

# Forum for Auditors of Broker-Dealers

December 1, 2015

Las Vegas, NV

# Caveat

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One of the benefits of today's session is that you will hear firsthand from one of the PCAOB Board members and numerous PCAOB staff. You should keep in mind, though, that when we share our views they are those of the speaker alone, and do not necessarily reflect the views of the Board, its members or staff.

# Welcome

**Mary Sjoquist**

Director, Office of Outreach and  
Small Business Liaison

# PCAOB Highlights

**Jay D. Hanson**  
Board Member

# Compliance and Industry Trends

**Tim Gustafson**

Office of Research & Analysis

December 1, 2015

Las Vegas, NV

# Office of Research & Analysis

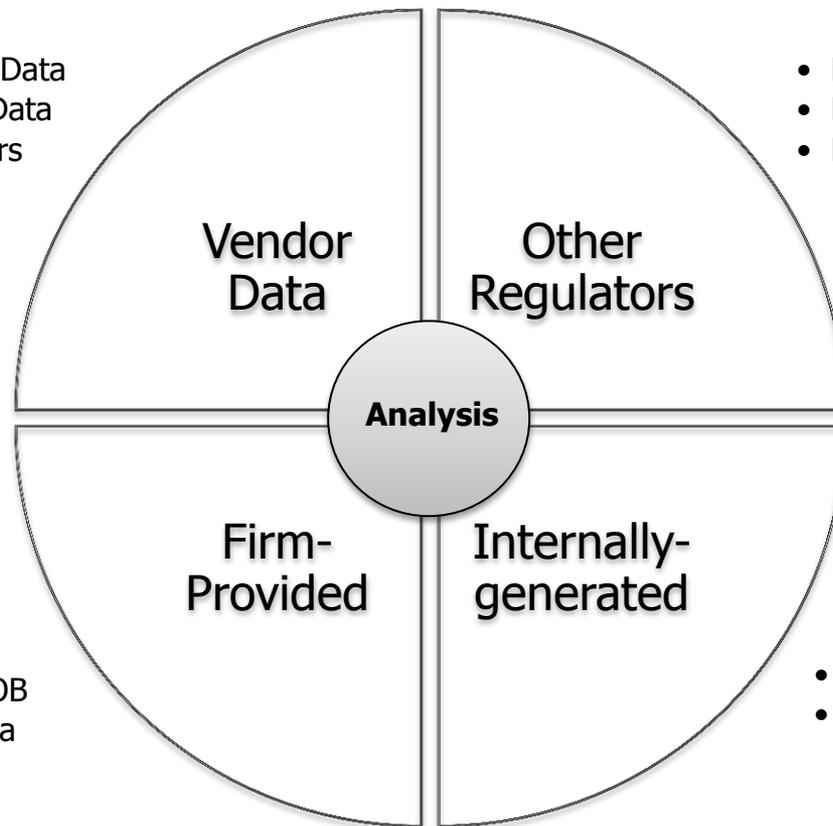
## ORA's contribution to the Board's broker-dealer audit oversight responsibilities include:

- Aggregating information on risk for other divisions,
- Presenting data analysis for inspection planning, and
- Evaluating trends affecting the audit market.

## Sources:

- Annual Report Data
- Issuer Parent Data
- Related Advisors

- FOCUS Report
- Form Custody
- Form BD



- Filings to PCAOB
- Inspection Data

- Original Research
- Inspections Findings

# Three trends affecting the BD audit market



## BD Migration to firms with more clients

- ❑ Fewer firms + fewer BDs
- ❑ Single BD client auditors leaving market
- ❑ Recent acceleration in trend



## New Compliance requirements

- ❑ Enforcement\*
- ❑ Inspection\*
- ❑ ORA study of Rule 17a-5 amendment adoption



## Pressures on Financial Condition

- ❑ Going concern rates
- ❑ Volatility in P&L
- ❑ Net capital deficiency patterns

Opportunity to specialize in BDs & differentiate on audit quality

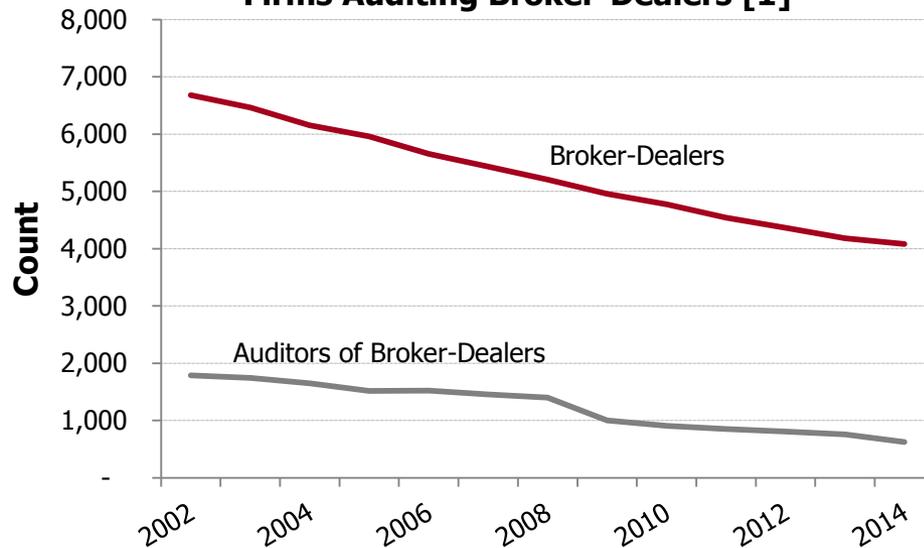
*\*Topics to be discussed in more detail by others at today's forum*



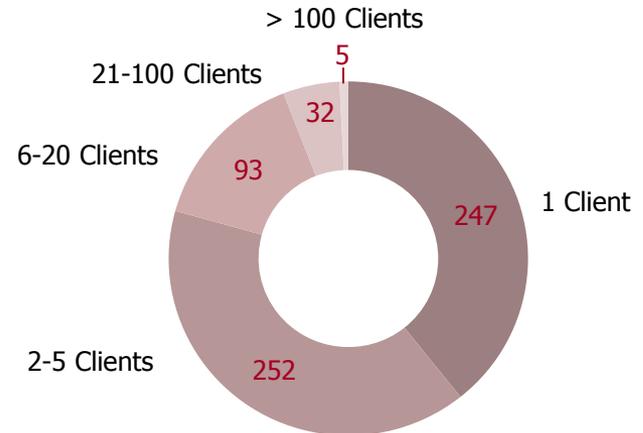
BD Migration to firms with more clients

# Decline in population

### Number of Broker-Dealers and Firms Auditing Broker-Dealers [1]



### Count of Audit Firms with 2014 FYE BD Clients [2]



## 16%

% of BDs that changed auditors between their 2013 and 2014 FYEs (This is higher than years 2010 through 2013).

## 79%

% of BD audit firms with 5 or fewer clients for 2014 FYEs

## 24%

% of BDs that are audited by firms with 5 or fewer BD clients. BDs audited by these firms are decreasing.

Source: [1] Broker and dealer counts are based on SIPC membership (which approximates similar patterns in the broader population of brokers and dealers). Audit firm counts are derived from Audit Analytics data through May 23, 2015, which includes firms that have not been registered by the PCAOB in years preceding the registration requirement. This auditor information is grouped by the fiscal year end of the financial statements audited.

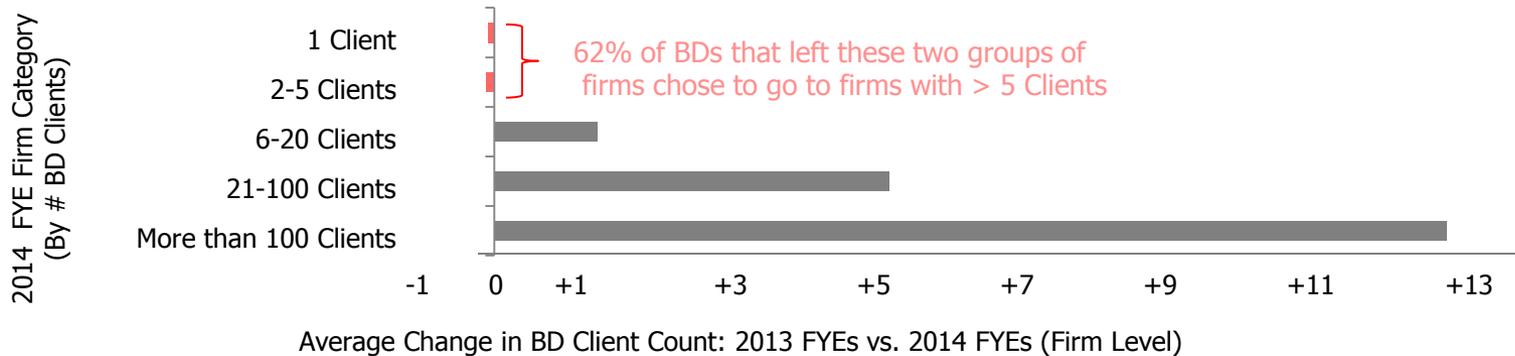
[2] Count of audit firms is based on brokers and dealer financial statements through May 15, 2015, for fiscal years ended during 2014, that included audit reports issued by firms registered with the PCAOB.

