PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers

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CONTENTS

OVERVIEW

The Public Company Accounting Oversight Board (PCAOB), among its areas of statutory jurisdiction, has registration, inspection, standard-setting, and disciplinary authority over the auditors of brokers and dealers registered with the U.S. Securities and Exchange Commission (SEC) that are obligated to file financial statements subject to audit by a PCAOB-registered firm.[1] Overseeing the audits of SEC-registered broker-dealers that are subject to PCAOB review is a key component of our mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

This *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* ("Annual Report") provides (1) information about our 2021 inspections approach, (2) a summary of our 2021 inspections observations, and (3) a description of "good practices," which include brief scenarios and possible procedures that may be effective to address those scenarios. The information in this Annual Report is provided under the requirements of PCAOB Rule 4020T, *Interim Inspection Program Related to Audits of Brokers and Dealers*, which addresses, among other things, reporting under that program.

Under Securities Exchange Act of 1934 ("Exchange Act") Rule 17a-5, broker-dealers registered with the SEC are generally required to file annually (1) a financial report that includes financial statements and supporting schedules (referred to in this Annual Report as "supplemental information"), (2) either a compliance report (if the broker-dealer did not claim it was exempt from Exchange Act Rule 15c3-3, *Customer Protection – Reserves and Custody of Securities* ("Customer Protection Rule")[2] or an exemption report (if the broker-dealer did claim it was exempt from the Customer Protection Rule or was otherwise eligible under SEC rules to file an exemption report), and (3) reports of an independent public accountant covering each of these required reports, as applicable. The broker-dealer must engage an independent public accountant to prepare a report based on an examination of the financial report in accordance with PCAOB auditing standards ("audit engagement") and a report based on an examination of certain statements in the compliance report ("examination engagement") or a report based on a review of the exemption report ("review engagement"). PCAOB attestation standards apply to examination engagements (AT No. 1) and review engagements (AT No. 2), (collectively, "attestation engagements").

This graphic depicts certain broker-dealer annual reporting requirements and related auditor responsibilities.

1 The use of the term "broker-dealer" in this Annual Report refers to entities that are registered with the SEC as both a broker and a dealer and to entities that are registered as only one or the other.

2 Broker-dealers that carry customer accounts, maintain custody or control of customer cash and securities, or clear securities transactions on behalf of customers, are among the broker-dealers that likely do not claim exemption from the Customer Protection Rule and therefore file a compliance report.

Broker-Dealer **claims exemption** from the Customer Protection Rule

Broker-Dealer prepares an **Exemption Report**

Independent public accountant prepares a **Review Report**

Broker-Dealer prepares the financial statements and the required supplemental information

Independent public accountant performs an audit of the financial statements and required supplemental information

Broker-Dealer **does not claim exemption** from the Customer Protection Rule

Broker-Dealer prepares a **Compliance Report**

Independent public accountant prepares an **Examination Report**

This graphic is provided as an example; it is not intended to, and does not, cover all instances where a broker-dealer may be eligible to file an exemption report.

The PCAOB has performed inspections of firms that audit broker-dealers since the inception of the interim inspection program in 2011, and 2021 marked the 11th year of these inspections. While inspection results over that period indicate that the quality of broker-dealer audit and attestation engagements has improved, the overall deficiency rates remain unacceptably high. Key observations from our 2021 inspections of firms that audit broker-dealers include the following:

- The percentage of firms inspected where we identified one or more audit and/or attestation engagement deficiencies remained high at 78% in 2021, consistent with 2020.
- The percentage of audit engagements reviewed where we identified deficiencies declined to 49% in 2021, from 61% in 2020, but remained high, primarily due to deficiencies associated with auditing revenue.
- Generally, the results of inspections of firms that audited 100 or fewer broker-dealers resulted in higher percentages of audit engagements with identified deficiencies, compared to the results for firms that audited more than 100 broker-dealers. For firms that audited 100 or fewer broker-dealers, the percentage of audit engagements with identified deficiencies declined to 60% from 71% in 2020 and 84% in 2019. For firms that audited more than 100 broker-dealers, the percentage of audit engagements with identified deficiencies declined to 32% in 2021 from 38% in 2020 and 41% in 2019.
- The percentage of examination engagements covered where we identified one or more deficiencies declined slightly, to 64% of engagements in 2021 from 67% in 2020, but remained high, primarily due to deficiencies in testing internal control over compliance (ICOC).[3]

[3] Internal Control Over Compliance is defined in paragraph (d)(3)(ii) of Exchange Act Rule 17a-5 as internal controls that have the objective of providing the broker-dealer with reasonable assurance that non-compliance with (1) Exchange Act Rule 15c3-1, *Net Capital Requirements for Brokers or Dealers* ("Net Capital Rule"), (2) the Customer Protection Rule, (3) Exchange Act Rule 17a- 13, *Quarterly Security Counts to be Made by Certain Exchange Members, Brokers and Dealers* ("Quarterly Security Counts Rule"), or (4) any rule of the designated examining authority of the broker-dealer that requires account statements to be sent to the customers of the broker-dealer (an "Account Statement Rule"), will be prevented or detected on a timely basis.

- The percentage of review engagements covered where we identified one or more deficiencies increased to 28% in 2021 from 23% in 2020.
- The percentage of firms inspected where we identified deficiencies in quality control (QC) systems declined to 48% in 2021 from 66% in 2020, with the majority of deficiencies in both years relating to engagement quality reviews.
- We identified no apparent violations of SEC independence rules in 2021, compared to two in 2020.[4]

This Annual Report describes identified deficiencies in audits of financial statements, audit procedures over supplemental information, examination engagements, and review engagements. Some of these deficiencies have been observed during inspections on a recurring basis for many years. The deficiencies described in this Annual Report can be used to assess critically the procedures planned for upcoming broker-dealer engagements. We recommend that all firms, whether or not recently inspected, review the deficiencies described in this Annual Report and evaluate what changes are needed in their own planned procedures to avoid similar deficiencies. For examination engagements, review engagements, auditing revenue, and engagement quality reviews, we highlight in this Annual Report specific actions that we recommend firms take now to improve quality. These specific actions can be found alongside the description(s) of certain related deficiencies.

By highlighting deficiencies and good practices, this Annual Report helps to advance our strategic goal of driving improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation. We hope this Annual Report, in addition to being helpful to audit firms, is also useful for other stakeholders, including management and audit committees (or equivalent bodies) of broker-dealers, as they engage with audit firms regarding audit quality and broker-dealer financial reporting.

[4] Violations of SEC independence rules that firms have reported to the PCAOB, including vis-à-vis their broker-dealer clients, are addressed through a separate PCAOB inspection program, and, consequently, are not included in this Annual Report, consistent with prior years.

