

# Forum for Auditors of Broker-Dealers

July 10, 2018

Denver, CO

# Welcome

Greg Scates, Director

Office of Outreach and Small Business  
Liaison

# Caveat

One of the benefits of today's session is that you will hear firsthand from numerous PCAOB staff members. 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.

# Learning Objective and Course Description

## Learning Objective

The PCAOB Forum for Auditors of Broker-Dealers is a one-day session that will offer attendees the opportunity to learn about the audit and attestation standards and rules related to broker-dealer audit and attestation engagements and interact with staff from the PCAOB, SEC, and FINRA. The Forum features a panel discussion on the required engagement quality review and a case study covering auditing revenue and testing controls. Additional sessions include updates from the SEC and FINRA along with updates from the PCAOB's Inspections, Enforcement, and Standards groups. The Forum provides the opportunity for participants to ask questions of all the presenters.

## Course Description

The PCAOB Forum for Auditors of Broker-Dealers is intended to assist auditors in furthering their understanding of audit and attestation standards and rules relevant to audit and attestation engagements for broker-dealers.

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFDEN2018>

# Stay Connected

- ❑ Stay up-to-date on current PCAOB activities (including announcements about future forums!) by signing up for our email list.

<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>

# CPE Credit

Name of Participant	
Firm	

**LEGIBLE** name and firm name

**MARK** sessions attended

**Add/Divide** Minutes

**SIGN** and **DATE**

<u>Session Title</u>	<u>Auditing Minutes</u>
Board Member Perspective	20
Panel: Engagement Quality Review	40
SEC Update	35
New Auditor's Report	30
FINRA Perspectives	45
Case Study: Revenue and Tests of Controls (Part 1)	30
Case Study: Revenue and Tests of Controls (Part 2)	80
Enforcement Update	30
Inspections Update	30
Standards Update	30
Q&A and Closing Remarks	30
<b>Total Minutes (400)</b>	400
<b>Total Minutes Divided by 50</b>	8

Signature \_\_\_\_\_ Date \_\_\_\_\_

# Polling and Messaging

- ❑ Use the following URL in your internet browser:

<https://web.meetoo.com/m#/125335506>

**OR**

- ❑ Download the Meetoo app (iOS and Android) and enter meeting ID  
**125-335-506**

# How many broker-dealers audits do you perform annually?

1. 0-5
2. 6-10
3. 11-20
4. 21 or more

Do you perform audits of clearing broker-dealers?

1. Yes
2. No

# How much broker-dealer industry experience do you have?

1. 0-5 years
2. 6-10 years
3. 11-15 years
4. 16 or more years

# Board Member Perspective

Kathleen Hamm

Board Member

# Panel Discussion: Engagement Quality Review

Greg Scates, Moderator

Greg MacCune, Inspections

Mike Walters, Inspections

Lisa Calandriello, Standards

# Discussion Topics

- Inspection findings and experience
- Possible root causes
- Qualifications to serve
- Required procedures
- Documentation

# What is your experience as an EQR?

- 1 I am not a partner or partner equivalent and have never performed an EQR
- 2 I am a partner or partner equivalent and have never performed an EQR
- 3 I have performed EQRs for broker-dealer engagements
- 4 I have performed EQRs for other engagements
- 5 Both 3 and 4.

# Panel Discussion: Engagement Quality Review

# What was the most common EQR deficiency cited in the most recent Annual Report on the Interim Inspection Program?

- 1 Failure to have an EQR
- 2 Sufficiency of the review procedures performed
- 3 Qualifications of the EQR
- 4 Other

# Panel Discussion: Engagement Quality Review

# Summary of Deficiencies in Engagement Quality Reviews

Deficiencies Related to Engagement Quality Review	Number of Audits	Number of Reviews	Number of Examinations
Performance of an engagement quality review	8	8	0
Insufficient review by the engagement quality reviewer	57	15	4
Engagement quality reviewer qualifications	4	3	1

Source: 2017 Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers.