# Shifting toward specialization

## Summary of auditor changes between 2013 and 2014 FYE (BD Level)

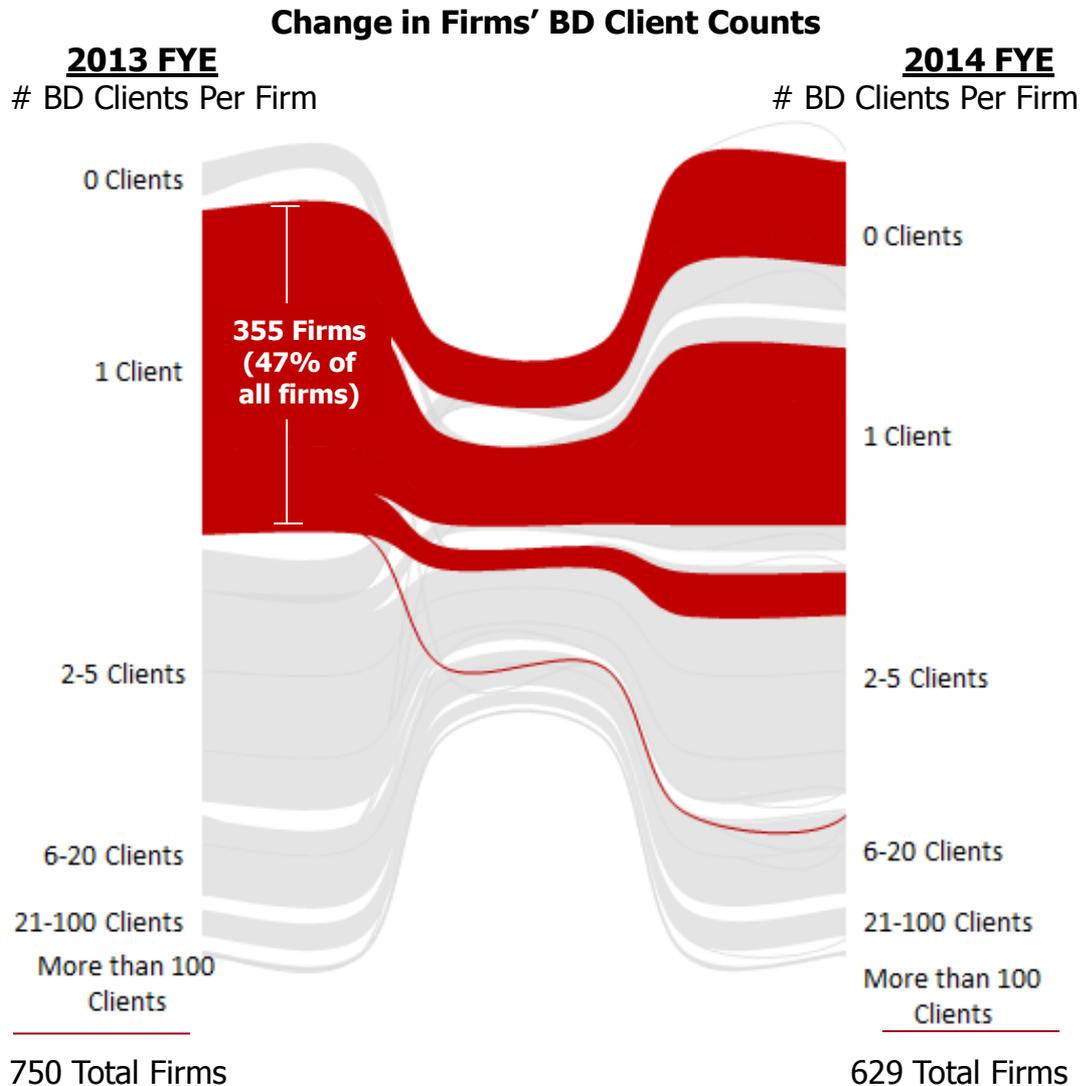
	Client Count of Successor Auditor Relative to Predecessor			Total BDs with auditor changes
	Decreased More than 20%	Within 20%	Increased More than 20%	
Predecessor Auditor				
1 Client	0%	0%	15%	15%
2-5 Clients	3%	3%	20%	26%
6-20 Clients	6%	3%	9%	18%
21-100 Clients	11%	2%	4%	17%
More than 100 Clients	13%	1%	10%	24%
	32%	10%	58%	100%

## Impact BD auditor changes noted above have on overall firm BD client counts (Audit Firm Level)



Source: Count of audit firms with 2014 broker and dealer clients is based on the number of brokers and dealers who filed financial statements through May 15, 2015, for fiscal years ended during 2014, that included audit reports issued by firms registered with the PCAOB. Count of Audit Firms with 2013 broker and dealer clients is based on the number of brokers and dealers who filed financial statements through May 27, 2014, for fiscal years ended during 2013, that included audit reports issued by firms registered with the PCAOB

# Firms with 1 BD client are leaving the market



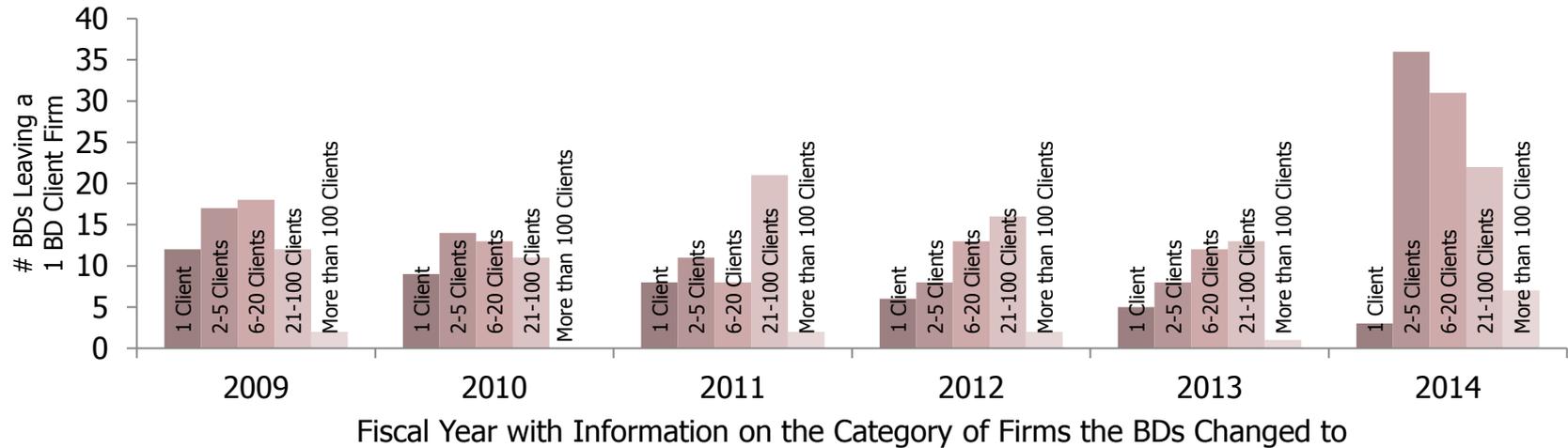
**355**  
# of firms with 1 BD client for the prior FYE (2013)

**32%**  
% of firms with 1 BD client that left the BD audit market in following year

**70%**  
% of firms that left the BD audit market that only had 1 BD audit client

# BDs leaving 1 client firms are now more likely to go to a 2-5 client firm relative to other size firms

## **BDs leaving 1 client firms summarized by the size of firm they change to [1]**

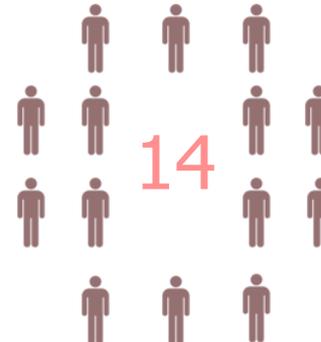


## **BDs leaving 1 client firms are also choosing firms with more CPAs [2]:**

Median number of CPAs in 2013 for 1 Client Firms that BDs left



Median number of CPAs in 2014 for the firms those same BDs engaged



# Firms with 2-5 BD clients were more successful in maintaining clients than those with 1 BD client

273

# of firms with 2-5 BD clients for the prior FYE (2013)

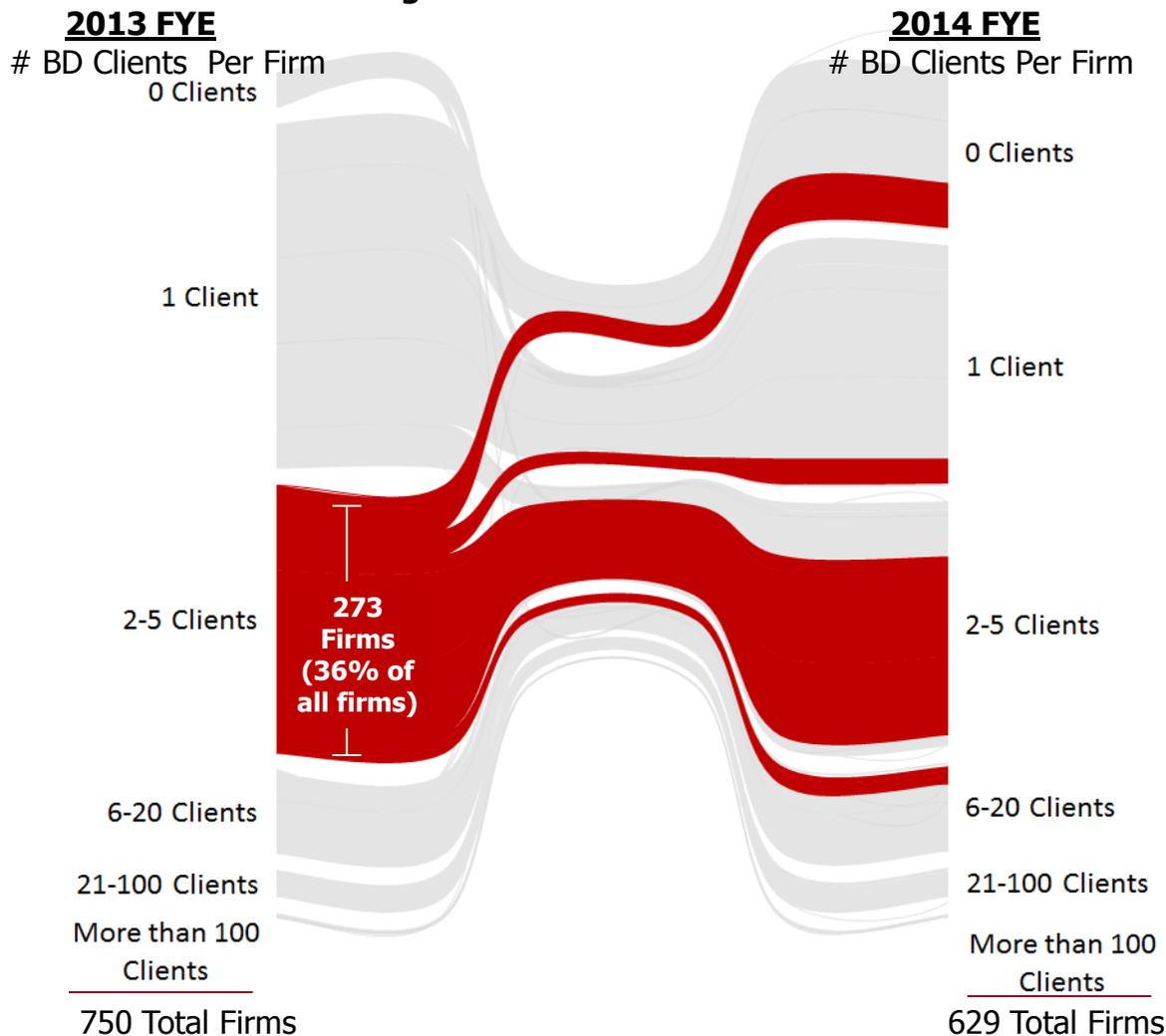
17%

% of firms with 2-5 BD clients leaving the audit market in following year

74%

% of firms with 2-5 BD clients that maintained or gained BD clients.