Inspections by the Numbers[5]			
	2021	**2020**	**2019**
Total firms inspected	**50**	**65**	**66**
Firms with identified deficiencies in audit engagements and/or attestation engagements	39 (78%)	51 (78%)	59 (89%)
Firms without identified deficiencies in audit engagements and attestation engagements	11 (22%)	14 (22%)	7 (11%)
Firms that audited more than 100 broker-dealers	6 (12%)	4 (6%)	4 (6%)
Firms that audited 100 or fewer broker-dealers	44 (88%)	61 (94%)	62 (94%)
Firms that also audited issuers	27 (54%)	34 (52%)	37 (56%)
Firms that did not audit issuers	23 (46%)	31 (48%)	29 (44%)
Firms that audited broker-dealers that filed compliance reports	25 (50%)	18 (28%)	21 (32%)
Firms that audited broker-dealers that only filed exemption reports	25 (50%)	47 (72%)	45 (68%)
Total audits	**92**	**105**	**106**
Audits with identified deficiencies	45 (49%)	64 (61%)	75 (71%)
- Audits with identified audit deficiencies and attestation deficiencies	27	27	53
- Audits with identified audit deficiencies but without identified attestation deficiencies	18	37	22
Audits without identified deficiencies	47 (51%)	41 (39%)	31 (29%)
Total examination engagements	**33**	**21**	**29**
Examination engagements with identified deficiencies	21 (64%)	14 (67%)	20 (69%)
Examination engagements without identified deficiencies	12 (36%)	7 (33%)	9 (31%)
Total review engagements	**58**	**83**	**74**
Review engagements with identified deficiencies	16 (28%)	19 (23%)	38 (51%)
Review engagements without identified deficiencies	42 (72%)	64 (77%)	36 (49%)

[5] Refer to the section of this Annual Report entitled “Information About Selected Firms and Engagements” for a discussion of changes in firms and engagements selected in 2021 relative to prior years.

2021 INSPECTIONS APPROACH

Under the interim inspection program, the PCAOB assessed firms' compliance with applicable laws, rules, and professional standards when performing audit and attestation engagements for broker-dealers. We also evaluated elements of firms' QC systems.

For our 2021 inspections, we selected PCAOB-registered firms that performed audits of certain SEC-registered broker-dealers with financial statement periods that ended during the period April 1, 2020, through March 31, 2021. The following table provides additional information about the population of firms from which those firms were selected.

Number of broker-dealer audits per firm	Number of firms	Total number of broker-dealer audits across all firms in this category
1	104	104
2 to 20	196	1,090
21 to 50	33	1,078
51 to 100	6	409
More than 100	6	737
Total	**345**	**3,418**

In selecting firms to inspect, we made risk-based selections that considered certain firm factors ("firm characteristics"), which included:

- The number of broker-dealer audits performed;
- Whether the firm conducted examination engagements;
- Whether the firm also issued audit reports for issuers;
- Results from previous inspections under the interim inspection program;
- The firm's or its personnel's history in auditing broker-dealers; and
- The existence of disciplinary actions against the firm or associated persons by the SEC, PCAOB, or other regulatory authorities.

The mix of firms inspected under the interim inspection program is different each year, and our 2021 selections included 10 firms inspected for the first time.

In selecting particular engagements for review, we made (1) random selections that provided an element of unpredictability and (2) risk-based selections that considered various broker-dealer factors ("broker-dealer characteristics"), which include:

- Whether the broker-dealer filed a compliance report with the SEC pursuant to Exchange Act Rule 17a-5;

- Whether the broker-dealer was a subsidiary of an issuer and the broker-dealer's respective significance to the consolidated financial statements of that issuer;
- Financial metrics such as asset, revenue, and net capital levels;
- Whether the broker-dealer has changed auditors, and certain circumstances related to those changes; and
- Existence of disciplinary actions against the broker-dealer by the SEC, the Financial Industry Regulatory Authority (FINRA), or other regulatory authorities.

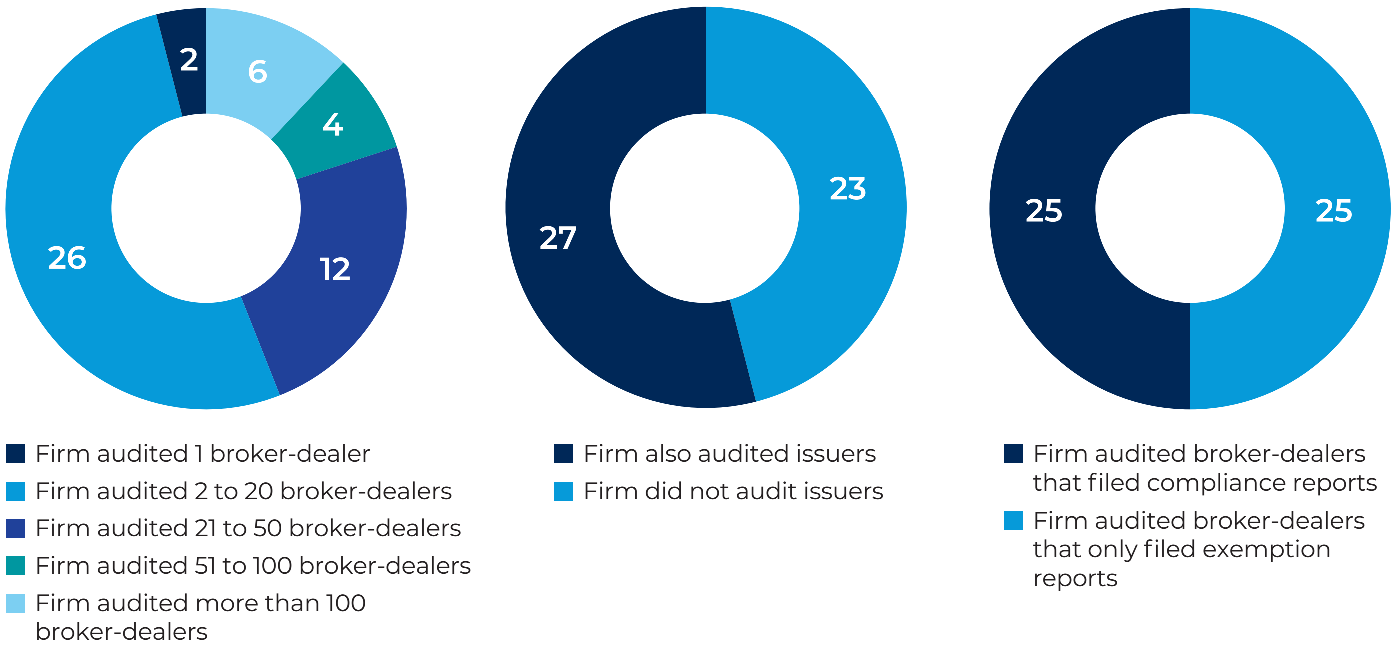
We did not review every aspect of the audit engagements we selected. Rather, we generally selected areas we believed to be of greater complexity and significance or areas of heightened risk of material misstatement to the broker-dealer's financial statements. We also selected nontraditional areas, such as cash and expenses and related accruals, on some audits to provide an added element of unpredictability. In addition, we reviewed certain areas of each selected audit that did not relate directly to the sufficiency or appropriateness of evidence firms obtained to support their audit opinions. Deficiencies identified from our review of these areas are included in the deficiency percentages presented in this Annual Report and the supplement to this Annual Report. Examples include requirements related to auditor reporting on broker-dealer financial statements and supplemental information and required auditor communications. The aspects of audit engagements we reviewed are collectively referred to as "audit areas" in this Annual Report.

We generally focused our review of the attestation engagements we selected on assertions made in broker-dealer compliance reports or exemption reports with a heightened risk of not being fairly stated in all material respects. We also reviewed the applicable auditor reports and engagement documentation for each selected attestation engagement.

