address amendments to Rule 17a-5 and reporting requirements in Form Custody:**
  - **FAQ No. 1 – Transitional guidance on reporting requirement for statements in the Compliance and Exemption Reports that refer to the “most recent fiscal year”**
  - **FAQ No. 2 – Period covered by the Compliance Report and the accountant’s examination report to satisfy the requirements for the internal control report under the Custody Rule**
  - **FAQ No. 3 - Applicability of the Compliance Report and the accountant’s examination report to other requirements in the Investment Adviser Custody Rule**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)*

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- ❖ **April 4, 2014 FAQs (cont'd) :**
  - **FAQ No. 4 – Reporting requirements for statement regarding independent public accountant**
  - **FAQ No. 5 – Proprietary Accounts of Broker-Dealers (PAB) reserve computation and the supporting schedules accompanying the financial statements**
  - **FAQ No. 6 – Types of broker-dealers that can file an exemption report if not claiming exemption from Rule 15c3-3**
  - **FAQ No. 7 – No. 16 – Various reporting matters related to Form Custody**

# *July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073) - Implementation Observations*

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## ❖ Reporting

- **SEC Form X-17a-5 Part III**
- **Compliance and Exemption Report**
  - **Reports must cover the requirements in Rule 17a-5(d)(3)(i)(A)-(C) for the Compliance Report and Rule 17a-5(d)(4)(i)-(iii) for the Exemption Report**
  - **Same person that signs the oath or affirmation to sign the Compliance or Exemption Report**
  - **No required template**
  - **Material Inadequacy report no longer relevant (replaced by Examination Report or Compliance Report for SEC registered broker-dealers)**



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# Other PCAOB Standards and Rules

# Other PCAOB Standards and Rules

- PCAOB auditing and related professional practice standards include:
  - Auditing Standards
  - Attestation Standards
  - Ethics and Independence Standards and Rules
  - Quality Control Standards
  
- Standards consist of:
  - Standards issued by the Board
  - Standards adopted by the Board on an initial transitional basis as amended by the Board

# Polling Question #7

Which of the following applies to audits of SEC-registered brokers or dealers for years ending on or after June 1, 2014?

- a. Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements
- b. Auditing Standard No. 7, Engagement Quality Review
- c. A, B, and D.
- d. Auditing Standard No. 3, Audit Documentation

## Polling Question #7

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Answer:

c. A., B., and D.

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***Applicability of Auditor  
Independence Rules to Broker-  
Dealer Audits***

# *Applicability of Auditor Independence Rules to Broker-Dealer Audits*

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- ❖ **Auditors of both issuer and non-issuer broker-dealers are required to be qualified and independent in accordance with the Commission's auditor independence requirements in Rule 2-01 of Regulation S-X, *Qualifications of Accountants***
  - **No currently proposed changes to current requirements**
- ❖ **Division of Enforcement activity in this area**

# *Applicability of Auditor Independence Rules to Broker-Dealer Audits*

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- ❖ **Examples of applicable independence requirements:**
  - **Non-Audit Services – An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides, among others, the following non-audit services to an audit client:**
    - **Bookkeeping or other services related to the accounting records or financial statements of the audit client**
    - **Financial information systems design and implementation**
    - **Management Functions or Human Resources**
  - **Other Financial Interests in Audit Client – Broker-dealer accounts. Refer to Rule 2-01(c)(1)(ii)(C)**

# *Applicability of Auditor Independence Rules to Broker-Dealer Audits*

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- ❖ **Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence**
  - **Auditors should not provide typing and word processing services nor financial statement templates that are not publicly available to broker-dealer audit clients**
  - **Auditors of non-issuer brokers-dealers are not subject to SEC rules related to:**
    - **Partner rotation requirements**
    - **Certain partner compensation arrangements**
    - **Audit committee administration requirements**
    - **“Cooling off” period requirements**

# *Contact Information*

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## ❖ **Division of Trading and Markets**

- <http://www.sec.gov/divisions/marketreg/mrcontact.htm>
- Phone: (202) 551-5777
- E-mail : [tradingandmarkets@sec.gov](mailto:tradingandmarkets@sec.gov)

## ❖ **Office of the Chief Accountant**

- **Professional Practice Group (including Independence )**
- **Accounting**
- Phone: (202) 551-5300
- E-mail : [OCA@sec.gov](mailto:OCA@sec.gov)

# Conforming Amendments

# Conforming Amendments

## □ *Dodd-Frank Conforming Amendments*

- Approved by the Board on December 4, 2013
- Among other things, tailors certain independence rules to apply to auditors of broker-dealers
  - Definition of audit committee (Rule 3501)
  - Overall framework (Rules 3502 and 3520)
  - Contingent fees (Rule 3521)
  - Tax transactions (Rule 3522)

Communications with audit committees concerning independence (Rule 3526)

- Effective June 1, 2014
- Also amended certain registration forms

# Conforming Amendments

- *Dodd-Frank Conforming Amendments (cont.)*
  - Did not amend certain other independence rules to apply to auditors of broker-dealers
    - Tax services for persons in a financial reporting oversight role (Rule 3523)
    - Audit Committee Pre-approval of Certain Tax Services (Rule 3524)
    - Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting (Rule 3525)

# Polling Question #8

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Does PCAOB Rule 3523 Tax services for persons in a financial reporting oversight role apply to auditors of broker-dealers?

- a. Yes
- b. No

# Polling Question #8

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Answer:

b. No.

## Keeping Current with Standards

- Our Web site - [www.pcaobus.org/Standards/index.aspx](http://www.pcaobus.org/Standards/index.aspx)
  - PCAOB standards and related rules, including interim standards
  - PCAOB proposed standards
  - Staff questions and answers
  - Staff audit practice alerts
  - Standing Advisory Group
- Contact us at [info@pcaobus.org](mailto:info@pcaobus.org)
- Submit inquiries at:  
[http://pcaobus.org/About/Pages/ContactUsWebForm.aspx?Contact=Standard-related Inquiries](http://pcaobus.org/About/Pages/ContactUsWebForm.aspx?Contact=Standard-related%20Inquiries)
- Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our Web site:  
<http://pcaobus.org/About/Pages/Subscribe.aspx>

# Questions?

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