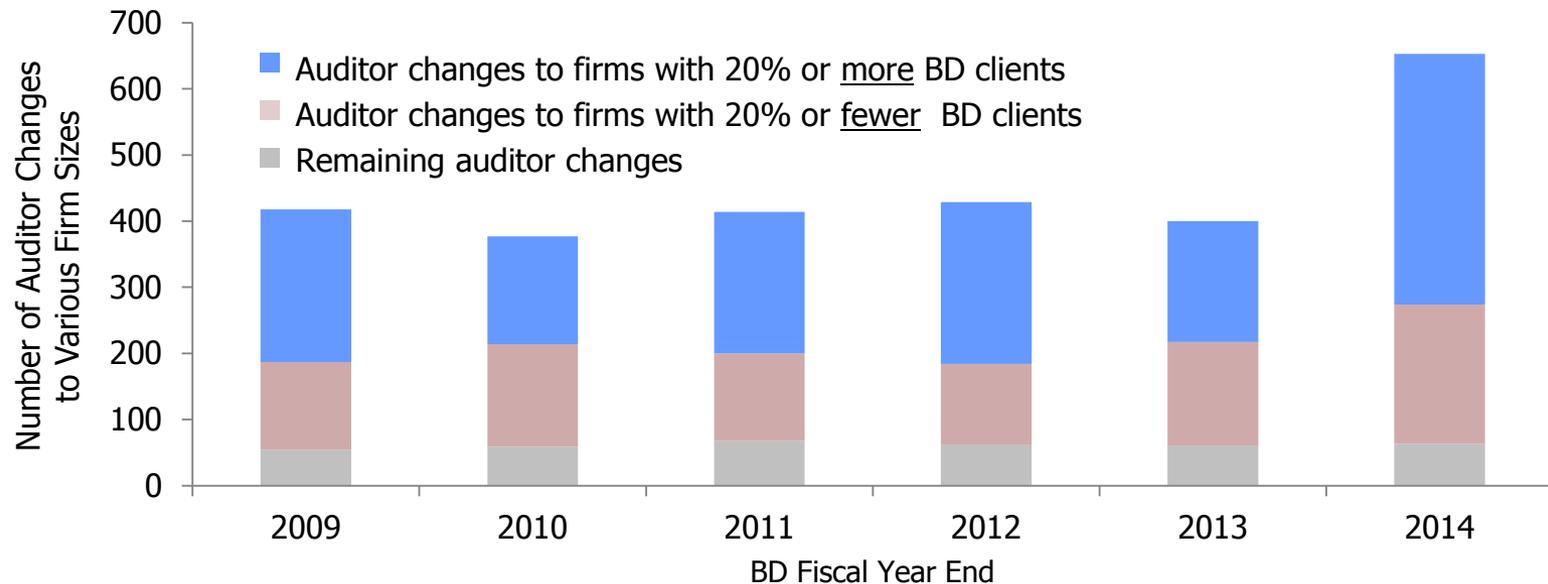
Change in Firms' BD Client Counts



The height of the graphic, for each firm size category, represents the proportion of the firms that were that size for the respective year. The red portion depicts change in size--between 2013 and 2014--of those firms that opined on between 2 and 5 broker and dealer clients with a 2013 fiscal year end.

# Overall, BDs are now more likely to select a firm with 20% or more BD clients than the prior firm

## Number of auditor changes by BD client counts of successor firms relative to predecessor firms:



### Trend Drivers:



General downward trend in the number of firms, after Madoff, PCAOB registration requirement, etc.

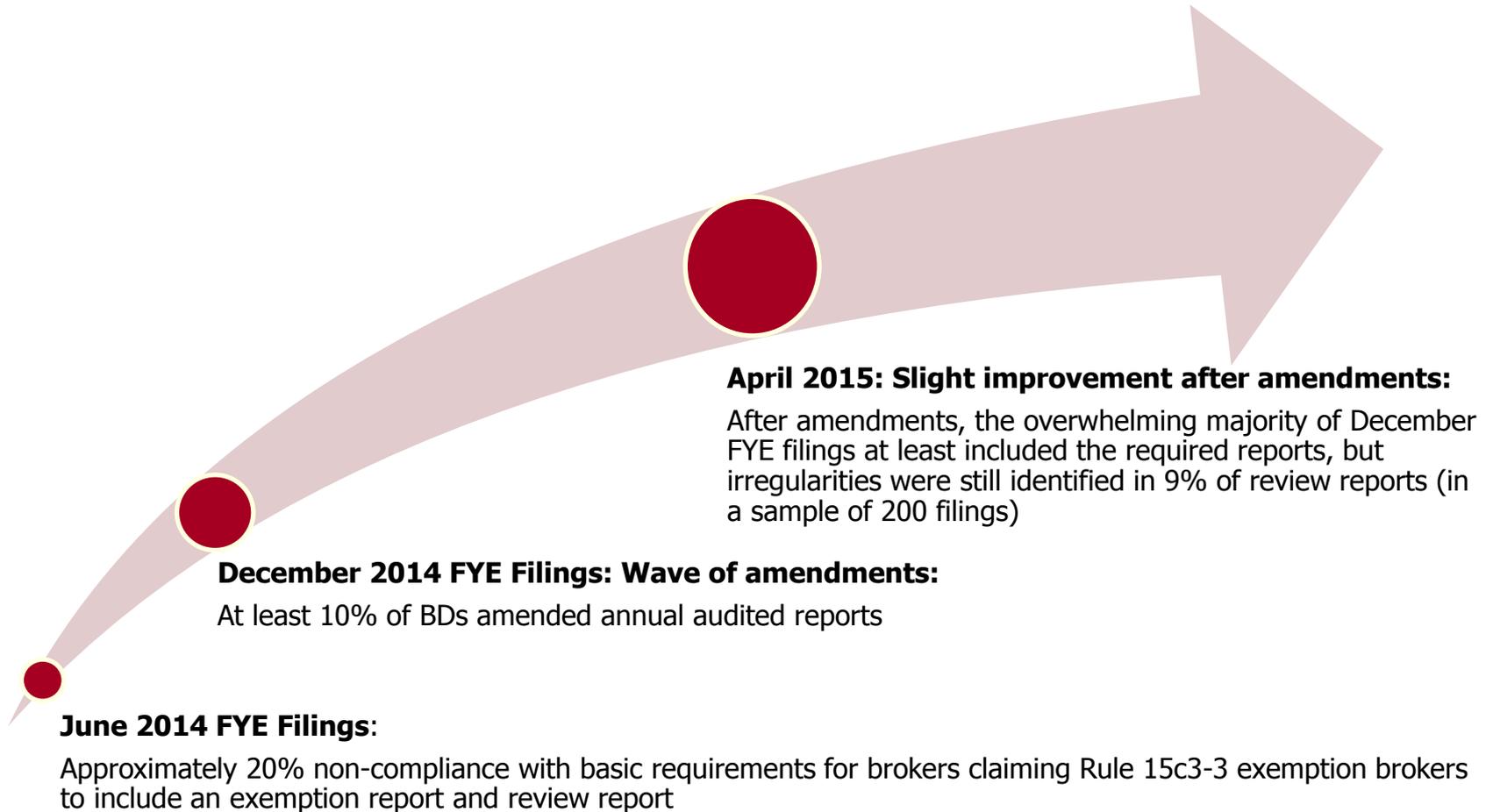


Major auditor acquisitions are one element at the larger end of the scale



Much of the increase in 2014 FYE auditor changes is the result of single-BD client firms getting out of the BD audit space

# 3 compliance studies we will discuss



# June 2014 FYE: ~20% non-compliance with several basic aspects of 17a-5 amendments and the related PCAOB audit and attestation standards

	BDs that do not claim exemption <i>Sample=10*</i>	BDs that claim exemption <i>Sample=160</i>
<b>Management is required to prepare:</b>	<p>✘ <u>Compliance Report</u></p> <p><i>10% omitted report*</i></p>	<p>✘ <u>Exemption Report</u></p> <p><i>21% omitted report</i></p>
<b>Auditor is engaged to perform attestation and issue:</b>	<p>✘ <u>Examination Report</u></p> <p><i>10% omitted the report and instead issued "Report on Material Inadequacies" *</i></p>	<p>✘ <u>Review Report</u></p> <p>20% either issued a "Report on Material Inadequacies" or issued a review report on an exemption report which was not present. 1% issued neither a "Report on Material Inadequacies" nor a review report.</p>
<b>Auditor is required to conduct audit under PCAOB standards:</b>	<p>✘ <i>10% performed the audit under US GAAS * (not PCAOB standards)</i></p>	<p>✘ <i>9% performed the audit under US GAAS (not PCAOB standards)</i></p>

\*The 10 in this sample of those not claiming exemption is too small of a group to base conclusions about the broader population.

Source: The information is based on a review of annual audited reports filed by a broker or dealer through October 15, 2014, for fiscal years ended on June 30, 2014, that included audit reports issued by firms registered with the PCAOB.

# Findings from amendments of December 2014 FYE annual audited reports filed during Q1 2015

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## **Classification of Main Cause of Amendment**

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Exemption Report, Compliance Report, Review Report, or Examination Report	75%	
Oath & Affirmation	10%	
SIPC Assessment	4%	
Audited Financial Statement Changes	5%	
Supplemental schedules opined on by the auditor	3%	
Auditor's report over financial statements and supplemental information	3%	
<b>Total (Among 383 Available Amended Filings)</b>	<b>100%</b>	

# December 2014 FYE: review of sample of filings

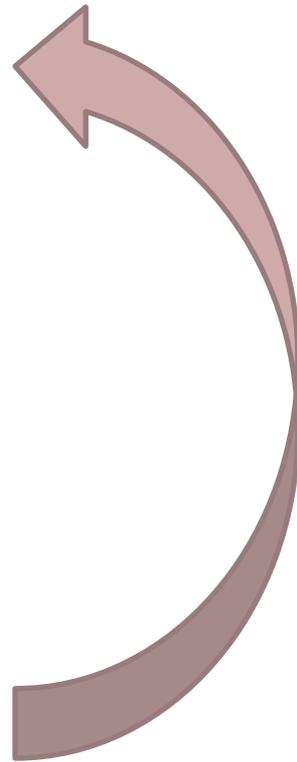
(after wave of amendments)

	BDs that do not claim exemption <i>Sample=11</i>	BDs that claim exemption <i>Sample=189</i>
<b>Management is required to prepare:</b>	 <p><u>Compliance Report</u> <i>0% omitted report</i></p>	 <p><u>Exemption Report</u> <i>5% omitted exemption report. 6% not properly executed. 4% omitted statement on compliance with exemption throughout the period.</i></p>
<b>Auditor is engaged to perform attestation and issue:</b>	 <p><u>Examination Report</u> <i>0 % omitted report</i></p>	 <p><u>Review Report</u> <i>2% omitted review report.</i></p> <p><i>4% included review report that mentions an exemption provision that is different than the exemption provision mentioned by management.</i></p> <p><i>5% included review reports that did not include all 12 elements under Attestation Standard 2 Paragraph 16.</i></p>
<b>Auditor is required to conduct audit under PCAOB standards:</b>	 <p><i>0% performed audit under US GAAS (not PCAOB standards)</i></p>	 <p><i>1% performed audit under US GAAS (not PCAOB standards)</i></p>

Source: The information is based on a review of annual audited reports filed by a broker or dealer through April 11, 2015, for fiscal years ended on December 31, 2014, that included audit reports issued by firms registered with the PCAOB.