INFORMATION ABOUT SELECTED FIRMS AND ENGAGEMENTS

Firms

We selected 50 firms for inspection in 2021. The following charts depict the number of broker-dealer audits performed by those 50 firms (as determined at the time of the inspection), whether or not the firms also audited issuers, and whether the firms audited broker-dealers that filed compliance reports or audited broker-dealers that only filed exemption reports.

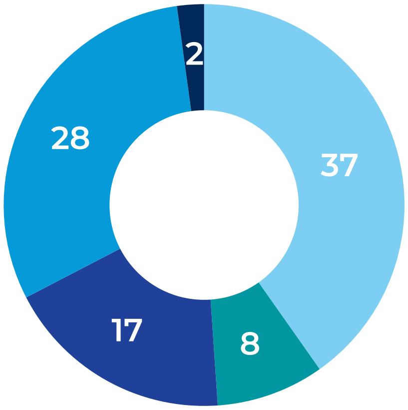


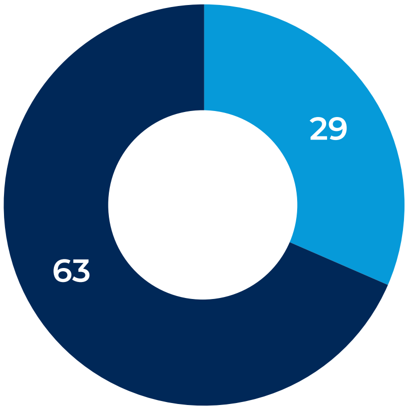
At the time of the 2021 inspections, of the 27 firms that audited issuers in addition to broker-dealers, four audited more than 100 issuers, and 23 audited 100 or fewer issuers.

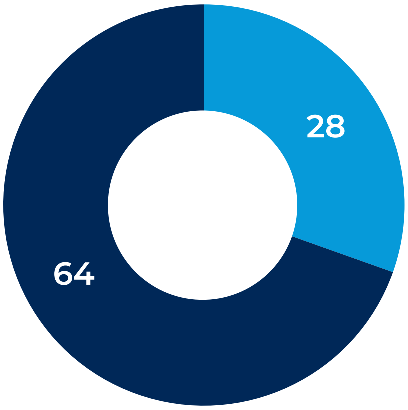
Engagements

We selected 90 financial statement audits of broker-dealers with financial statement periods that ended between April 1, 2020 and March 31, 2021, for our review during our 2021 inspections of the 50 selected firms. We also reviewed audits of two broker-dealers with financial statement periods that ended December 31, 2019; audits of these broker-dealers were originally scheduled for review during 2020 but were deferred until 2021.

The following charts provide information about the distribution of the 92 audits among the selected firms, using the same criteria as the corresponding firm charts.







The following table presents information about the minimum net capital requirements and actual net capital reported for the 92 broker-dealers whose audits were selected for review, stratified by whether the broker-dealer filed a compliance report or an exemption report.[6]

Broker-Dealers	Number of audits reviewed	Range of minimum net capital requirements (Thousands)	Range of actual net capital reported at fiscal year end (Thousands)
Compliance report filer	34	\$250 - \$1,800,000	\$250 - \$12,000,000
Exemption report filer	58	\$5 - \$7,000	\$5 - \$700,000
Total	**92**	**\$5 - \$1,800,000**	**\$5 - \$12,000,000**

For each audit engagement selected, we also reviewed the related attestation engagement, except in two instances involving broker-dealers that filed exemption reports. In addition, we reviewed the related attestation engagements for one broker-dealer that filed both a compliance report and exemption report due to changes in its business operations.

6 In prior annual reports, we stratified between firms that "claimed" or "did not claim" an exemption under the Customer Protection Rule. Because broker-dealers, under some circumstances, are eligible to file an exemption report for reasons other than claiming an exemption under the Customer Protection Rule, we have refined our reporting to distinguish between broker-dealers that "filed a compliance report" versus those that "filed an exemption report." As a result, certain broker-dealers that, in the past, would have been included under the characterization "did not claim" an exemption are instead included in this Annual Report as having filed an exemption report.

Of the 92 audit engagements that we reviewed, 72 were risk-based selections, and 20 were random selections. The following table shows the percentage of audits, areas, and attestation engagements with deficiencies for the engagements selected at random and those selected on a risk basis.

Selection method	Number of audits reviewed	Percentage of audits reviewed with deficiencies	Percentage of audit areas reviewed with deficiencies	Percentage of examinations covered with deficiencies	Percentage of reviews covered with attestation deficiencies
Risk-based	72	58%	18%	64%	37%
Random	20	15%	2%	N/A	10%
Total	**92**	**49%**	**15%**	**64%**	**28%**

For each of the 20 broker-dealers selected randomly, we reviewed the audit of the broker-dealer and the related review engagement. We noted that the percentage of audits, audit areas, and review engagements with deficiencies was significantly lower for random selections when compared to the risk-based selections.

Additional information about inspection results based on firm characteristics, broker-dealer characteristics, and inspection frequency is included in the supplement to this Annual Report.

The selected firms and engagements for our 2021 inspections reflect certain changes relative to prior years:

- In 2021, we selected for review a greater number of engagements for broker-dealers that filed compliance reports than in prior years. This was in response to heightened risks associated with potential changes in control procedures during the COVID-19 pandemic for broker-dealers that file compliance reports due to their responsibility for custody and control of customers' funds and securities. Broker-dealers that file compliance reports are generally larger and more complex than broker-dealers that file exemption reports, as are the related audit and attestation engagements. This necessitated a greater allocation of PCAOB resources in 2021 to review these selections. Consequently, we selected fewer engagements involving broker-dealers that filed exemption reports, resulting in fewer selections overall for review in 2021, compared to 2020 and prior years. Many broker-dealer auditors audit only broker-dealers that file exemption reports. Also, a relatively small proportion of SEC-registered broker-dealers file compliance reports. As such, our focus on audit and attestation engagements for broker-dealers that file compliance reports in 2021 narrowed the overall populations of both firms and broker-dealer engagements from which we made a greater proportion of our selections.
- In 2021, we selected a greater percentage of audit engagements at random (as opposed to risk-based) to increase unpredictability.

These changes are reflected in the 2021 inspection results presented in this Annual Report.

OBSERVATIONS FROM INSPECTIONS

Inspections under the interim inspection program included review of portions of a firm's selected engagements and evaluation of elements of the firms' QC systems. Staff communicated the following, as applicable, to each inspected firm:

- Identified deficiencies in the firm's audits of broker-dealer financial statements and supplemental information, and its examination and review attestation engagements;
- Other identified instances of non-compliance with PCAOB standards; and
- Identified deficiencies related to the firm's QC system.

Other instances of non-compliance with PCAOB standards include deficiencies that do not relate directly to the sufficiency or appropriateness of evidence firms obtained to support their audit opinions.

The deficiencies we identified do not necessarily mean that the broker-dealer's financial statements, supplemental information, or compliance or exemption reports are not fairly presented or stated, in all material respects. It is often not possible for us to reach a conclusion on those points based on our inspection because we have only the information in the broker-dealer's filings and the information the firm retained. We do not have access to the broker-dealer's management, or direct access to its underlying books and records, and other information.