# What is the greatest challenge in having an effective EQR on BD engagements?

- 1 Finding a qualified reviewer
- 2 Coordinating the timing of the review
- 3 Conducting the review or responding to EQR comments
- 4 Identifying the aspects of the engagements to communicate or to review
- 5 Something else

# Panel Discussion: Engagement Quality Review

# Qualifications of an EQR

- ❑ Associated person
  - ❑ Partner or “equivalent position”
  - ❑ Outside reviewer
- ❑ Objectivity
  - ❑ Engagement responsibilities
  - ❑ “Cooling-off” period
- ❑ Competence

# Which of the following is true?

- 1 My firm has less than five issuer audit clients and less than ten partners
- 2 My firm has five or more issuer audit clients or more than ten partners
- 3 I'm not certain of the number of issuer audit clients and partners at my firm

# Panel Discussion: Engagement Quality Review

# Summary of Documentation Deficiencies

Deficiencies Related to Documentation	Number of Audits	Number of Reviews	Number of Examinations
Engagement completion document	9	9	1
Documentation of significant findings or issues	21	11	0
Other documentation matters	3	0	1

Source: 2017 Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers.

A standard checklist is an appropriate engagement completion document.

- 1 True
- 2 False
- 3 It depends

# Questions?





# PCAOB Forum for Auditors of Broker-Dealers: SEC Update

July 10, 2018

Andrew Pidgeon, Professional Accounting Fellow – Accounting  
Tom Collens, Professional Accounting Fellow – Professional Practice  
Office of the Chief Accountant  
U.S. Securities and Exchange Commission