# Exceptions noted in exemption report in sample of 200 filings

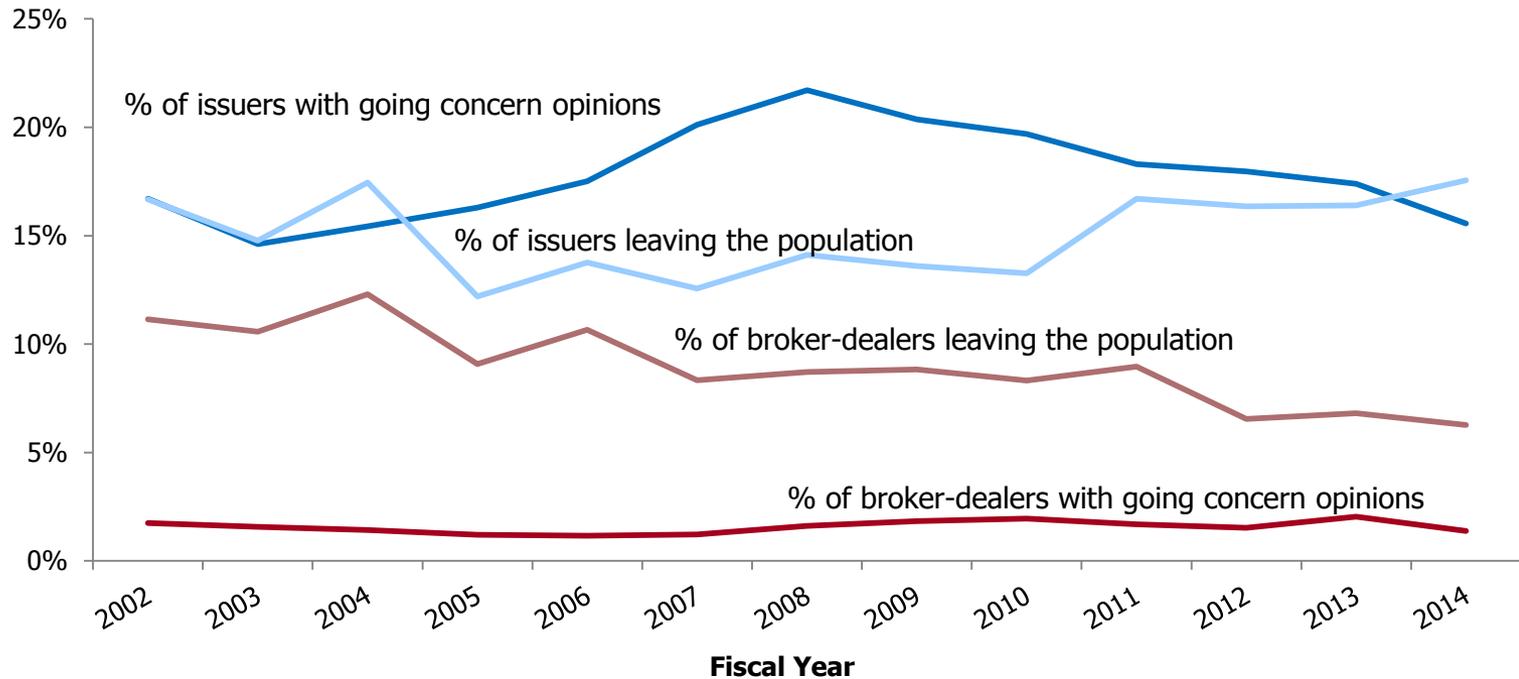
- ❑ Only 3% of exemption reports in sample noted exceptions.
- ❑ All BDs with exceptions noted were audited by global network firms except for one. For the one BD audited by a smaller firm, the exceptions were identified by a FINRA exam.
- ❑ Most exceptions noted related to delays in forwarding checks.
- ❑ In the 3% of reports with exceptions noted, there was disclosure of 4,200 checks in total that were not properly forwarded.



# Comparison in rate of going concern: broker-dealers vs. issuers

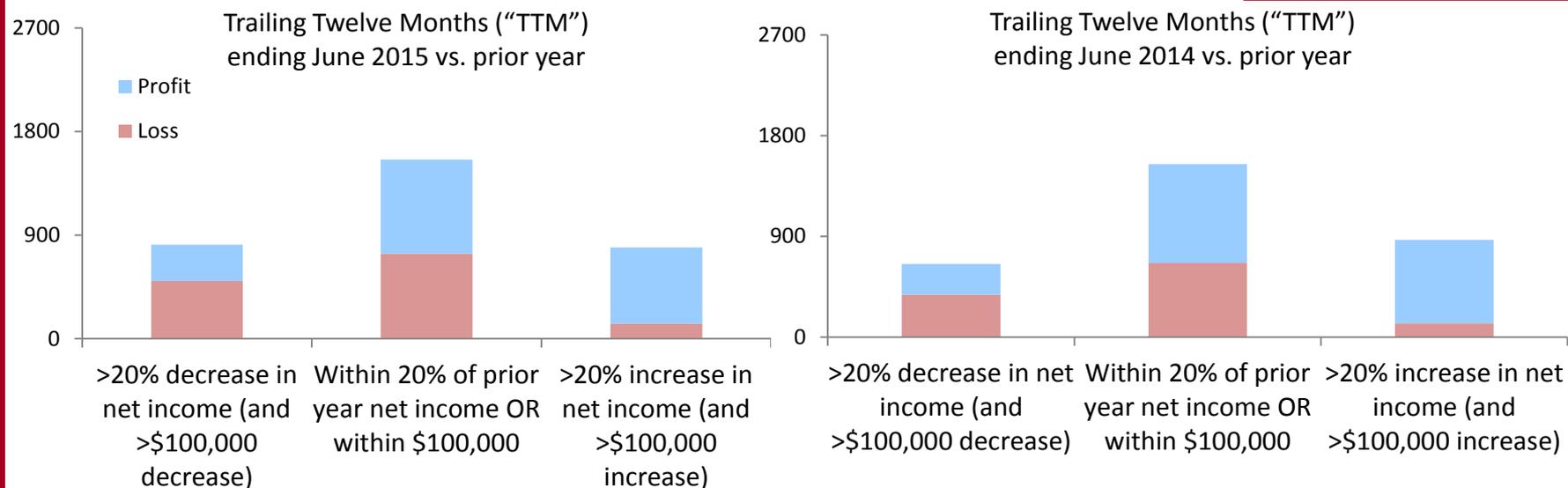


### % of Broker-Dealers and Issuers with Going Concern Opinions And Terminations



Source: Counts of audit reports with information on going concern paragraphs is derived by Audit Analytics audit report data for SEC filings through May 29, 2015. Counts of brokers and dealers leaving the population are derived from SIPC annual reports for SIPC members which approximates similar patterns in the broader population of brokers and dealers. Counts of issuers leaving the population are derived from Audit Analytics audit report data on SEC registrants (excluding benefit plans, brokers and dealers). Issuers are counted as leaving the population in the year following the fiscal year of their last audited financial statements.

# BDs audited by smaller firms show volatility in net income



**25%**

% of BDs audited by smaller firms that reported more than a 20% increase in net income in one of the two prior TTM periods and a 20% decrease in the other (changes of <100,000 excluded)

**43%**

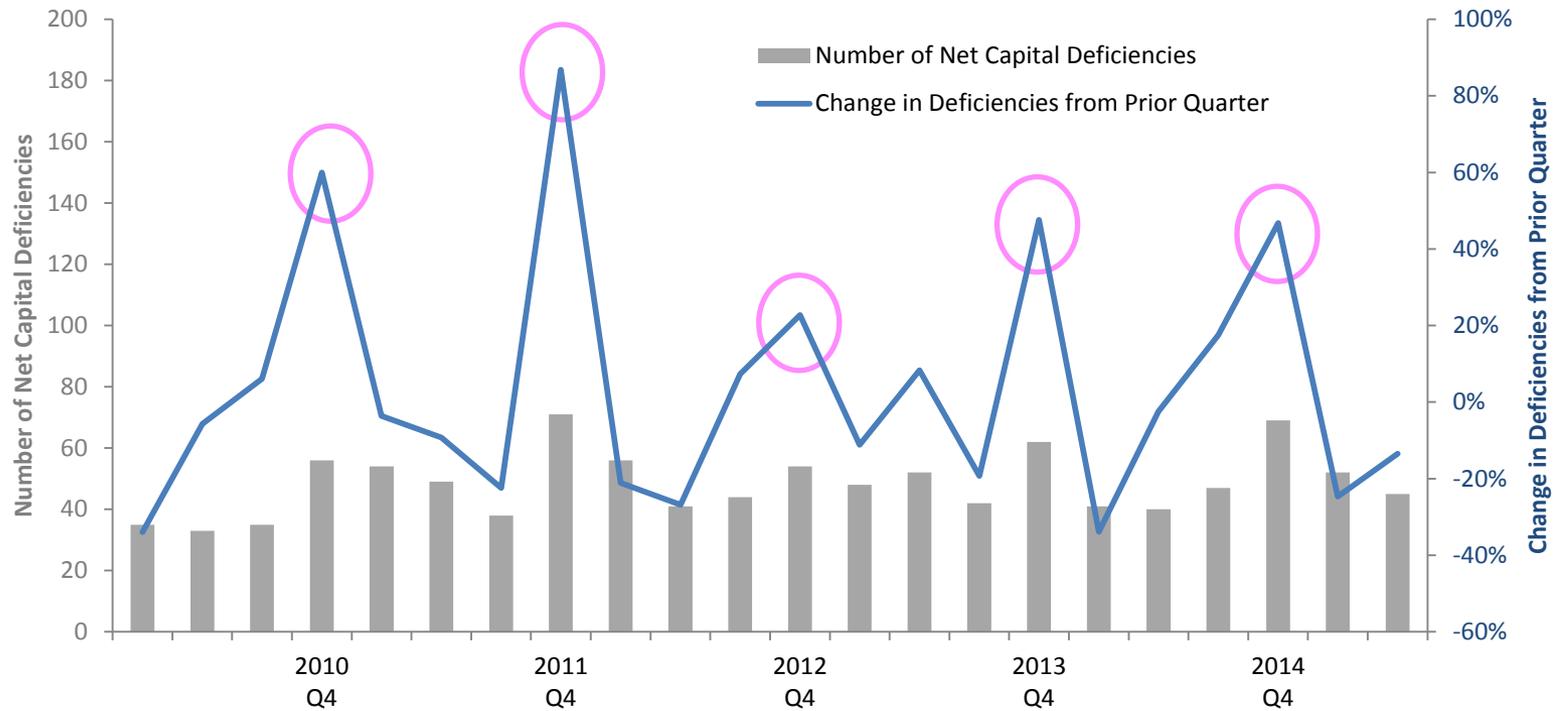
% of BDs audited by smaller firms that reported a loss in the TTM ending during June 2015.

**24%**

% of BDs audited by smaller firms that reported a loss in the two consecutive TTM ending during June 2015.

Source: This net income information is based on unaudited Financial and Operational Combined Uniform Single ("FOCUS") reports filed with FINRA through August 28, 2015, for the calendar quarters ended during the trailing 12 months ended June 30, 2015, June 30, 2014 and June 20, 2013. Audit firm information is based on brokers and dealer financial statements filed through May 15, 2015, for fiscal years ended during 2014, that included audit reports issued by firms registered with the PCAOB that are not part of the 6 largest global network firms.