Our selections of firms for inspection and engagements for review do not constitute representative samples of the populations of firms that audit broker-dealers or broker-dealer engagements. Additionally, our inspection findings are specific to the particular portions of the engagements reviewed. They are not an assessment of all work performed by the firms selected for inspection or of all procedures performed for the engagements reviewed. Further, the populations of firms and broker-dealers are not homogeneous. Therefore, the observations in this Annual Report are not necessarily representative of the population of all firms that perform broker-dealer audits or of all broker-dealer audit and attestation engagements. Refer to the section of this Annual Report entitled "Information About Selected Firms and Engagements" for information about certain changes in selected firms and engagements in 2021 relative to prior years.

Throughout this section, we generally present observations within each area in order based on frequency of occurrence.

Good Practices

Throughout this Annual Report, we highlight good practices that may be effective to address various scenarios. These good practices are provided as examples and do not modify or establish auditing or attestation standards.

We encourage auditors to consider how these examples may apply to their broker-dealer engagements and to implement changes to engagement procedures proactively where necessary to comply with PCAOB standards.

Importantly, the good practices we highlight are dependent upon the specific attendant facts and circumstances.

Deficiencies in Attestation and Audit Engagements

This section of our report discusses deficiencies we identified related to attestation and audit engagements when firms did not perform — or did not sufficiently perform — certain required procedures, or otherwise comply with the applicable standards. Attestation engagements include examinations of statements made by broker-dealers in compliance reports and reviews of statements made by broker-dealers in exemption reports.

Deficiencies in Examination Engagements

In an examination engagement, the auditor must plan and perform an examination of statements made by the broker-dealer in its compliance report, in accordance with AT No. 1.

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Examination engagements	33	21	64%	67%	69%

General Requirements

Firms did not obtain a sufficient understanding of financial responsibility rules[7] that were relevant to the broker-dealer's assertions. (AT No. 1.06)

Planning the Examination Engagement

Firms did not sufficiently plan the examination engagement, including sufficient planning to:

- Obtain a sufficient understanding of broker-dealer processes, including relevant controls, regarding compliance with one or more financial responsibility rules, in particular, controls to ensure all account statements required by the Account Statement Rule are produced and delivered to customers; and
- Assess the risk associated with a related party that was an investment adviser. (AT No. 1.09)

One firm did not assess whether multiple deficiencies in the broker-dealer's change management, user access, and other information technology controls presented a risk of fraud, including the risk of misappropriation of customer assets, relevant to compliance with the Net Capital Rule and the Reserve Requirements Rule and the effectiveness of the broker-dealer's ICOC. (AT No. 1.10)

Testing Controls over Compliance

Deficiencies in testing ICOC continue to drive high deficiency rates in examination engagements. Many of the identified deficiencies relate to AT No. 1 requirements for auditors to obtain sufficient appropriate evidence about the operating effectiveness of controls important to the auditor's conclusion regarding the effectiveness of ICOC ("important controls").

[7] The term "financial responsibility rules" refers to the same rules cited in Exchange Act Rule 17a-5 paragraph (d)(3)(ii) and AT No. 1, namely, the Net Capital Rule, Customer Protection Rule, Quarterly Security Counts Rule, and Account Statement Rule. Paragraph (e) of the Customer Protection Rule, specifically, is referred to as the "Reserve Requirements Rule."

Deficiency Focus

Testing Controls over Compliance

The majority of identified examination engagement deficiencies related to testing the design and operating effectiveness of important controls over compliance with broker-dealer financial responsibility rules. (AT No. 1.11, .14, and .16) The level of deficiencies overall was comparable to the prior year and remained high.

Where did firms fall short in testing important controls?

Specific identified deficiencies relating to four aspects of the financial responsibility rules are as follows:

1. For the Reserve Requirements Rule, firms did not sufficiently test controls related to the determination of credit and debit balances reported within the customer reserve computation pursuant to Exhibit A of the Customer Protection Rule, including controls over the accuracy of the stock record allocation adjustments. One firm also did not test controls over making timely deposits to the special reserve bank account. Note: Per the Reserve Requirements Rule, broker-dealers must maintain deposits in bank accounts specially designated for the benefit of customers, in amounts computed in accordance with the rule.
2. For the possession or control requirements of the Customer Protection Rule, firms did not test, or sufficiently test, controls over the determination of excess margin securities subject to segregation requirements (for customers with multiple accounts under common ownership), and pricing of customers' fully paid and excess margin securities. Firms also did not sufficiently test controls over identification and resolution of deficits requiring action within the timeframe specified by the rule. In addition, one firm did not sufficiently test controls over whether a broker-dealer maintained control of customer securities in broker-dealer omnibus credit accounts with carrying broker-dealers that were free of any charge, lien, or claim of any kind in favor of the carrying broker-dealers or any persons claiming through such carrying broker-dealers.
3. For the Account Statement Rule, firms did not test, or sufficiently test, controls over the production and delivery of complete and accurate account statements, either electronically or by mail, to all customers, including controls over the completeness of the population of account statements to be produced and delivered, and the completeness and accuracy of required disclosures in the account statements.
4. For the Quarterly Security Counts Rule, firms did not sufficiently test controls over accounting for all securities subject to the broker-dealer's control or direction, but not in its physical possession.

In other cases, firms did not test the design or operating effectiveness of any internal controls over compliance with one or more financial responsibility rules.

Firms did not test, or sufficiently test, the following types of important controls:

- Controls over the accuracy and completeness of information produced by the broker-dealer upon which the design and operating effectiveness of ICOC were dependent;
- Controls with a review element – particularly the nature and extent of management's review, including criteria used by management to identify matters for investigation and how such matters were resolved; and
- Information technology or automated application controls.

Recommended Action for Firms: Important Controls

Enhance procedures to test important controls over compliance with the financial responsibility rules for broker-dealers that file compliance reports.

The majority of identified deficiencies in examination engagements relate to testing of controls over compliance with the financial responsibility rules. We recommend firms improve their testing of these important controls in three areas: (1) controls over the accuracy and completeness of information produced by the broker-dealer, upon which the design and operating effectiveness of ICOC are dependent, (2) controls with a review element, and (3) information technology controls. Training and increased involvement of more experienced engagement team members in this aspect of examination engagements may be helpful. Of particular concern are firms that did not test the design or operating effectiveness of any internal controls over compliance for one or more financial responsibility rules. We recommend such firms focus on the determination of important controls and related testing strategies for each financial responsibility rule during planning for examination engagements. The elevated percentage of examination engagements with deficiencies cannot meaningfully improve without progress in this area.

Good Practices: Information Technology Controls Related to the Financial Responsibility Rules

Scenario: A broker-dealer used an internally developed application to support its business operations, including recording of customer securities transactions. The application was used in the broker-dealer's ICOC with the financial responsibility rules. The auditor determined the information technology controls over the application to be important to the auditor's conclusion about whether the broker-dealer maintained effective ICOC with the financial responsibility rules.

Good Practices:

- The auditor obtained an understanding of the information technology processes and identified controls, including information technology controls associated with program development, program changes, access to programs and data, and computer operations that it deemed relevant in addressing the risks related to the financial responsibility rules.
- The auditor tested the design and operating effectiveness of the information technology controls in each of these areas throughout the period and as of the broker-dealer's fiscal year end. To test controls over computer operations the auditor observed the timely monitoring of data processing, inspected monitoring results including any indications of interruptions, and inspected notifications regarding system interruptions and communications indicating timely resolution.
- The auditor considered whether the results of the tests of controls indicated that the controls were designed and operated effectively, when designing its compliance tests.