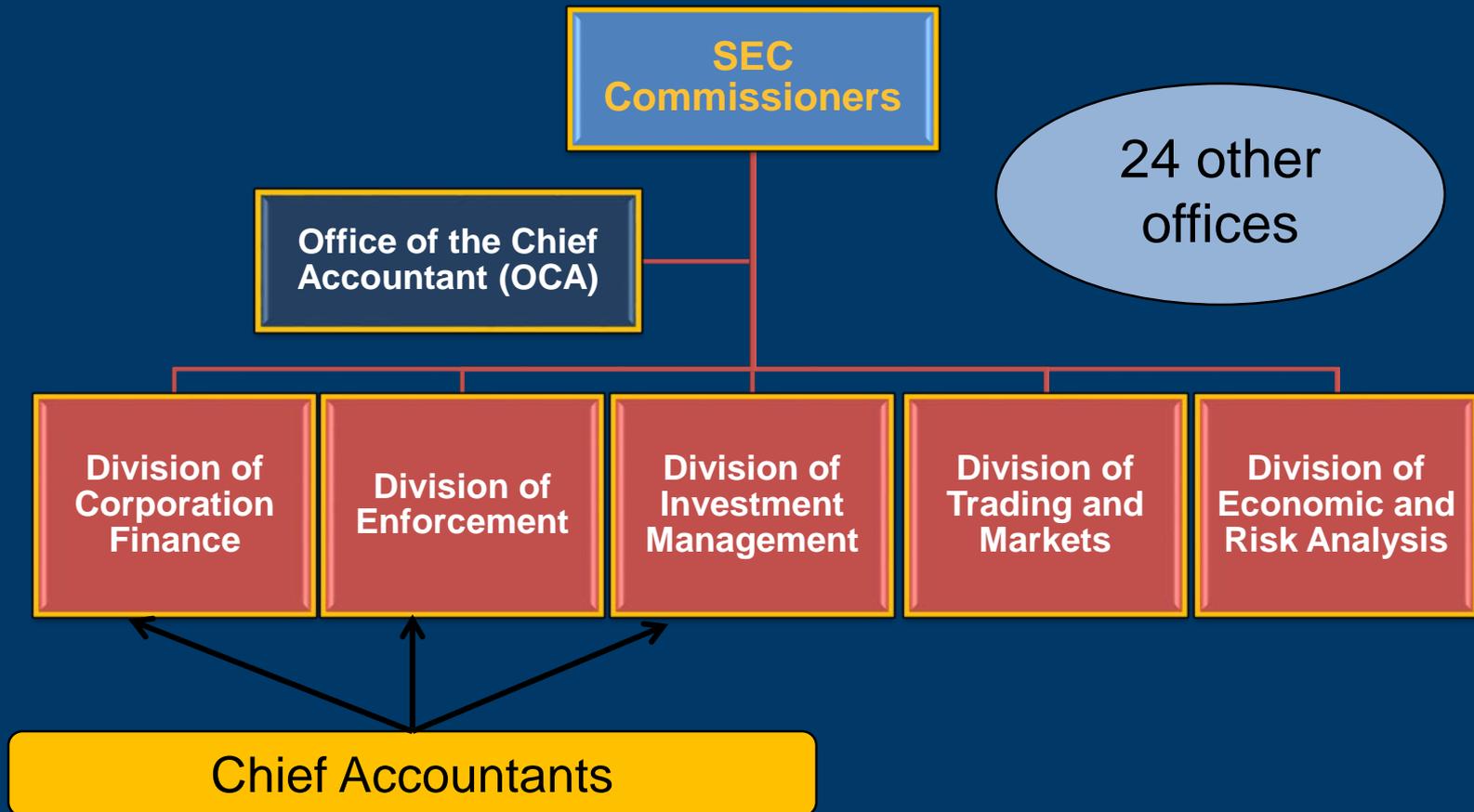
## Disclaimer

The Securities and Exchange Commission (“SEC” or “Commission”) disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. The views expressed herein are those of the speaker and do not necessarily reflect the views of the Commission, the Commissioners, or other members of the staff.

# Agenda

- Office of the Chief Accountant (OCA) – Overview
- OCA – Accounting update
- OCA – Professional Practice update

# OCA – Overview: SEC structure



# OCA – Overview: Responsibilities

- Principal adviser to the Commission on accounting and auditing matters
- Rulemaking, interpretive guidance, and reports
- Oversight and monitoring of standard setting
- Consultations

# OCA – Overview: Main groups

- Accounting
- Professional Practice
- International
- Office Chief Counsel and Enforcement Liaison

# OCA - Accounting

# Accounting: Workstreams

- Operations (including rulemaking support)
- Consultations
- Oversight/monitoring of accounting standards:
  - Financial Accounting Standards Board (FASB)
  - International Accounting Standards Board (IASB)
- New U.S. GAAP standards – transition

# Accounting: New standard implementation

- Revenue standard (2018)
- Leases standard (2019)
- Credit losses standard (2020)

# Accounting: New revenue standard

- Thank you
- OCA's role in implementation
  - Monitoring implementation groups (TRG and AICPA task forces)
  - Participating in meetings with preparers, industry groups, and accounting firms to understand application issues
  - Providing staff views through the consultation process
  - Delivering over 20 OCA staff speeches in 3 years
- Disclosures – continue monitoring
- OCA staff will continue to respect well-reasoned, practical judgments when grounded in the principles of the new standard

# Accounting: New leases standard

- Impacts any registrant with leasing activities
- FASB objective was to increase transparency and comparability
  - Standard addresses primary objective of the 2005 SEC staff report on off-balance sheet arrangements
  - Limits the costs of implementation by leveraging existing lease classification for expense attribution
  - Improved disclosures will aid in understanding amount, timing and uncertainty in cash flows
- OCA staff engaging in dialogue with various constituents on implementation questions

## Accounting: New leases standard (cont.)

- Lessor costs
- Combination/separation of lease/non-lease components
- Consultations
- Disclosures
- OCA staff is available for consultation!