# Evidence of the impact audits have on BD financial reporting quality





# *PCAOB Forum for Auditors of Broker-Dealers*

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***Kevin Stout***

***Senior Associate Chief Accountant***

***Office of the Chief Accountant***

***U.S. Securities and Exchange Commission***

***December 1, 2015***



# *Disclaimer*

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***The Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any private publication or statement by any of its employees. The views expressed herein are those of the author and do not necessarily reflect the views of the Commission or of the author's colleagues upon the staff of the Commission.***

# *Agenda*

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- ❖ **Implementation of July 30, 2013 Amendments to the SEC's Broker-Dealer Annual Reporting Requirements (Release No. 34-70073)**
  - **Overview of the Annual Reporting Requirements**
- ❖ **Applicability of Auditor Independence Rules to Broker-Dealer Audits**
- ❖ **Office of Compliance Inspections and Examinations - Broker-Dealer Inspections**
- ❖ **Other Topics**



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*Overview of the Annual  
Reporting Requirements*

# *Overview of the Annual Reporting Requirements*

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## ❖ Reporting

- Annual Reports under Rule 17a-5(d) generally include:
  - Financial Report (audited financial statements and certain supporting schedules);
  - Compliance Report or Exemption Report; and
  - Independent public accountant reports
- Independent public accountant reports must be in accordance with the standards of the PCAOB
- Material Inadequacy report no longer relevant for compliance with Rule 17a-5 (replaced by Compliance Report or Exemption Report for SEC registered broker-dealers)

# *Overview of the Annual Reporting Requirements*

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## ❖ **Reporting**

- **Compliance Report and Exemption Report must cover the requirements in Rule 17a-5(d)(3) for the Compliance Report and Rule 17a-5(d)(4) for the Exemption Report**
- **Same person that signs the oath or affirmation to sign the Compliance or Exemption Report**

## ❖ **Reporting by non-carrying broker-dealers that are not claiming exemption under Rule 15c3-3(k)**

- **Frequently Asked Questions (FAQ 6) by Division of Trading & Markets on April 4, 2014.**
- **Relief from filing a Compliance Report**
- **Exemption Report (if applicable) – needs to be sufficiently descriptive of why the broker-dealer has no obligations under Rule 15c3-3**

# *Overview of the Annual Reporting Requirements*

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- ❖ **Notification Requirements under paragraph (h) of Rule 17a-5 of non-compliance or material weakness**
  - **The auditor must immediately notify the broker-dealer of the nature of the non-compliance or material weakness**
  - **The broker-dealer must file a notification with the Commission and the regulatory authority that examines the broker-dealer 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 the designated examining authority within one business day**

# *Overview of the Annual Reporting Requirements*

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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.**

# *Overview of the Annual Reporting Requirements*

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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**

# *Overview of the Annual Reporting Requirements*

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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**

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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***
  - **Requirements apply to engagement quality reviewers – see Rule 2-01(f)(7)**
- ❖ **Recent enforcement activity in this area**
  - **Commission sanctioned 8 firms that were not independent under Rule 2-01(c)(4)(i) criteria – preparation of financial statements**  
<http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543608588>
  - **PCAOB disciplinary orders**

# *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**

# *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**

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***Office of Compliance Inspections  
and Examinations (OCIE) -  
Broker-Dealer Inspections***

# *OCIE Broker-Dealer Inspections*

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- ❖ ***Scoping involves, among other considerations:***
  - ***Review of Annual Reports, Form Custody and eFocus filings***
  - ***Compliance with the annual reporting requirements***
- ❖ ***Inspections – Recurring Common Themes***
  - **Expense Sharing Agreements**
  - **Capital contributions and withdrawals**
  - **Haircut computations**
  - **Classification of allowable vs. non-allowable assets**
  - **Compliance with Rule 15c3-3 exemption**
  - **Books & Records**
  - **Other**

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## *Other Topics*

# *Other Topics*

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- ❖ ***Broker-dealer related consultations with OCA***
  - **Recent Examples**
- ❖ ***New Revenue Recognition Accounting Standard***
  - **AICPA Revenue Recognition Task Force – Brokers and Dealers in Securities**

# *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)

# FINRA Perspectives

**PCAOB Forum for Auditors of Broker-Dealers**  
**Las Vegas, NV - December 1, 2015**

Susan DeMando Scott, Associate Vice President  
Risk Oversight and Operational Regulation - Financial Operations  
Policy Group



# Nature and Scope of FINRA's Financial Surveillance and Risk-Based Examination Programs



# FINRA's Financial Surveillance Program

- **Includes the routine review of a firm's financial and operational reports:**
  - Filed pursuant to SEA Rule:
    - FOCUS Report
    - Schedule I
    - Annual Report
    - Form Custody - Initial Filing as of 12/31/2013
  - Filed pursuant to FINRA Rule:
    - Form SSOI (Supplemental Statement of Income) - Initial Filing as of 09/30/2012
      - Regulatory Notice 12-11
    - Form OBS (Supplemental Schedule for Derivatives and Other Off-Balance Sheet Items) - Initial Filing as of 06/30/2013
      - Regulatory Notice 13-10
    - Form SIS (Supplemental Inventory Schedule) - Initial Filing as of 12/31/2014
      - Regulatory Notice 14-43
- **Reviews are largely determined by the creation of certain “exceptions”**
- **Select manual reviews are also conducted.**

# FINRA's Risk-Based Examination Program

- **Scope, content, frequency and nature of a firm's examination depends on the depends on the characteristics of the firm.**
  - Characteristics include, but are not limited to, firm size and complexity, business lines, and nature of operations.
- **FINRA's routine examinations are conducted on a one to four year cycle.**
  - Nonetheless, examination frequency can be modified for various regulatory reasons.
- **Certain events may result in accelerated or special examinations.**

# Sources of Information



# Sources of Information

## Interpretations of Financial and Operation Rules

<http://www.finra.org/Industry/Regulation/Guidance/FOR/>

## FINRA Annual Regulatory and Examination Priorities Letter

<http://www.finra.org/industry/finra-annual-regulatory-and-examination-priorities-letter>

Questions?



# Audit Standards Update

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**Barbara Vanich**

Associate Chief Auditor

December 1, 2015

Las Vegas, NV

# Topics for Discussion

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- ❑ Auditing Standard No. 18, *Related Parties*
- ❑ Going Concern
- ❑ Revenue Recognition

## AS No. 18, *Related Parties*

- ❑ On June 10, 2014, the Board adopted Auditing Standard No. 18, *Related Parties*, amendments regarding significant unusual transactions, and other amendments to PCAOB auditing standards
- ❑ The standard and amendments address:
  - Evaluating a company's identification of, accounting for, and disclosure of, relationships and transactions between the company and its related parties
  - Identifying and evaluating a company's significant unusual transactions
  - Obtaining an understanding of a company's financial relationships and transactions with its executive officers, as part of the auditor's risk assessment process

## **AS No. 18, *Related Parties* (cont'd)**

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- ❑ Auditing Standard No. 18 and the amendments are effective for audits of financial statements for fiscal years beginning on or after December 15, 2014, including reviews of interim financial information within those fiscal years

# Going Concern

- Considering whether changes to PCAOB auditing standards are necessary in view of:
  - Changes to U.S. GAAP, which now require management to evaluate a company's ability to continue as a going concern
- Issued Staff Audit Practice Alert No. 13, *Matters Related to the Auditor's Consideration of a Company's Ability to Continue as a Going Concern* (September 22, 2014)
- Developing a staff consultation paper to solicit public comment

# Going Concern – Staff Audit Practice Alert No. 13

- In evaluating whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, including whether they contain the required disclosures, auditors should assess management's going concern evaluation
  - In making this assessment, the auditor should look to the requirements of the applicable financial reporting framework
- The Alert reminds auditors that AU sec. 341 requirements for the auditor's evaluation, and the auditor's reporting when substantial doubt exists, have not changed and continue to be in effect
- Auditors should continue to look to the existing requirements in AU sec. 341 when evaluating whether substantial doubt exists for purposes of determining whether the auditor's report should be modified

# Revenue Recognition

- ❑ The Office of the Chief Auditor issued Staff Audit Practice Alert No. 12, *Matters Related to Auditing Revenue in an Audit of Financial Statements*, on September 9, 2014, in light of significant audit deficiencies frequently observed by the Board's staff relative to aspects of auditing revenue.
- ❑ The practice alert highlights certain requirements of PCAOB standards relating to aspects of auditing revenue.

# Revenue Recognition(cont'd)

- Significant audit deficiencies in which auditors did not perform sufficient audit procedures with respect to revenue include:
  - The failure to perform sufficient procedures to test whether revenue was recognized in conformity with the applicable financial reporting framework, including whether revenue was recognized in the correct period;
  - The failure to evaluate, or evaluate sufficiently, whether revenue was appropriately disclosed in the financial statements;
  - The failure to address fraud risks regarding revenue;
  - Unsupported reliance on controls over revenue because either controls were not tested sufficiently or identified control deficiencies were not evaluated sufficiently;
  - Unsupported reliance on company-generated data and reports used to audit revenue because the data and reports were not tested or not tested sufficiently;
  - Insufficient testing of revenue transactions, including failure to appropriately apply audit sampling;
  - The failure to perform sufficient substantive analytical procedures; and
  - The failure to sufficiently test revenue in companies with multiple locations or business units.

# Revenue Recognition(cont'd)

- ❑ Specifically, the alert discusses the following topics and related significant audit deficiencies regarding auditing revenue:

## *Testing Revenue Recognition, Presentation, and Disclosure*

- Testing the recognition of revenue from contractual arrangements
- Evaluating the presentation of revenue—gross versus net revenue
- Testing whether revenue was recognized in the correct period
- Evaluating whether the financial statements include the required disclosures regarding revenue

## *Other Aspects of Testing Revenue*

- Responding to risks of material misstatement due to fraud associated with revenue
- Testing and evaluating controls over revenue
- Applying audit sampling procedures to test revenue
- Performing substantive analytical procedures to test revenue
- Testing revenue in companies with multiple locations

# Keeping Current with Standards-Related Activities

- Our website –  
<http://www.pcaobus.org/Standards/Pages/default.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)
- Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our website at:  
<http://pcaobus.org/About/Pages/RSSFeeds.aspx>

# Questions





**Break**

# **Inspections: Case Studies**

**Kate Ostasiewski and Mike Walters**

Division of Registration and Inspections

December 1, 2015

Las Vegas, NV

# Agenda

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- Audit Documentation
- Internal Controls
- Engagement Quality Review

# Summary – Relevant PCAOB Standards

## □ Audit Documentation

- Auditing Standard No. 3, *Audit Documentation*

## □ Internal Controls

- Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*
- Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*
- Auditing Standard No. 14, *Evaluating Audit Results*

## □ Engagement Quality Review

- Auditing Standard No. 7, *Engagement Quality Review*

# Audit Documentation

# Audit Documentation Objectives

AS 3 paragraph 2 describes the objectives of audit documentation:

...Audit documentation also **facilitates the planning, performance, and supervision of the engagement**, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes **records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached** by the auditor...

# Audit Documentation – Work Paper Review

## Exercise

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You are reviewing the work performed related to the audit of Broker-Dealer X, which was conducted in accordance with PCAOB standards.

Refer to the sample 12b-1 receivables and operating expense work papers included in your materials.

What elements of documentation are missing from each work paper, considering the requirements of AS No. 3?

# Documentation of Significant Findings or Issues

Which does not represent a significant finding or issue that must be documented as required by paragraph 12 of AS No. 3?