Performing Compliance Tests

Firms did not perform, or sufficiently perform, tests of compliance with the Reserve Requirements Rule as of the end of the broker-dealer's fiscal year, including:

- Testing the accuracy and completeness of the information used to prepare the customer reserve computation, including the accuracy of stock record allocation adjustments;
- Determining whether the broker-dealer obtained a written notification letter or whether the notification letter included required language for accounts to qualify as special reserve bank accounts. One firm also did not determine whether a broker-dealer deposited funds in at least the required amount in a special reserve bank account in accordance with the Reserve Requirements Rule; and
- Evaluating whether the credit balances reported within the customer reserve computation were determined in accordance with the Reserve Requirements Rule. (AT No. 1.21)

Firms did not perform procedures to obtain evidence about the existence of customer funds or securities. (AT No. 1.23)

Good Practices: Customer Reserve Computation

Scenario: The auditor considered management's weekly reserve computation review control to be an important control for addressing compliance with the Reserve Requirements Rule. The auditor determined that the control owner used reports prepared by the broker-dealer as part of the review.

Good Practices:

- The auditor inquired of the control owner regarding the nature of the review, information used during the review, criteria used to identify errors in the weekly reserve computations, and procedures to correct identified errors.
- The auditor identified and tested controls over the accuracy and completeness of the reports used by the control owner as part of the review throughout the year.
- The auditor selected a sample of weekly reserve computations performed during the year, including the year-end computation, and re-performed the control owner's review by tracing the credit and debit balances included in the computations to their source reports, inspecting evidence of management's review, and determining that the credit and debit balances included in the computations were in accordance with the Reserve Requirements Rule.

The evidence obtained through these procedures was relevant to the auditor's requirement to test ICOC and perform compliance tests for the Reserve Requirements Rule per AT No. 1, as well as to perform audit procedures on supplemental information per AS 2701.

Evaluating the Results of the Examination Procedures

Firms did not evaluate, or sufficiently evaluate:

- Evidence regarding the timing of the performance and review of quarterly security counts; and
- Identified deficiencies regarding information technology controls to determine whether a material weakness in ICOC existed. (AT No. 1.25 and .26)

One firm did not evaluate whether sufficient appropriate evidence was obtained to support the broker-dealer's assertion that it was not required to produce and deliver account statements. (AT No. 1.27)

Obtaining a Representation Letter

Firms did not obtain written representations from the management of the broker-dealer. (AT No. 1.32)

Reporting on the Examination Engagement

Firms omitted, or did not properly present, required elements in their examination reports, including omission of a statement regarding management's responsibilities, erroneous identification of the broker-dealer's compliance report, or reference to a required assertion that the broker-dealer appeared to omit from its compliance report. (AT No. 1.36)

Firms did not modify their examination reports to express an adverse opinion on the broker-dealer's ICOC when a material weakness in ICOC existed. (AT No. 1.36; Appendix .C1, and Appendix .C2)

Deficiencies in Review Engagements

In a review engagement, the auditor must plan and perform the review of the statements (assertions) made by the broker-dealer in its exemption report, in accordance with AT No. 2.

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Review engagements	58	16	28%	23%	51%

General Requirements

One firm did not obtain a sufficient understanding of the conditions relevant to the broker-dealer's claim of exemption under paragraph (k)(1) of the Customer Protection Rule. (AT No. 2.05)

Firms did not assemble a complete and final set of review documentation by the documentation completion date. (AT No. 2.05; AS 1215.15)

Review Procedures

Firms did not evaluate evidence obtained in the audit of the financial statements that contradicted broker-dealer assertions in review reports regarding compliance with the exemption provision claimed. Such evidence included:

- For broker-dealers that only claimed an exemption under paragraph (k)(2)(ii) of the Customer Protection Rule, evidence from broker-dealer books and records and financial statements that described customer securities businesses that were conducted outside of arrangements with clearing brokers;
- Evidence from FINRA membership agreements and Financial and Operational Combined Uniform Single (FOCUS) reports that identified a different exemption; and
- Evidence that the broker-dealer's policies did not align with prompt transmittal requirements under paragraph (k)(2)(ii) of the Customer Protection Rule. (AT No 2.10)

Firms did not make required inquiries, including inquiries about controls in place to maintain compliance with the exemption provisions, and those involving the nature, frequency, and results of related monitoring activities. (AT No. 2.10)

One firm did not evaluate whether the broker-dealer's special account for the exclusive benefit of customers was established and maintained in accordance with paragraph (k)(2)(i) of the Customer Protection Rule. (AT No. 2.10)

Evaluating the Results of the Review Procedures

Firms did not sufficiently evaluate information that should have caused them to believe that one or more of the broker-dealer's assertions were not fairly stated in all material respects. Such information included, for broker-dealers that only claimed an exemption under paragraph (k)(2)(ii) of the Customer Protection Rule, evidence from broker-dealer books and records and financial statements that described customer securities businesses that were conducted outside of arrangements with clearing brokers. (AT No. 2.11)

Reporting on the Review Engagement

Firms did not accurately identify, in their review reports, assertions made by broker-dealers in their exemption reports, including:

- Reference in review reports to exemption provisions that were different than those referred to in the broker-dealer's exemption reports; and
- Omission from a review report of provisions in paragraph (k) of the Customer Protection Rule under which the broker-dealer claimed an exemption in its exemption report. (AT No 2.16)

Recommended Action for Firms: Audit Evidence

Firms should take into account, during review engagements, relevant evidence from the audit of the financial statements, for broker-dealers that file exemption reports.

The most frequently cited deficiency in review engagements involves firms that did not take into account evidence obtained during the audit that contradicted broker-dealer assertions in review reports regarding compliance with the exemption provision claimed. This is particularly true for broker-dealers that only claimed an exemption under paragraph (k)(2)(ii) of the Customer Protection Rule and that conduct customer securities transactions outside of arrangements with clearing brokers. For these broker-dealers, we recommend that engagement team members discuss evidence obtained through the audit regarding the nature of the broker-dealer's operations and its products and services, and how that evidence relates to assertions made by the broker-dealer in review reports.

One firm, in its review report, did not include the required statement regarding management's responsibility for compliance with the identified exemption provisions throughout the fiscal year and for its assertions in its exemption report. (AT No. 2.16)

One firm dated its review report prior to the date on which it completed its review procedures. (AT No. 2.18)

Deficiencies in Auditing Financial Statements

We did not assess all procedures performed for the audit engagements selected for review. We reviewed portions of those engagements. The audit areas reviewed varied among engagements, and the frequency with which we reviewed audit areas varied between years.