# OCA – Accounting: Recent matters

# Accounting: Recent matters

## Staff Accounting Bulletin No. 118

- Staff Accounting Bulletin No. 118 (SAB 118) was issued in response to concerns expressed by preparers and other constituents regarding scope of changes of Tax Cuts and Jobs Act (TCJA) and requirement under ASC 740 to recognize tax effects in period of enactment
- Permits use of a measurement period approach when the accounting for certain tax effects of the TCJA is incomplete
- Provisional amounts may be recorded for specific tax effects that are incomplete where a reasonable estimate can be made

# Accounting: Recent matters

## Staff Accounting Bulletin No. 118 (cont.)

- Provisional amounts should be updated and recorded as current period adjustments during the measurement period as additional information is obtained, prepared or analyzed
- Measurement periods begins on the enactment date (December 22, 2017) and ends when the accounting for the specific tax effects is completed, not to exceed one year from the enactment date
- Various disclosures are required where material if provisional amounts are recorded under SAB 118

# Accounting: Recent matters

## Trends in accounting restatements

- Three accounting areas most commonly identified in a restatement:
  - Debt/equity accounting
  - Income tax accounting
  - Statement of cash flows classification
- Continuing assessment of resources
  - Sufficient training and competence
  - Accounting policy function
  - Qualified service provider

# Accounting: Recent matters

## Trends in accounting consultations

- Most frequently consulted topics in 2017:
  - Revenue Recognition
  - Business Combinations
  - Financial Assets
  - Financial Statement Presentation
  - Consolidations

# **OCA – Professional Practice: Update**

# Professional Practice: Topics

- Responsibilities
- Internal control over financial reporting (ICFR)
- Auditor's reporting model
- Auditor independence

# Professional Practice: Responsibilities

- Assist in Commission oversight of the PCAOB
- ICFR
- Audit committee disclosure and communications
- Auditor independence
- Other activities:
  - Enforcement assistance
  - Rulemaking support

# Professional Practice: ICFR

- Importance of ICFR to:
  - Investors
  - Management
  - Audit committees
- Working together – audit committees, auditors, and management
- New GAAP standards
- Identification of material weaknesses

# Professional Practice: Auditor's Reporting Model

- Commission approved on October 23, 2017
- Implementation considerations:
  - Changes effective for audits of fiscal years ending on or after December 15, 2017, except for the requirements related to critical audit matters
  - Critical audit matters

# Professional Practice: Auditor Independence Rules for Audits of Brokers and Dealers

- Auditors of brokers and dealers are required to be qualified and independent in accordance with SEC and PCAOB rules
- Auditors of non-issuer brokers and dealers are not subject to SEC rules related to:
  - Partner rotation
  - Partner compensation arrangements
  - Audit committee administration
  - Certain provisions regarding financial reporting oversight roles
- Auditors of non-issuer brokers and dealers are also not subject to certain PCAOB independence rules

# Professional Practice: Auditor Independence – Rule 2-01

- Consider rule 2-01 of Regulation S-X when evaluating a relationship or provision of service that:
  - Creates a mutual or conflicting interest between the accountant and the audit client;
  - Places the accountant in the position of auditing his or her own work;
  - Results in the accountant acting as management or an employee of the audit client; or
  - Places the accountant in a position of being an advocate for the audit client

# Professional Practice: Auditor Independence – Rule 2-01 (cont.)

- Rule 2-01(c) specifically addresses financial relationships, non-audit services, contingent fees, partner rotation, and audit committee administration of the engagement
- Prohibited non-audit services include:
  - Bookkeeping or other services related to the accounting records or financial statements of the audit client
  - Financial information systems design and implementation
  - Appraisal and valuation services, fairness opinions, or contribution-in-kind reports
  - Actuarial services
  - Internal audit outsourcing services
  - Management functions
  - Human resources
  - Broker-dealer, investment adviser, or investment banking services
  - Legal services
  - Expert services unrelated to the audit

# Professional Practice: Bookkeeping / Financial Statement Preparation

- Auditors should not provide bookkeeping services whether through an explicit engagement or through informal support
- Auditors should not provide typing, word processing services, or any other administrative support related to the production of the financial statements
- Auditors should not provide financial statement templates that are not available publicly to broker or dealer audit clients