- a. Accounting principles for revenue recognition of underwriting fees, a new, significant revenue source.
- b. Significant deficiencies in internal control over recognition and/or deferral of revenue recognition.
- c. Audit adjustments – recorded and unrecorded.
- d. Alternative audit procedures performed in conjunction with non-replies to customer account confirmations which revealed no exceptions.
- e. Audit evidence obtained relating to valuation of private-label mortgage-backed securities, an area of significant risk.

# Internal Controls

# Scenario, Part 1 – Internal Controls

## Background

- ❑ XYZ Brokers, Inc., is a registered broker dealer which claims exemption from Rule 15c3-3 and is an audit client of The Audit Firm, LLP.
- ❑ All trades (about 1,000 per month / 12,000 per year) are executed through the clearing broker.
- ❑ XYZ Trades appear similar in nature (mainly equity securities).
- ❑ XYZ's process for recording commissions revenue was uniform throughout the year and occurs monthly.
- ❑ The Audit Firm LLP is engaged to conduct an audit of XYZ Brokers in accordance with PCAOB standards.

# Scenario, Part 1 – Internal Controls (continued)

## Audit Approach

- ❑ Annual commission revenue exceeded auditor materiality.
- ❑ Inherent risk for commission revenue was considered moderate.
- ❑ Control risk was assessed at “moderate to low”.
- ❑ Controls in operation at December 31, 2015, the audit year-end, over all relevant assertions for commission revenue were identified and tested for design and operating effectiveness, without exception.

Has The Audit Firm LLP performed sufficient tests of controls to reduce the nature, timing and extent of planned substantive procedures for the audit period over relevant assertions for commission revenue?

Why or why not?

# Scenario, Part 2 – Internal Controls

## Understanding Gained of XYZ Brokers, Inc. Period-End Financial Reporting Process

- ❑ The Owner of XYZ Brokers, Inc. also serves as the Chief Executive Officer and Chief Compliance Officer for the broker-dealer.
- ❑ The Owner has 20 years of industry experience. Previously, he was a FINOP at another broker-dealer before starting XYZ Brokers, Inc.
- ❑ The Chief Financial Officer is also the FINOP for XYZ Brokers, Inc. She is a CPA who previously worked at an audit firm with several broker-dealer clients.
- ❑ The Chief Financial Officer prepares monthly financial statements, net capital computations, and reviews various reconciliations.

# Scenario, Part 2 – Internal Controls (continued)

## Understanding Gained of XYZ Brokers, Inc. Period-End Financial Reporting Process (continued)

- ❑ Accounting staff consist of a bookkeeper and bookkeeping assistant. Each has taken basic accounting classes. The bookkeeper also has 10 years of industry experience.
- ❑ Accounting staff handle daily accounting, posting to the general ledger and reconciling cash and clearing related accounts monthly.
- ❑ The Owner, the Chief Financial Officer and the accounting staff all have the ability to post journal entries to the QuickBooks general ledger.

What questions would you have if you were The Audit Firm LLP when considering whether controls exist and are designed effectively over the period-end financial reporting process?

# Scenario, Part 3 – Internal Controls

## Testing Controls related to Period-End Financial Reporting

- ❑ For a sample of 2 months The Audit Firm LLP obtained the clearing statement reconciliation package prepared by Accounting Staff at month end.
- ❑ The Audit Firm LLP observed that each package included a reconciliation and supporting documentation, including the clearing firm statement and a copy of the related general ledger balances.
- ❑ The Audit Firm LLP observed that the reconciliation was initialed by the CFO indicating her review and approval.
- ❑ The Audit Firm LLP concluded that controls are operating effectively and reduced the nature, timing and extent of substantive procedures with respect to affected balances.

Given these facts is there sufficient audit evidence to support the operating effectiveness of the CFO's review of reconciliations?

# Scenario, Part 3 – Internal Controls (continued)

## Control Considerations as the Audit Progresses

- ❑ During its substantive procedures over cash, The Audit Firm LLP identified that the operating account balance in the general ledger did not agree with the bank balance at year end.
- ❑ The difference (the general ledger balance was higher) was just under Audit Firm LLP's tolerable misstatement.
- ❑ The cash reconciliation prepared by the Accounting staff also identified the difference, but there was no explanation.
- ❑ The cash reconciliation was signed by the CFO, indicating her review and approval.

Given these facts, pursuant to Auditing Standard No. 14, what should Audit Firm LLP consider when evaluating the results of its audit?

# Engagement Quality Review

# Engagement Quality Review Objectives

The objective of the engagement quality reviewer, as indicated in Auditing Standard No. 7, is to perform an evaluation of the significant judgments made by the engagement team and the related conclusions reached. Given this objective, which of the following do you believe the EQR should review?

- a. Rationale for the assessment of risk of material misstatement for occurrence of underwriting revenue as high, and the audit evidence obtained to respond to the risk.
- b. Walkthrough of controls relating to commissions expense.
- c. Substantive procedures to test the valuation of level 3 securities.
- d. Investment Committee meeting minutes discussing current year portfolio performance and strategy.
- e. a and c.
- f. All of the above.

# Engagement Quality Reviewer Qualifications

Engagement quality reviewers:

- ❑ Must be an associated person of a registered public accounting firm
- ❑ May be
  - A partner or another individual in an equivalent position from the firm that issues the report; or
  - An individual from outside the firm
- ❑ Must have competence, independence, integrity, and objectivity

# Engagement Quality Review Process - Audit

The EQR performed the following procedures below. Which procedure performed **is not** a requirement of Auditing Standard No. 7?

- a. evaluated the overall materiality and tolerable misstatement, and the rationale including XYZ's revenue, regulatory environment, and significant transactions.
- b. evaluated the significant judgments and conclusions made with respect to fraud risks related to revenue recognition and reviewed audit procedures performed to address the risk.
- c. reviewed the engagement work papers relating to the tests of details for fixed assets accounts, balances of which in combination, were quantitatively material.
- d. reviewed client acceptance documentation, including scope of non-audit services provided to XYZ, and evaluated SEC independence implications.

# Questions?

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# Division of Enforcement and Investigations Update

**R. Davis Taylor**

Associate Director, Division of Enforcement  
and Investigations

December 1, 2015

Las Vegas, NV

# Agenda

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- Today we'll discuss:
  - Broker-Dealer Auditor Independence Matters
  - Engagement Quality Review Matters
  - Other Matters of Note

# Broker-Dealer Auditor Independence Matters – December 8, 2014

- ❑ The Board settled disciplinary orders against seven firms for violating independence rules
- ❑ The seven firms prepared at least portions of the financial statements, including notes, filed by their broker-dealer audit clients with the Securities and Exchange Commission
- ❑ The financial statements were also audited by the sanctioned firms
- ❑ Each auditor's preparation of portions of the financial statements was a prohibited non-audit service that impaired independence
- ❑ The SEC simultaneously settled with eight firms for violating independence rules

# Broker-Dealer Auditor Independence Matters – December 8, 2014

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- In each case, the preparation consisted of one or more of the following:
  - Addition or deletion of line items
  - Aggregation of line items
  - Classification of line items
  - Changes to line item descriptions or amounts
  - Addition or deletion of captions
  - Addition of columns or tabular presentations

# Broker-Dealer Auditor Independence Matters – July 9, 2015

- The Board settled disciplinary orders against seven additional firms and two associated persons for independence violations
- The steps taken to prepare the financial statements included same as in December 2014 orders, plus changes to captions and disaggregation of line items
- The offenders fell into three groups:
  - Ordinary offenders
  - Repeat offenders
  - Aggravated repeat offenders

# Broker-Dealer Auditor Independence Matters – July 9, 2015

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- Ordinary offenders
  - Two firms
  - Prepared audit client's financial statements
  - Non-repeat offenders; comparable to seven broker-dealer audit firms sanctioned in December 2014
  - Each firm sanctioned with a censure, a \$2,500 penalty, and remedial measures

# Broker-Dealer Auditor Independence Matters – July 9, 2015

- Repeat offenders
  - Two firms
  - Prepared audit client's financial statements after receiving inspection comments noting that preparation impaired independence
  - Did things differently the next year, but still engaged in financial statement preparation activities
    - *CST Group*: Prepared draft statements with placeholders for dollar amounts
    - *Walker & Armstrong*: Obtained draft but made extensive changes
  - Each firm sanctioned with a censure, a \$7,500 penalty, and remedial measures

# Broker-Dealer Auditor Independence Matters – July 9, 2015

- Aggravated repeat offenders
  - Two firms and two associated persons
  - Prepared audit client's financial statements after receiving inspection comments noting that preparation impaired independence
  - Each firm sanctioned with a censure, a \$20,000 penalty, a 1-year prohibition on new broker-dealer clients, and remedial measures
  - Each associated person sanctioned with a censure and a 1-year bar from association with a registered firm
  - One associated person also sanctioned with a \$10,000 penalty; other associated person was sole owner of firm

# Broker-Dealer Auditor Independence Matters – July 9, 2015

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- ❑ The Board also announced that an unnamed eighth firm had prepared financial statements, but would not be sanctioned
- ❑ The Board awarded credit for extraordinary cooperation based on the firm's:
  - ❑ Timely and voluntary self-reporting to the PCAOB Tip Line; and
  - ❑ Timely, voluntary, and meaningful remedial actions, including communicating the violation to the client and discussing the conduct and violation at an annual firm training session

# Engagement Quality Review Matters – July 23, 2015

- ❑ The Board settled disciplinary orders against seven firms and seven associated persons for conduct including violations of AS 7, *Engagement Quality Review*
- ❑ AS 7 requires EQRs of audits, interim reviews, and examinations/reviews of broker-dealer compliance/exemption reports
- ❑ Each firm violated one of two requirements:
  - ❑ 5 firms - EQR requirement: “An engagement quality review and concurring approval of issuance are required....” (AS 7 ¶ 1) “In an audit, the firm may grant permission to the client to use the engagement report only after the engagement quality reviewer provides concurring approval of issuance.” (AS 7 ¶ 13)
  - ❑ 2 firms - cooling off requirement: “The person who served as the engagement partner during either of the two audits preceding the audit subject to the engagement quality review may not be the engagement quality reviewer.” (AS 7 ¶ 8)

# Engagement Quality Review Matters – July 23, 2015

- With respect to sanctions, the firms fell into three groups:
  - One or two violations of cooling off requirement  
**= censure**
  - One or two violations of requirement to have EQR performed  
**= censure, remedial measures, penalty (\$5K, \$7.5K)**
  - Multiple violations of requirement to have EQR performed  
**= censure, revocation, larger penalty (\$10K, \$15K)**
- Two cases included other conduct (*e.g.*, audit standard violations)
- Each associated person sanctioned with censure and bar (where firm received revocation) or otherwise censure
- Note in particular:
  - *R.R. Hawkins*: Inspectors had reminded firm of requirement
  - *Keith K. Zhen, CPA*: Firm had EQR done in earlier audits