Identifying and Assessing Risks of Material Misstatement

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Identifying and assessing risks of material misstatement	92	5	5%	6%	15%

Firms did not perform sufficient risk assessment procedures for one or more sources of revenue, which contributed to identified deficiencies described in the section of this Annual Report entitled "Revenue." Specifically, firms did not:

- Obtain a sufficient understanding of the broker-dealer's internal control over financial reporting, including information systems, business processes, and control activities, to identify and assess the risks of material misstatement and design further audit procedures; (AS 2110.18 and .28)
- Evaluate the design of broker-dealer controls intended to address identified fraud risks, and determine whether those controls had been implemented; (AS 2110.72) and
- Sufficiently evaluate qualitative and quantitative risk factors related to financial statement line items and disclosures and determine the likely sources of potential misstatements. (AS 2110.59, .60, and .61)

One firm did not identify and assess the risks of material misstatement at the assertion level, which contributed to identified deficiencies described in the section of this Annual Report entitled "Fair Value Measurements." (AS 2110.59)

Financial Statement Areas

Financial statement area	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Revenue	79	26	33%	47%	53%
Related party relationships and transactions	18	4	22%	25%	27%
Consideration of an entity's ability to continue as a going concern	11	3	27%	30%	67%
Expenses and related accruals	12	3	25%	N/A	N/A
Fair value measurements	13	3	23%	4%	0%
Receivables and payables	21	3	14%	22%	27%

Revenue

Inspection observations about auditing revenue continued to reveal high deficiency rates in audit engagements. Many of the identified deficiencies related to requirements for auditors to perform audit procedures to address assessed risks of material misstatement for all relevant assertions of each significant account and disclosure, plan appropriate audit samples, and obtain audit evidence that is sufficient and appropriate. Certain identified deficiencies described in the sections of this Annual Report entitled “Identifying and Assessing Risks of Material Misstatement” and “Evaluating Audit Results” also involved revenue.

Deficiency Focus

Revenue – Responding to Risks of Material Misstatement

Most of the identified deficiencies in the revenue area related to firms that did not adequately respond to the risks of material misstatement for each relevant assertion of revenue accounts. (AS 2301.08)

While the percentage of engagements with deficiencies in this area decreased in each of the last two years, deficiencies overall remained at high levels.

In most cases, firms either identified a fraud risk related to revenue or did not rebut the presumption of revenue recognition as a fraud risk. Accordingly, these firms should have addressed the risk of material misstatement through appropriate substantive procedures that included tests of details.

Where did firms fall short in responding to risks associated with revenue?

Deficiencies in this area included instances of firms that did not perform any procedures for one or more significant revenue accounts, or did not perform procedures to address the assessed risks of material misstatement for one or more relevant assertions for one or more significant revenue accounts. More specifically, the following were deficiencies related to auditing common sources of broker-dealer revenue:

1. For commissions, firms did not sufficiently test whether the commission recorded by the broker-dealer was accurate based on the terms of the securities trade (including price and quantity) and the applicable commission or commission rate.
2. For investment banking fees, firms did not sufficiently test the amount of capital raised, the rate used to determine fees, and whether the investment banking transactions had occurred.
3. For investment advisory fees, firms did not sufficiently test the accuracy of the amount of assets under management, and whether fee rates were consistent with the terms of the broker-dealer's contract with its customer.
4. For trading gains and losses, firms did not test prices and quantities associated with broker-dealer security purchases and sales.
5. For success fees, one firm did not test the consideration received by a customer for the sale of its business, which was used to determine the fee.
6. For interest, one firm did not test the accuracy of the market values of securities borrowed, rates, and customer balances used in calculating stock borrow interest and the accuracy of the rates and customer debit balances used in calculating customer debit interest.

Identified deficiencies in auditing revenue with dual citations to AS 2301.08 and another PCAOB standard are described elsewhere in the "Revenue" section of this Annual Report.

Other Revenue Deficiencies Involving Substantive Procedures

When planning a sample for a substantive test of details, firms did not consider tolerable misstatement, the allowable risk of incorrect acceptance, and the characteristics of the population. (AS 2315.16, .23, .23A)

Firms used information produced by the broker-dealer as audit evidence but did not test the accuracy and completeness of that information, whether by testing controls, testing the information, or a combination of both. (AS 1105.10)

When performing substantive tests of details, firms limited testing to items over a certain amount, did not test the remaining balance, and inappropriately projected the results of its procedures to the entire population. (AS 1105.27; AS 2301.08)

One firm tested fewer items than it determined was necessary to obtain sufficient evidence from its substantive procedures. (AS 2301.08 and.42)

One firm did not perform sufficient procedures that provided a reasonable basis for extending audit conclusions from an interim date to the period end. (AS 2301.45)

When using substantive analytical procedures, one firm did not test, or test controls over, the completeness and accuracy of the data used to develop its expectations. (AS 2305.16)

One firm did not use a sample size for dual purpose testing that was the larger of the samples that would have been required for either test of controls or substantive testing. (AS 2315.44)

Other Revenue Deficiencies Involving Control Risk Assessments at Less Than Maximum

The following deficiencies relate to instances where firms modified the nature, timing, or extent of their substantive procedures based on a control risk assessment at less than the maximum, yet such modification was not supported due to deficiencies in testing controls.

Firms did not test the operating effectiveness of necessary user organization controls at the broker-dealer, as specified in the service auditor's report. (AS 2601.14)

Firms did not determine whether the specific tests of controls and results in the service auditor's report were relevant to the assertions for which the firms assessed control risk at less than the maximum, or did not perform procedures to address the audit period not covered by the service auditor's report. (AS 2601.16)

Firms did not perform tests of controls and, as a result, the sample sizes the firms used were too small to provide sufficient appropriate audit evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

One firm did not make required inquiries concerning the service auditor's professional reputation in considering whether the service auditor's report was satisfactory for its purposes. (AS 2601.18)

Recommended Actions for Firms: Revenue

Enhance procedures to identify, assess, and respond to risks of material misstatement.

Deficiencies related to revenue comprise over half of the audit deficiencies identified in 2021 and include deficiencies throughout the audit process - risk assessment, responding to risk, and evaluating audit results. Firms should enhance their understanding of the broker-dealer's internal control over financial reporting, including information systems and related business processes, and their understanding of control activities including controls that are intended to address identified fraud risks. Firms should also design audit procedures to address the assessed risks of material misstatement at the assertion level, including tests of details that are specifically responsive to risks of improper revenue recognition due to fraud when identified. In addition, firms must evaluate whether the broker-dealer's financial statements are presented fairly, in all material respects, including whether the broker-dealer's revenue recognition and related disclosures comply with the requirements of FASB ASC Topic 606, *Revenue from Contracts with Customers*.

Good Practices: Revenue

Scenario: A broker-dealer earned fees from the private placement of securities. The auditor took a substantive approach that included tests of details to address an identified fraud risk related to improper revenue recognition.

Good Practices:

- The auditor evaluated the design and implementation of the broker-dealer's controls to ensure that revenue was recognized when or as the performance obligations were satisfied and in amounts that were consistent with the terms of the broker-dealer's agreements with its customers.
- The auditor obtained the details of fees of successful placements for the year and compared the total fees shown in the details to the total fees per the broker-dealer's general ledger.
- The auditor selected all successful placements with fees over its tolerable misstatement determined for the audit. In addition, the auditor selected a sample of successful placements from the remaining population.
- For each selection, the auditor recalculated the fees using total capital raised as shown by a listing of capital contributed by each investor (the "investor listing") and the rate shown in the agreement between the broker-dealer and its customer. The auditor tested the completeness and accuracy of the investor listing by comparing capital raised to subscription documents and vice versa for a sample of investors. In addition, the auditor obtained evidence that the placement had closed, including vouching of cash received by the broker-dealer.