# Professional Practice: Auditor Independence Resources

- Rule 2-01 of Regulation S-X
  - [https://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:3.0.1.1.8&rgn=div5%20-%2017:3.0.1.1.8.0.18.3#se17.3.210\\_12\\_601](https://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:3.0.1.1.8&rgn=div5%20-%2017:3.0.1.1.8.0.18.3#se17.3.210_12_601)
- SEC - Auditor Independence FAQ's
  - <https://www.sec.gov/info/accountants/ocafagaudind080607.htm>
- SEC Release - Strengthening the Commission's Requirements Regarding Auditor Independence
  - <https://www.sec.gov/rules/final/33-8183.htm>
- SEC Release - Revision of the Commission's Auditor Independence Requirements
  - <https://www.sec.gov/rules/final/33-7919.htm>

**BREAK (15 minutes)**

# New Auditor's Report

Lisa Calandriello, Associate Chief Auditor  
Office of the Chief Auditor

# Overview of the New Auditor's Report

- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ Retains pass/fail opinion but makes significant changes to the auditor's report:
  - ❑ Critical audit matters
  - ❑ Additional improvements

# New Auditor's Report – Overview of Key Changes Effective December 15, 2017



- ❑ Basic Elements and Form of Auditor's Report
  - ❑ Required order of the "Opinion on the Financial Statements" and "Basis for Opinion" sections
  - ❑ Section titles
  - ❑ Required addressees
  - ❑ Indication that the notes are part of the financial statements
  - ❑ Statement on auditor independence
  - ❑ New phrase "whether due to error or fraud"
  - ❑ New language about the nature of the audit that aligns with the risk assessment standards
  - ❑ Auditor tenure

**These key changes apply to audits conducted under PCAOB standards**

# New Auditor's Report – Auditor Tenure

The auditor's report must include a statement containing the year the auditor began serving consecutively as the company's auditor.

- ❑ Determining Auditor Tenure
  - ❑ Reflect the entire relationship between the company and the auditor
    - ❑ The auditor's relationship with the company is not affected by the company's status as a public company
  - ❑ Calculate taking into account firm or company mergers, acquisitions, or changes in ownership structure



# Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in December 2011 to audit W Broker's financial statements for the years ended December 31, 2012.
  
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  - ❑ 2011
  - ❑ 2012

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1. 2011
2. 2012

# Auditor Tenure – Example A

- ❑ The auditor signs the engagement letter in December 2011 to audit W Broker's financial statements for the years ended December 31, 2012.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1. **2011**

2. 2012

# Auditor Tenure – Example B

- ❑ Auditor ABC cannot locate the initial engagement letter nor do they know when the firm began performing audit procedures for W Broker either by looking at the firm or broker records.
- ❑ However, auditor ABC knows that they issued the first auditor's report on W Broker's financial statements for the year ended December 31, 1990 in March 1991.
- ❑ The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as W Broker's auditor.
  - ❑ 1990
  - ❑ 1991
  - ❑ 1992

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as W Broker's auditor.

1. 1990
2. 1991
3. 1992

# Auditor Tenure – Example B

- ❑ Auditor ABC cannot locate the initial engagement letter nor do they know when the firm began performing audit procedures for W Broker either by looking at the firm or broker records.
- ❑ However, auditor ABC knows that they issued the first auditor's report on W Broker's financial statements for the year ended December 31, 1990 in March 1991.
- ❑ The auditor would state in the auditor's report \_\_\_\_ as the year the auditor began serving consecutively as W Broker's auditor.

1990

**1991**

1992

However, if the auditor estimates that in order to issue the auditor's report in 1991, the work would have commenced in 1990, the auditor could state 1990 as the year the auditor began serving consecutively as the company's auditor.

