Update: Interim Inspection Program Related to Audits of Brokers and Dealers

Khalilah Imperatricce
Division of Registration and Inspections
October 19, 2020
DISCLAIMER

Any views expressed are my own and do not necessarily reflect the views of the Board as a whole, any individual Board Members, or other staff.
AGENDA

• Inspection Program Objectives
• 2019 Inspections Results
• 2020 Inspections Status
• Looking Ahead to 2021
INSPECTION PROGRAM OBJECTIVES

- Assess compliance with applicable Board and Commission rules and PCAOB standards
- Help inform the Board’s eventual determinations about the scope and elements of a permanent inspection program
- Assist in the development of the approach to inspections under a permanent inspection program
## FIRMS AUDITING BROKER-DEALERS

<table>
<thead>
<tr>
<th>Broker-Dealer Audits per Firm</th>
<th>Number of Firms - 2019</th>
<th>Number of Broker-Dealer Audits - 2019</th>
<th>Number of Firms - 2018</th>
<th>Number of Broker-Dealer Audits - 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>123</td>
<td>123</td>
<td>140</td>
<td>140</td>
</tr>
<tr>
<td>2 to 20</td>
<td>245</td>
<td>1,287</td>
<td>257</td>
<td>1,443</td>
</tr>
<tr>
<td>21 to 50</td>
<td>27</td>
<td>822</td>
<td>24</td>
<td>758</td>
</tr>
<tr>
<td>51 to 100</td>
<td>12</td>
<td>810</td>
<td>9</td>
<td>641</td>
</tr>
<tr>
<td>More than 100</td>
<td>4</td>
<td>579</td>
<td>5</td>
<td>727</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>411</strong></td>
<td><strong>3,621</strong></td>
<td><strong>435</strong></td>
<td><strong>3,709</strong></td>
</tr>
</tbody>
</table>

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2020 and August 20, 2019*
INSPECTION RESULTS

• Inspections are not an assessment of all work performed by the firms selected for inspection or all of the procedures performed for the engagements reviewed

• The selection of firms for inspection and engagements for review do not constitute representative samples of the population of firms that audit broker-dealers or the engagements completed by those firms
INSPECTIONS BY THE NUMBERS

2019
- **66** Firms Inspected
  - 7 with no deficiencies
- **106** Audit Engagements
  - 31 with no deficiencies
  - 53 with audit and attestation deficiencies
  - 22 with audit deficiencies, but no attestation deficiencies
- **29** Examination Engagements
  - 9 with no deficiencies
- **74** Review Engagements
  - 36 with no deficiencies

2018
- **67** Firms Inspected
  - 3 with no deficiencies
- **105** Audit Engagements
  - 25 with no deficiencies
  - 55 with audit and attestation deficiencies
  - 25 with audit deficiencies, but no attestation deficiencies
- **24** Examination Engagements
  - 6 with no deficiencies
- **79** Review Engagements
  - 36 with no deficiencies

<table>
<thead>
<tr>
<th></th>
<th>Audits</th>
<th>Examination Engagements</th>
<th>Review Engagements</th>
<th>Auditor Independence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicable Engagements Reviewed</td>
<td>106</td>
<td>29</td>
<td>74</td>
<td>29</td>
</tr>
<tr>
<td>Percentage of Engagements with Deficiencies</td>
<td>71%</td>
<td>69%</td>
<td>51%</td>
<td>17%</td>
</tr>
</tbody>
</table>

## INSPECTION RESULTS BY AUDITS PER FIRM – 2019

<table>
<thead>
<tr>
<th>Broker-Dealer Audits per Firm</th>
<th>Number of Firms Inspected</th>
<th>Audits with Audit and Other Deficiencies</th>
<th>Areas with Audit and Other Deficiencies</th>
<th>Examinations with Attestation and Other Deficiencies</th>
<th>Reviews with Attestation and Other Deficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>10</td>
<td>90%</td>
<td>48%</td>
<td>N/A</td>
<td>67%</td>
</tr>
<tr>
<td>2 to 20</td>
<td>32</td>
<td>82%</td>
<td>35%</td>
<td>60%</td>
<td>70%</td>
</tr>
<tr>
<td>21 to 50</td>
<td>14</td>
<td>84%</td>
<td>31%</td>
<td>83%</td>
<td>69%</td>
</tr>
<tr>
<td>51 to 100</td>
<td>6</td>
<td>83%</td>
<td>31%</td>
<td>100%</td>
<td>22%</td>
</tr>
<tr>
<td>More than 100</td>
<td>4</td>
<td>41%</td>
<td>8%</td>
<td>63%</td>
<td>13%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>66</strong></td>
<td><strong>71%</strong></td>
<td><strong>27%</strong></td>
<td><strong>69%</strong></td>
<td><strong>51%</strong></td>
</tr>
</tbody>
</table>