## Other Matters of Note

- ❑ Akiyo Yoshida, CPA (Dec. 17, 2014)
- ❑ Morrill & Associates, LLC, Douglas W. Morrill, CPA, and Grant L. Hardy, CPA (Jan. 12, 2015)
- ❑ David A. Aronson, CPA, P.A. and David A. Aronson, CPA (Oct. 2, 2015)
- ❑ Ron Freund, CPA (Jan. 25, 2015) (adjudicated proceeding)

<http://pcaobus.org/Enforcement/Decisions/Pages/default.aspx>

# PCAOB Center for Enforcement Tips, Complaints and Other Information

- ❑ Website:  
<http://pcaobus.org/Enforcement/Tips/Pages/default.aspx>
- ❑ E-mail: [TIPS@pcaobus.org](mailto:TIPS@pcaobus.org)
- ❑ Letter           PCAOB Complaint Center  
                      1666 K Street, NW  
                      Washington, DC 20006
- ❑ FAX:             202-862-0757
- ❑ Telephone:    800-741-3158

# Questions



# Lunch

(75 minutes)

# **Inspections: Observations and Trends**

**Bob Maday and Kate Ostasiewski**

Division of Registration and Inspections

December 1, 2015

Las Vegas, NV

# Agenda

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- ❑ Summary of Interim Inspection Program
- ❑ 2015 Inspection Plan
- ❑ Inspection Observations
- ❑ Actions for Auditors
- ❑ Questions

## Interim Inspection Program - Objective

- ❑ Assess compliance with applicable Board and Commission rules and professional 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

# Interim Inspection Program and Status of Permanent Program

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- ❑ Interim Inspections
  - ❑ Continue
  - ❑ Results
- ❑ Permanent Inspection Program
  - ❑ Rule Proposal Process
  - ❑ Timing

# Interim Inspection Process

- ❑ Communication and scheduling
- ❑ Inspection of audit work
- ❑ Information gathering
- ❑ Communication of findings/observations
- ❑ Firm response to findings and responsibilities
- ❑ Reporting
- ❑ Communication with the SEC and other regulators
- ❑ Enforcement

# 2015 Interim Inspection Program Plan

- ❑ Audits of brokers and dealers, which are required to be performed in accordance with PCAOB standards
- ❑ Examination and Review Engagements, also to be performed in accordance with PCAOB standards
- ❑ Continue to increase inspection coverage
  - ❑ 75 firms and portions of 115 audit and attestation engagements

## 2015 Interim Inspection Program Plan (continued) – Areas of Inspection Focus

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- ❑ Audit deficiencies in the financial statement audit
- ❑ Attestation standards
- ❑ Auditing supplemental information accompanying audited financial statements
- ❑ Engagement Quality Review
- ❑ Auditor independence

# 2015 Inspections – Observations

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- ❑ Financial Statement Audit
- ❑ Attestation standards
- ❑ Supplemental information
- ❑ Engagement Quality Review
- ❑ Independence

# Interim Inspection Program – Reporting

## ❑ Past Annual Reports

- 2011 - inspected 10 Firms and portions of 23 audits
- 2012 - inspected 43 Firms and portions of 60 audits
- 2013 - inspected 60 Firms and portions of 90 audits

## ❑ Supplemental Report

- Inspected 5 firms and portions of 5 audits

## ❑ Inspections – 2015 Annual Report

- 2014 - inspected 66 firms and portions of 106 audits

# 2014 Inspections - PCAOB Standards

- ❑ Inspected five firms covering one audit at each
- ❑ Observations:
  - Audit Opinion
  - Examination Report / AT1
  - Review Report / AT2
  - Engagement Quality Review / AS7
  - Engagement Completion Document / AS3
  - Other Deficiencies Similar to Previously Reported

## Interim Inspection Program – 2014

- ❑ Covered 66 firms and portions of 113 audits
- ❑ Continued coverage of cross-sections of firms and brokers and dealers
- ❑ Included seven current audits by seven firms previously inspected
- ❑ Observations similar to past inspections, including independence findings

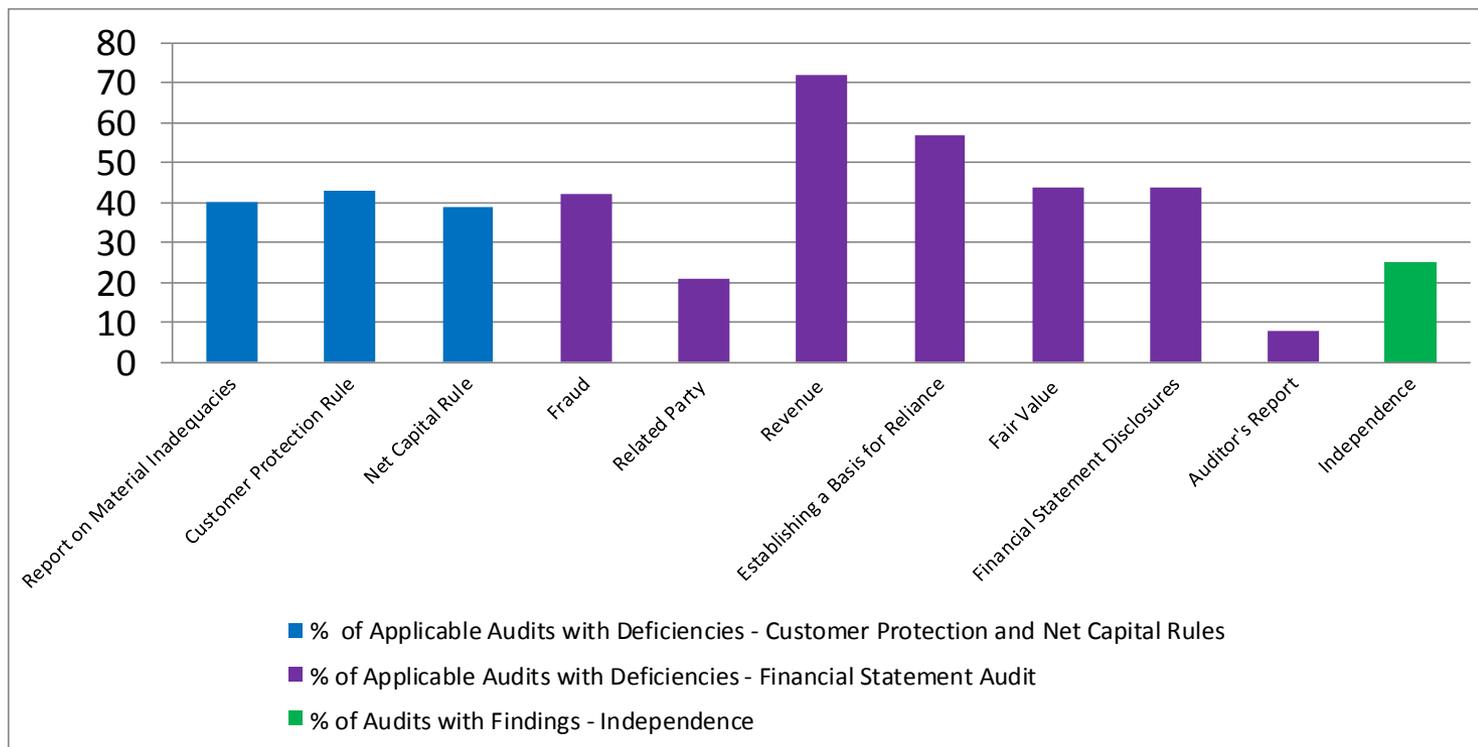
## Interim Inspection Program - Disclaimer

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The information presented in the following slides is not necessarily indicative of the population of firms or of audits of brokers and dealers because the selection of firms and of audits of brokers and dealers for inspection is not necessarily representative of these populations.

# Inspections Observations by Audit Area - 2014

## % of Applicable Audits with Observations



# Compliance with Independence Requirements - 2014

24 out of 66 Firms failed to satisfy independence requirements by:

- ❑ Preparing, or assisting in the preparation of financial statements or supporting schedules
- ❑ Preparation of journal entries or source data underlying the financial statements
- ❑ Indemnity clauses included in the engagement letter

# Compliance with Independence Requirements - 2014 (continued)

- ❑ Auditors of brokers and dealers registered with the SEC are subject to SEC independence requirements in (b) and (c) of Rule 2-01 of Regulation S-X.
- ❑ Effective for fiscal years ending on or after June 1, 2014 certain PCAOB independence rules apply to auditors of broker-dealers

# Net Capital Requirements and Customer Protection Rule - 2014

Deficiencies noted related to testing compliance with *net capital requirements*:

- ❑ Minimum net capital requirements
- ❑ Allowable assets
- ❑ Haircuts

Deficiencies noted related to testing compliance with the *customer protection rule*:

- ❑ Customer credits or debits
- ❑ Special Reserve Bank Account
- ❑ Possession or control requirements

# Net Capital Requirements and Customer Protection Rule - 2014 (continued)

Effective for fiscal years ending on or after June 1, 2014:

- ❑ Auditing Standard No.17 – Auditing Supplemental Information Accompanying Audited Financial Statements
- ❑ Attestation Standard No. 1 – Examination Engagements Regarding Compliance Reports of Brokers and Dealers
- ❑ Attestation Standard No. 2 - Review Engagements Regarding Exemption Reports of Brokers and Dealers

# Financial Statement Audit - 2014

The most frequent audit deficiencies related to:

- ❑ Revenue (72%)
- ❑ Reliance on Records and Reports (57%)
- ❑ Fair Value Accounting Estimates (44%)
- ❑ Financial Statement Presentation and Disclosures (44%)