# Auditor Tenure – Example C

- ❑ Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- ❑ Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- ❑ The auditor would state in the auditor's report \_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.
  - ❑ 1997
  - ❑ 2002
  - ❑ 2017
  - ❑ 2018

The auditor would state in the auditor's report \_\_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1. 1997
2. 2002
3. 2017
4. 2018

# Auditor Tenure – Example C

- Auditor ABC has been the auditor of Company X since 1997. Auditor DEF has been the auditor of Company Y since 2002. Company X acquires Company Y in 2017; Company X is the accounting acquirer.
- Auditor ABC continues to serve as the combined company's auditor. The auditor's report on the combined company's financial statements for the year ending December 31, 2017 is dated February 28, 2018.
- The auditor would state in the auditor's report \_\_\_\_ as the year the auditor began serving consecutively as the company's auditor.

1997

2002

2017

2018

# New Auditor's Report – Auditor Tenure

- ❑ Reporting of Tenure
  - ❑ Auditors have discretion to present auditor tenure in the part of the auditor's report they consider appropriate.
  - ❑ No required location is specified within the auditor's report.
  - ❑ If there is uncertainty as to the year the auditor began serving as the company's auditor, state that the auditor is uncertain as to the year and provide the earliest year of which the auditor has knowledge.
  - ❑ Auditors can provide additional information in the auditor's report about tenure, if the information would provide context or otherwise assist the reader's understanding of the relationship between the auditor and the company.

# Supplemental Information

- ❑ AS 2701, *Auditing Supplemental Information Accompanying Audited Financial Statements*, establishes the requirements that apply to reports on supporting schedules filed by the broker or dealer pursuant to SEC Rule 17a-5.
- ❑ AS 2701.11 allows the auditor's report on the supporting schedules to be included in the auditor's report on the financial statements, but does not specify a location.
- ❑ Since there is no specified location, the report on supporting schedules may be placed where the auditor considers appropriate.
- ❑ An appropriate section title may be added to aid the reader in distinguishing the auditor's report on supplemental information from the other sections of the auditor's report.

# Supplemental Information Example

## Basis for Opinion

\*\*\*

We believe that our audits provide a reasonable basis for our opinion.

### Supplemental Information

The [*identify supplemental information*] has been subjected to audit procedures performed in conjunction with the audit of W Broker financial statements. The [*supplemental information*] is the responsibility of W Broker's management. Our audit procedures included determining whether the [*supplemental information*] reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the [*supplemental information*]. In forming our opinion on the [*supplemental information*], we evaluated whether the [*supplemental information*], including its form and content, is presented in conformity with [*specify the relevant regulatory requirement or other criteria, if any*]. In our opinion, the [*identify supplemental information*] is fairly stated, in all material respects, in relation to the financial statements as a whole.

[*Signature*]

We have served as W Broker's auditor since [*year*].

[*City and State or Country*]

[*Date*]

Under the new standard, the notes to the financial statements and related schedules are identified as part of the financial statements in the Opinion on the Financial Statements section of the auditor's report. Is supplemental information covered by the related schedules?

1 Yes

2 No

Under the new standard, the notes to the financial statements and related schedules are identified as part of the financial statements in the Opinion on the Financial Statements section of the auditor's report. Is supplemental information covered by the related schedules?

1. Yes

2. No

# Explanatory Paragraphs

- ❑ The standard includes a list of circumstances with references to other PCAOB standards in which the auditor is required to include explanatory paragraph (or explanatory language) in the auditor's report. Those include, among others:
  - ❑ Going concern (AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*);
  - ❑ Other auditors (AS 1205, *Part of the Audit Performed by Other Independent Auditors*);
  - ❑ Change between periods in accounting principles or in the method of their application (AS 2820, *Evaluating Consistency of Financial Statements*); and
  - ❑ A material misstatement in previously issued financial statements (AS 2820)
- ❑ Some PCAOB standards specify the location of required explanatory paragraphs within the auditor's report and may also have a requirement for an appropriate section title.
- ❑ If the auditor is required to include an explanatory paragraph but the location is not specified, the paragraph may be placed where the auditor considers appropriate.