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2020.*
# INSPECTION RESULTS BY AREA – 2019

<table>
<thead>
<tr>
<th>Area</th>
<th>Applicable Engagements with Deficiencies</th>
<th>Applicable Engagements with Deficiencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attestation Procedures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Review Engagements</td>
<td>36</td>
<td>49%</td>
</tr>
<tr>
<td>Examination Engagements</td>
<td>20</td>
<td>69%</td>
</tr>
<tr>
<td>Auditing Supporting Schedules</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Capital Rule</td>
<td>20</td>
<td>31%</td>
</tr>
<tr>
<td>Auditing Financial Statements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revenue</td>
<td>52</td>
<td>54%</td>
</tr>
<tr>
<td>Financial Statement Presentation and Disclosure</td>
<td>39</td>
<td>37%</td>
</tr>
</tbody>
</table>

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2020.*
REVIEW ENGAGEMENTS

• Inquiries

• Understanding exemption provisions

• Evaluation of evidence from the audit and the results of the review procedures

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<tbody>
<tr>
<td>Applicable Engagements</td>
<td>74</td>
</tr>
<tr>
<td>Reviewed Engagements with</td>
<td>38</td>
</tr>
<tr>
<td>Deficiencies</td>
<td></td>
</tr>
<tr>
<td>Percentage</td>
<td>51%</td>
</tr>
</tbody>
</table>
EXAMINATION ENGAGEMENTS

- Testing of Internal Control over Compliance (ICOC)
  - Management review controls
  - Controls over the accuracy and completeness of information
  - Information technology controls and automated application controls
- Performing compliance tests

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<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Applicable Engagements Reviewed</td>
<td>29</td>
</tr>
<tr>
<td>Engagements with Deficiencies</td>
<td>20</td>
</tr>
<tr>
<td>Percentage</td>
<td>69%</td>
</tr>
</tbody>
</table>
NET CAPITAL RULE – SUPPORTING SCHEDULE

- Adjustments to net worth
  - Addition of discretionary and subordinated liabilities

- Allowable assets and assets not readily convertible to cash
  - Commissions and concessions receivable

- Haircuts for securities positions and undue concentration charges

- Operational charges and other deductions
  - Failed security transactions

<table>
<thead>
<tr>
<th>Engagements</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>65</td>
<td>20</td>
</tr>
</tbody>
</table>

Applicable Engagements Reviewed: 65
Engagements with Deficiencies: 20
Percentage: 31%
- Information produced by the broker-dealer used as audit evidence
- Relevant assertions
- Audit sampling

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Applicable Engagements Reviewed</td>
<td>97</td>
</tr>
<tr>
<td>Engagements with Deficiencies</td>
<td>51</td>
</tr>
<tr>
<td>Percentage</td>
<td>53%</td>
</tr>
</tbody>
</table>
• Revenue
• Related parties
• Going concern
2020 INSPECTIONS STATUS

- Selection of firms and broker-dealer audits
- Remote inspections
- Inspection focus
  - Systems of quality control
  - Audits of the financial statements and supporting schedules
  - Examination and review engagements
    - Application of SEC staff guidance
LOOKING AHEAD TO 2021

• Financial responsibility rule developments
  • Temporary relief
  • Updated SEC staff and FINRA guidance

• Financial statement audit risks
  • Fraud risks
  • Specific accounts and disclosures
    • Securities owned
    • Going concern
    • Risks and uncertainties
    • Subsequent events
  • Net capital
LOOKING AHEAD TO 2021

• Areas of potential impact from COVID-19
  • Changes in processes and controls at broker-dealers
  • Changes in processes and controls at service organizations
  • Relevance and reliability of audit evidence
  • Required communications with audit committees (or equivalents)
LOOKING AHEAD TO 2021

• New and amended auditing standards effective for fiscal years ending on or after December 15, 2020 include:
  • AS 1105: Audit Evidence
  • AS 1201: Supervision of the Audit Engagement
  • AS 1210: Using the Work of an Auditor-Engaged Specialist
  • AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements
CONCLUSION

• Consider how to proactively implement improvements in the following areas:
  • Systems of quality control
  • Testing the design and operating effectiveness of ICOC
  • Consideration of relevant evidence from the audit during review engagements
  • Identification and assessment of the risks of material misstatement
QUESTIONS

Please submit any questions or feedback you might have on this presentation to forum@pcaobus.org.