Related Party Relationships and Transactions

Firms did not sufficiently test the accuracy and completeness of data used to allocate expenses between broker-dealers and their affiliates. (AS 2301.08; AS 2410.11 and .12)

Firms did not identify omitted or inaccurate disclosures of information necessary to understand the effects of related party transactions on the broker-dealer's financial statements in accordance with FASB ASC Topic 850, *Related Party Disclosures*. (AS 2410.17; AS 2810.30 and .31)

Consideration of an Entity's Ability to Continue as a Going Concern

Firms did not perform sufficient audit procedures to obtain evidential matter about prospective financial information and the intent and ability of other parties to provide financial support to the broker-dealers, which were significant elements of managements' plans to overcome the adverse effects of the conditions and events that indicated substantial doubt. (AS 2415.07, .08, and .09)

Firms did not sufficiently consider the need for disclosures under FASB ASC Topic 205, *Presentation of Financial Statements*, when substantial doubt was raised, but alleviated by managements' plans. (AS 2415.11; AS 2810.30 and .31)

One firm omitted an explanatory paragraph from its auditor's report despite concluding that substantial doubt remained after considering identified conditions and events and management's plans. (AS 2415.12; AS 3101.18)

Expenses and Related Accruals

Firms did not test one or more relevant assertions for expense and related accrual accounts. (AS 2301.08)

One firm tested key items from certain accounts that comprised "other expenses" on the broker-dealer's statement of income, but did not test the remaining accounts, and inappropriately projected the results of its procedures to the entire population. (AS 1105.27; AS 2301.08)

Fair Value Measurements

Fair value measurement deficiencies in this Annual Report were identified pursuant to the revised AS 2501. Deficiencies in this audit area in previous annual reports were identified pursuant to the rescinded AS 2502.

Firms did not perform procedures, or perform procedures beyond inquiry, to test the fair value of financial instruments. (AS 2501.07)

Firms did not evaluate whether broker-dealers properly classified securities in accordance with the fair value hierarchy set forth in FASB ASC Topic 820, *Fair Value Measurement*, or did not detect the omission of disclosures required for securities classified as level 3. (AS 2501.30; AS 2810.30 and .31)

One firm did not evaluate the relevance of pricing information provided by a pricing service and used by a broker-dealer to determine the fair value of securities. (AS 2501.20, .A2, and .A5)

Good Practices: Fair Value Measurements

Scenario: A broker-dealer held a portfolio of equity and debt securities measured at fair value. The broker-dealer measured its equity securities based on prices quoted on an exchange and debt securities based on inputs other than quoted prices that were observable either directly or indirectly. The broker-dealer obtained its pricing information for both equity and debt securities from third-party pricing service A. The auditor chose to test the broker-dealer's estimated fair value of equity and debt securities by developing an independent expectation of fair value and used information from third-party pricing service B.

Good Practices:

- The auditor obtained an understanding of the broker-dealer's process to develop its estimates, including the source of the broker-dealer's pricing information.
- The auditor obtained an understanding of the types of securities being valued, including their terms, characteristics, and the extent to which their fair values were based on inputs that were observable directly or indirectly.
- The auditor obtained prices for a sample of equity and debt securities from third-party pricing service B and quantities from the auditor's confirmations with the custodians of the securities.
- The auditor determined the pricing information provided by pricing service B was reliable based on an evaluation of the pricing service's experience and expertise with valuing equity and debt securities, the methodologies used to determine fair value, and the auditor's understanding that the broker-dealer did not have a relationship with pricing service B.
- The auditor evaluated the process used by pricing service B to identify transactions in comparable debt securities, which pricing service B used to price the debt securities selected by the auditor for testing.
- The auditor compared its independent expectation to the broker-dealer's estimates and evaluated any differences.

Receivables and Payables

Firms used information produced by the broker-dealer as audit evidence in their substantive testing of accounts receivable, receivables from customers, and payables to customers but did not test, or sufficiently test, the accuracy and completeness of that information, whether by testing controls, testing the information, or a combination of both. (AS 1105.10)

One firm did not test fees that reduced the recorded balance of payables to customers. (AS 2301.08)

One firm did not consider the materiality of payables to customers when determining its extent of substantive testing and, as a result, did not obtain sufficient evidence to address the assessed risks of material misstatement. (AS 2301.08 and .42)

One firm did not perform sufficient tests of controls to support a control risk assessment at less than the maximum and the related modification to the nature, timing, and extent of substantive procedures for receivables from customers and payables to customers. As a result, the firm's sample size was too small to provide sufficient appropriate audit evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Evaluating Audit Results

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Evaluating audit results	92	16	17%	26%	37%

Firms did not sufficiently evaluate whether the presentation of broker-dealer financial statements, including disclosures, was in conformity with FASB ASC Topic 606, *Revenue from Contracts with Customers*, with respect to:

- Qualitative and quantitative disclosures of information regarding revenue from contracts with customers;
- Revenue recognition, including determination of performance obligations, transaction price, and whether performance obligations were satisfied at a point in time or over time; and
- Revenue recognized prior to satisfaction of the performance obligation. (AS 2810.30 and .31)

Firms did not sufficiently evaluate whether the presentation of broker-dealer financial statements, including disclosures, was in conformity with FASB ASC Topic 230, *Statement of Cash Flows*. Specifically, firms did not:

- Detect presentation of cash flows that did not comply with FASB ASC Topic 230; and
- Detect inaccurate disclosure of the amount of restricted cash. (AS 2810.30 and .31)

One firm did not detect that the broker-dealer's presentation of proprietary trading securities and related cash flows did not comply with FASB ASC Topic 940, Financial Services – Brokers and Dealers. (AS 2810.30 and .31)

Firms did not take into account relevant audit evidence that appeared to contradict assertions in the financial statements for revenue and receivables. (AS 2810.03)

Refer to the sections of this Annual Report entitled "Related Party Relationships and Transactions," "Consideration of an Entity's Ability to Continue as a Going Concern," and "Fair Value Measurements" for descriptions of identified deficiencies related to evaluation of financial statement disclosures in those respective areas.

Deficiencies in Auditing Supplemental Information Accompanying Audited Financial Statements

	2021			2020	2019
	Number of applicable audits reviewed	Number of audits reviewed with identified deficiencies	Percentage	Percentage	Percentage
Customer Protection Rule	26	12	46%	39%	42%
Net Capital Rule	34	6	18%	31%	31%

Performing Audit Procedures on Supplemental Information

Firms did not perform, or sufficiently perform, procedures to test the completeness and accuracy of information presented in customer and broker-dealer reserve computations, including information produced by the broker-dealers used to prepare the computations. Firms also did not perform, or sufficiently perform, procedures to evaluate whether customer reserve computations were determined in compliance with the Reserve Requirements Rule, including whether:

- Customer cash balances (credits) were properly netted with unpaid fees (debits); and
- An account qualified as a special reserve bank account, given language in the bank notification letter that permitted the bank to impose charges on the account. (AS 2701.04)

Firms did not perform, or sufficiently perform, procedures to test the completeness and accuracy of information relating to the possession or control requirements for customers, including information produced by the broker-dealer used to prepare the possession or control information. Firms also did not perform, or sufficiently perform, procedures to evaluate whether information relating to the possession or control requirements for customers was determined in compliance with the Customer Protection Rule, including whether:

- Segregation instructions were provided to the carrying broker-dealer for omnibus credit accounts;
- Excess margin calculations properly took into account, for each customer, accounts under common ownership; and
- Foreign custody accounts were good control locations. (AS 2701.04)

Firms did not perform, or sufficiently perform, procedures to evaluate whether the following aspects of net capital computations were determined in compliance with the Net Capital Rule:

- Allowable assets and assets not readily convertible into cash, including deposits with clearing broker-dealers and commissions receivable;
- Adjustments to net worth, including subordinated liabilities and liabilities or expenses related to the broker-dealer’s business assumed by a third party;
- Operational charges and other deductions, including stock loan and stock borrow deficits; and

- Minimum net capital requirement for a broker-dealer that engaged in multiple business lines. (AS 2701.04)

One firm did not detect that net capital included as supplemental information in the broker-dealer's financial statements did not reconcile with the broker-dealer's FOCUS report. (AS 2701.04)

Evaluation of Audit Results

One firm did not sufficiently take into account quantitative factors when evaluating the materiality of uncorrected misstatements. (AS 2701.08)

Other Instances of Non-Compliance with PCAOB Standards

This section of our report discusses identified instances of non-compliance with PCAOB standards that do not relate directly to the sufficiency or appropriateness of evidence firms obtained to support their audit opinions.