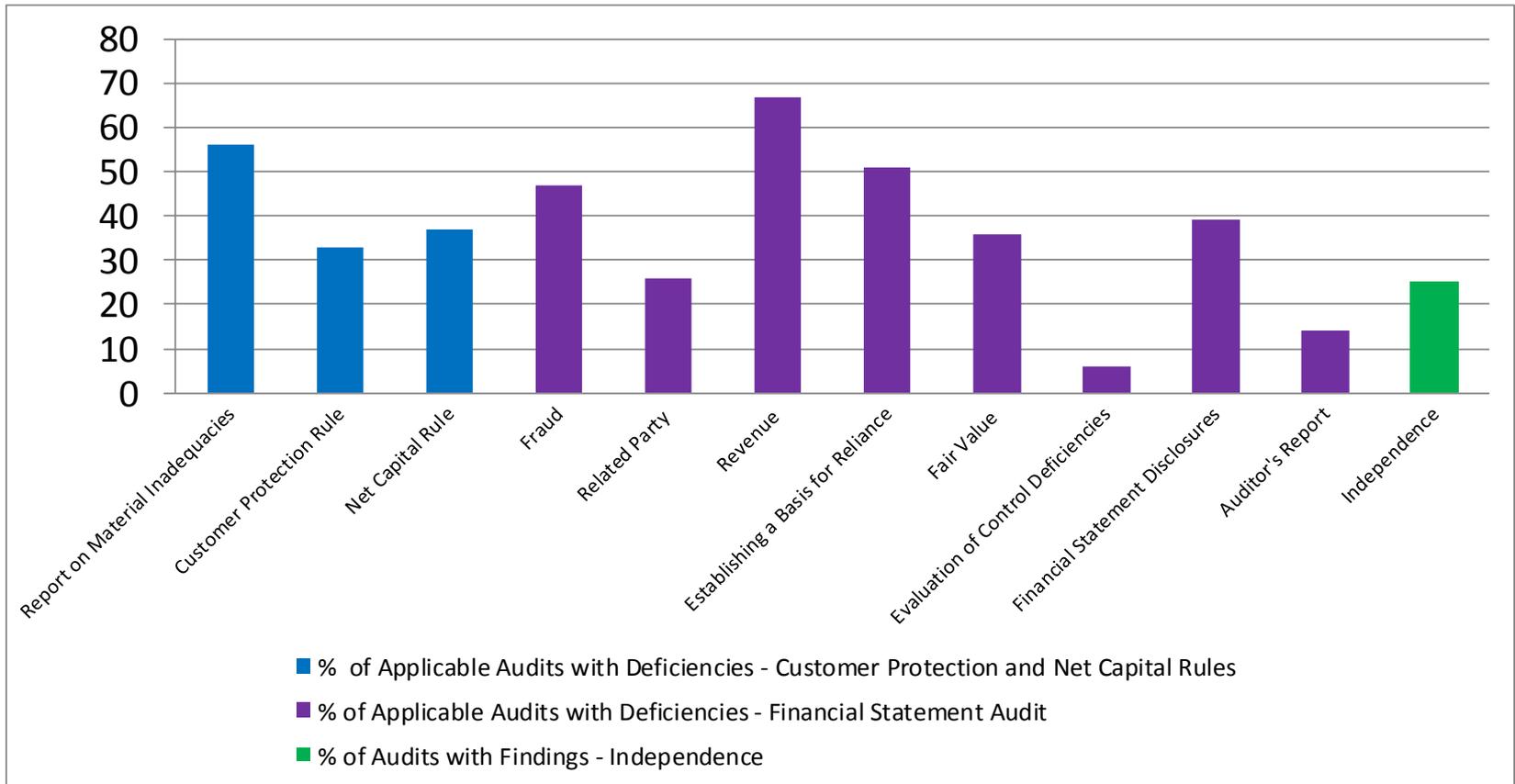
# Financial Statement Audit – 2014 (continued)

## Inspection Observations and Relevant PCAOB Standards

	Audit Procedure	PCAOB Standard(s)
<b>Revenue</b>	<ul style="list-style-type: none"> <li>• <i>Identifying and Assessing Risk</i></li> <li>• <i>Responding to Risk of Material Misstatement</i></li> <li>• <i>Substantive Analytical Procedures</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AS 12</b></li> <li>• <b>AS 13</b></li> <li>• <b>AU 329</b></li> </ul>
<b>Fraud</b>	<ul style="list-style-type: none"> <li>• <i>Identifying and Assessing Risk</i></li> <li>• <i>Responding to Fraud Risk</i></li> <li>• <i>Addressing Risk of Management Override</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AS 12</b></li> <li>• <b>AS 13</b></li> <li>• <b>AU 316</b></li> </ul>
<b>Related Parties</b>	<ul style="list-style-type: none"> <li>• <i>Identifying RP Relationships/Transactions</i></li> <li>• <i>Evaluating RP Accounting and Disclosure</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AU 334</b></li> </ul>
<b>Basis for Reliance</b>	<ul style="list-style-type: none"> <li>• <i>Evaluating Sufficiency of Audit Evidence</i></li> <li>• <i>Use of Service Organizations</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AS 15</b></li> <li>• <b>AU 324</b></li> </ul>
<b>Evaluation of Deficiencies</b>	<ul style="list-style-type: none"> <li>• <i>Responses to Risk of Material Misstatement</i></li> <li>• <i>Evaluating Audit Results</i></li> <li>• <i>Communications about Control Deficiencies</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AS 13</b></li> <li>• <b>AS 14</b></li> <li>• <b>AU 325</b></li> </ul>
<b>FS Disclosures</b>	<ul style="list-style-type: none"> <li>• <i>Evaluating FS Presentation, Including Disclosures and Communicating Results</i></li> </ul>	<ul style="list-style-type: none"> <li>• <b>AS 14</b></li> <li>• <b>AS 16</b></li> </ul>

# Inspections Observations by Audit Area - Inception of the Program Through 2014

## % of Applicable Audits with Observations



# Summary of Inspection Observations: Since Inception of Interim Inspection Program

- ❑ Observations identified in portions of approximately 87% of audits (243 of 279)
- ❑ Independence findings identified in 71 of 279 audits
- ❑ Higher percentage of audits with deficiencies during 2014 as compared to 2013
- ❑ Deficiencies were found across various stratifications of *firm* characteristics
- ❑ Deficiencies were found across various stratifications of *broker-dealer* characteristics

# Actions for Auditors

- ❑ Take appropriate action when audit deficiencies are discovered after the date of the audit report
- ❑ Be proactive – seek ways to better anticipate and address risks
- ❑ Take action now regarding identified independence and audit deficiency observations
- ❑ Review PCAOB guidance and participate in periodic Forums and webcasts

# Questions?

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# **Risk Assessment and Related Case Studies**

**Kate Ostasiewski, Greg MacCune and Mike Walters**

Division of Registration and Inspections

December 1, 2015

Las Vegas, NV

# Agenda

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- Objectives
- PCAOB Risk Assessment Standards
- Case Study

# Objectives

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- ❑ Demonstrate the role of risk assessment throughout the audit process
- ❑ Emphasize coordination of the audit of the financial statements, audit procedures performed on supplemental information and the examination or review engagement
- ❑ Target case study examples in areas where the PCAOB has identified recurring audit quality deficiencies

# PCAOB Risk Assessment Standards

- ❑ Auditing Standard No. 8, *Audit Risk*
- ❑ Auditing Standard No. 9, *Audit Planning*
- ❑ Auditing Standard No. 10, *Supervision of the Audit Engagement*
- ❑ Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*
- ❑ Auditing Standard No. 12, *Identifying and Assessing the Risks of Material Misstatement*
- ❑ Auditing Standard No. 13, *The Auditor's Responses to the Risk of Material Misstatement*
- ❑ Auditing Standard No. 14, *Evaluating Audit Results*
- ❑ Auditing Standard No. 15, *Audit Evidence*

# Case Study – Trusted Securities, Inc.

# Background

- ❑ Trusted Securities Inc. (TSI) is an introducing broker-dealer and also trades for its own account
  - Historically reported \$100,000 minimum capital requirement
  - Historically claimed an exemption under Rule 15c3-3 under paragraph (k)(2)(ii)
  - Has a clearing and custody arrangement with Clearview
- ❑ TSI is 100% owned by Trusted Parent, Inc. (TPI), which has another subsidiary: Affiliated Securities, Inc. (ASI)
- ❑ ASI engages in proprietary trading and is introduced on a fully disclosed basis to Clearview by TSI
- ❑ Key personnel at TSI include: the President, the FINOP, an Investment Officer, accounting and support staff and 50 registered representatives across 8 cities
- ❑ TSI employees operate out of office space leased from TPI

# Background (*continued*)

- ❑ TSI's customer base is primarily individuals, with some institutional customers
- ❑ TSI has a standard customer agreement with standard commission rates by product type
- ❑ TSI receives a significant number of securities orders (both fixed income and equity) each month
- ❑ TSI maintains a blotter of trades and records of aggregate trade volume by security type
- ❑ TSI receives monthly statements from Clearview which are used by accounting staff to record commissions earned in the general ledger
- ❑ Clearview statements include both trade-level detail and monthly totals

# Planning, Risk Assessment and Materiality

## □ Revenue

- Inquired of FINOP and Accounting personnel to update understanding of TSI's process for recording revenue
- Inherent risk high for occurrence, moderate for all other assertions
- Improper revenue recognition related to the occurrence of commissions revenue is both a significant risk and a fraud risk

# Materiality

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- ❑ Overall materiality for financial statements set at \$40,000
- ❑ Tolerable misstatement set at \$30,000
- ❑ \$40,000 used as materiality for audit of supplemental information

# Planning, Risk Assessment and Materiality

## □ Supplemental Information

- Excess net capital several times actual minimum net capital requirement
- Significant to net capital computation: commissions receivable, securities owned (haircuts) and the net capital requirement (minimum dollar amount and aggregate indebtedness computation)
- Risk of Material Misstatement assessed at low

# Planning, Risk Assessment and Materiality

## □ Review of Exemption Report

- Key personnel are experienced, competent and have not changed
- All key personnel and processes operate from corporate location
- TSI claimed a (k)(2)(i) exemption in its Exemption report, in addition to (k)(2)(ii)
- TSI identified two exceptions to the identified exemption provisions in its Exemption report
- Risk of misappropriation of assets considered low

# Engagement Coordination

- Engagement partner to discuss basis for exemption claim and any related change in business with FINOP
- Engagement team coordinated responsibility for review of key documents that could affect various parts of audit and review engagements
- Audit and supplemental information procedures coordinated:
  - Commissions Receivable
  - Securities Owned
  - Net Capital

# Questions and Discussion

# Response to Risk Assessment - Commissions

- ❑ Control Risk high for all assertions
- ❑ Performed substantive tests of detail
- ❑ Three scenarios:
  - Scenario #1 – use of Clearview as a service organization
  - Scenario #2 – performed substantive tests of Clearview information
  - Scenario #3 – performed substantive tests of Clearview information

# Questions and Discussion

# Results of Commissions Testing

- Performed substantive procedures and found no audit differences
- Obtained and read TSI's updated membership agreement with FINRA
  - Approved to act as placement agent for private securities offerings
  - Earns revenue based on percentage of investment amount
- Met with President and FINOP to obtain more information to evaluate significance of new business
- Total placement fees earned for 2015 were \$260,000 of which \$100,000 was uncollected at December 31, 2015

# Questions and Discussion

# Revenue – Updated Audit Response

- ❑ Inherent risk high for completeness and occurrence, moderate for all other assertions
- ❑ Revenue recognition and cutoff identified as both significant and fraud risks
- ❑ Control risk high for all assertions
- ❑ Performed substantive tests of detail
- ❑ Performed additional procedures

# Questions and Discussion

**BREAK – 15 Minutes**

# Response to Risk Assessment - Supplemental Information

- ❑ Evaluated methods to prepare supplemental information and inquired regarding changes
- ❑ Tested 3 months (including December) net capital computation and FOCUS filing
- ❑ For December net capital computation:
  - Assessed treatment of commissions receivables
  - Tested securities haircuts and supporting information
- ❑ Identified that TSI included placement fees of \$100,000 as allowable for net capital purposes
- ❑ Resulted in an overstatement of net capital at December 31, 2015

# Questions and Discussion

# Review Procedures

- Reviewed documents including:
  - FINRA membership agreement
  - Current year FINRA examination letter
  - Current BrokerCheck report
  - Written Supervisory procedures manual
  - Example registered representative agreement
  - Customer complaint log
- Inquired of the President, FINOP, accounting personnel and two registered representatives
- Reviewed documentation supporting two instances of non-compliance identified and reported by TSI
- Performed additional procedures regarding (k)(2)(ii) exemption

# Questions and Discussion

# PCAOB/SEC/FINRA Panel

**Moderator: Jay Hanson**

# Closing Remarks

**Jay Hanson**