Deficiencies in Auditor Reports on the Financial Statements and Supplemental Information

	2021			2020	2019
	Number of applicable audits reviewed	Number of audits reviewed with identified deficiencies	Percentage	Percentage	Percentage
Auditor reports on the financial statements and supplemental information	92	1	1%	7%	14%

One firm, in its auditor report, omitted a statement in the opinion indicating that the related notes to the financial statements were audited, and incorrectly stated the year the firm began serving consecutively as auditor. (AS 3101.08 and .10)

Refer to the section of this Annual Report entitled “Consideration of an Entity's Ability to Continue as a Going Concern” for the description of an identified deficiency related to consideration of the effects of going concern on the auditor's report.

Deficiencies in Auditor Communications

	2021			2020	2019
	Number of applicable audits reviewed	Number of audits reviewed with identified deficiencies	Percentage	Percentage	Percentage
Auditor communications	92	3	3%	2%	5%

Firms did not communicate to the audit committee (or equivalent body) matters related to the results of the audit, including a firm that did not communicate matters relating to its evaluation of the broker-dealer's ability to continue as a going concern. (AS 1301.12 through .24)

Firms did not affirm in writing to the audit committee (or equivalent body) that the firms were independent with respect to the broker-dealer in compliance with PCAOB Rule 3520, as prescribed by PCAOB Rule 3526.

Deficiencies in Audit Documentation

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Audit documentation	92	3	3%	2%	25%

Firms did not assemble a complete and final set of audit documentation by the documentation completion date, or properly document additions to the audit work papers after the report release date. (AS 1215.15 and .16)

Deficiencies in Quality Control Systems

Our inspections indicate that 24 (out of 50 inspected) firms' QC systems did not appear to provide reasonable assurance that firm personnel had complied with applicable professional standards in the areas of engagement performance and/or independence, integrity, and objectivity.

Deficiencies Regarding Firms' Quality Control Systems Related to Engagement Performance

	Number and percentage of firms with identified quality control deficiencies		
	2021	2020	2019
Engagement performance	23 (46%)	43 (66%)	52 (79%)

Firm policies and procedures did not provide reasonable assurance that:

- Engagement teams made required communications to the audit committee (or equivalent body) in accordance with AS 1301. (QC 20.03 and .17)
- Engagement teams took into consideration tolerable misstatement to determine samples for substantive tests of details in accordance with AS 2315. (QC 20.03, .17 through .19)
- Engagement teams assembled complete and final set of audit and attestation documentation for retention as of the documentation completion date in accordance with AS 1215. (QC 20.17)

- Engagement partners reviewed and supervised audit and attestation engagements with due professional care in accordance with AS 1201, which contributed to not identifying deficiencies in those engagements. (QC 20.03 and .17)

Engagement Quality Review

Firm policies and procedures did not provide reasonable assurance that engagement quality reviews for audit and attestation engagements were performed with due professional care in accordance with AS 1220. This contributed to engagement quality reviewers not identifying certain errors in, or certain required disclosures omitted from, broker-dealer financial statements, documents containing broker-dealer management assertions, and engagement reports. It also contributed to engagement quality reviewers not identifying deficiencies in audit responses in areas of significant risks, including fraud risks. All of these areas were required to be reviewed by the engagement quality reviewer. (QC 20.03 and .17) In addition, other firms did not perform engagement quality reviews for broker-dealer audit and attestation engagements. (QC 20.03 and .17)

The following table provides information about engagement quality review deficiencies by engagement type:

	2021			2020	2019
	Number of applicable engagements reviewed	Number of engagements reviewed with identified deficiencies	Percentage	Percentage	Percentage
Audit engagements	45	21	47%	68%	68%
Review engagements	18	7	39%	74%	71%
Examination engagements	21	4	19%	14%	10%

Recommended Actions for Firms: QC Systems

Strengthen QC systems, particularly engagement quality reviews.

Engagement quality reviews at many firms were not performed with due professional care in accordance with AS 1220. Other firms did not perform engagement quality reviews at all. Firms should ensure that their policies and procedures cover all aspects of each engagement, including engagement quality reviews pursuant to AS 1220. We recommend that firm policies and procedures address compliance with AS 1220 for broker-dealer engagements, including how the firm ensures its engagement quality reviewers meet the AS 1220 qualification requirements. Some firms may consider appointment of individuals from outside the firm as engagement quality reviewers when necessary to meet the qualification requirements.

Other Deficiencies Regarding Firms' Quality Control Systems

	Number and percentage of firms with quality control deficiencies		
	2021	2020	2019
Personnel management	0 (0%)	1 (2%)	1 (2%)
Monitoring	0 (0%)	0 (0%)	2 (3%)
Independence, integrity, and objectivity	2 (4%)	0 (0%)	2 (3%)

Firm policies and procedures did not provide reasonable assurance that engagement quality reviewers maintained objectivity in accordance with AS 1220 and did not serve as the engagement partners during either of the two audits preceding the audit subject to the engagement quality reviews. (QC 20.03 and .09)

PCAOB STANDARDS AND RULES ASSOCIATED WITH INSPECTIONS OBSERVATIONS

AT No. 1	Examination Engagements Regarding Compliance Reports of Brokers and Dealers
AT No. 2	Review Engagements Regarding Exemption Reports of Brokers and Dealers
AS 1105	Audit Evidence
AS 1201	Supervision of the Audit Engagement
AS 1215	Audit Documentation
AS 1220	Engagement Quality Review
AS 1301	Communications with Audit Committees
AS 2110	Identifying and Assessing Risks of Material Misstatement
AS 2301	The Auditor's Responses to the Risks of Material Misstatement
AS 2305	Substantive Analytical Procedures
AS 2315	Audit Sampling
AS 2410	Related Parties
AS 2415	Consideration of an Entity's Ability to Continue as a Going Concern
AS 2501	Auditing Accounting Estimates, Including Fair Value Measurements
AS 2502	Auditing Fair Value Measurements and Disclosures (rescinded)
AS 2601	Consideration of an Entity's Use of a Service Organization
AS 2701	Auditing Supplemental Information Accompanying Audited Financial Statements
AS 2810	Evaluating Audit Results
AS 3101	The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion
QC 20	System of Quality Control for a CPA Firm's Accounting and Auditing Practice
Rule 3520	Auditor Independence
Rule 3526	Communication with Audit Committees Concerning Independence

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