# Explanatory Paragraph Example

## Report of Independent Registered Public Accounting Firm

To the Directors and Equity Owners of W Broker

### Opinion on the Financial Statements

We have audited the accompanying statement of financial condition of W Broker as of December 31, 20X2, the related statements of [*titles of the financial statements, e.g., income, changes in stockholders' equity, changes in liabilities subordinated to claims of general creditors, and cash flows*], for the year ended December 31, 20X2, and the related notes [*and schedules*] (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of W Broker as of December 31, 20X2, and the results of its operations and its cash flows for the year ended December 31, 20X2, in conformity with [*the applicable financial reporting framework*].

### Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

### Basis for Opinion

These financial statements are the responsibility of W Broker's management. Our responsibility is to express an opinion on W Broker's financial statements based on our audits.

\*\*\*

# Emphasis Paragraphs

- ❑ Although not required, the standard includes the ability for the auditor to emphasize a matter regarding the financial statements (“emphasis paragraph”).
- ❑ Emphasis paragraph may be placed where the auditor considers appropriate.
- ❑ If the auditor includes an emphasis paragraph in the auditor's report, the auditor is required to use an appropriate section title.

# What does CAM stand for?

- 1 Critical Accounting Matter
- 2 Critical Audit Matter
- 3 Current Audit Matter
- 4 Certified Audit Magician

# What does CAM stand for?

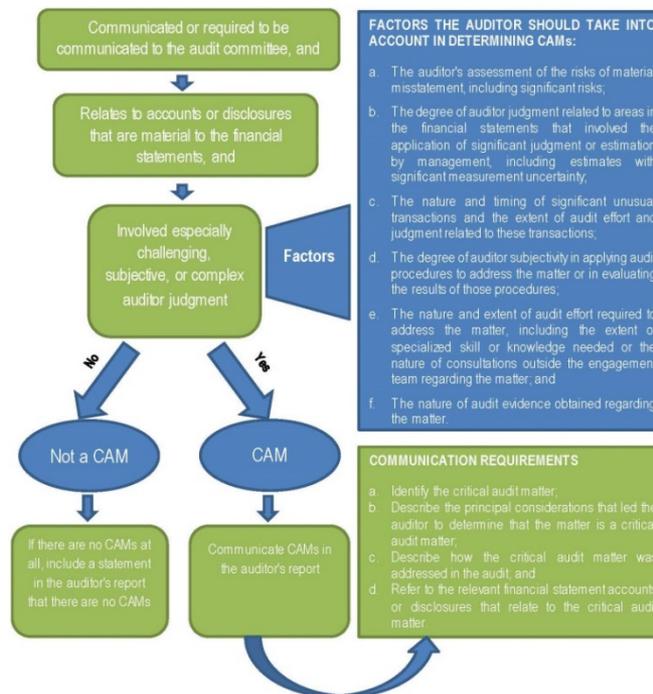
1. Critical Accounting Matter
2. Critical Audit Matter
3. Current Audit Matter
4. Certified Audit Magician

# Critical Audit Matters

- ❑ CAM requirements do not apply to audits of:
  - ❑ Brokers and dealers;
  - ❑ Investment companies, other than business development companies;
  - ❑ Employee benefit plans; and
  - ❑ Emerging growth companies
- ❑ Auditors of these entities may choose to include CAMs voluntarily.

# Critical Audit Matters

## Determining and Communicating Critical Audit Matters ("CAMs")



# Resources



- ❑ AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*
- ❑ PCAOB Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments To PCAOB Standards* (June 1, 2017)
- ❑ SEC, *Order Granting Approval of Proposed Rules on the Auditor's Report*, Exchange Act Release No. 34-81916 (Oct. 23, 2017).
- ❑ Staff guidance, *Changes to the Auditor's Report Effective for Audits of Fiscal Years Ending on or after December 15, 2017* (updated Dec. 28, 2017)
- ❑ Questions pertaining to ARM may be directed to the staff in the PCAOB's Office of the Chief Auditor via the standards' help line at (202) 591-4395 or may be submitted through a web form at <https://pcaobus.org/About/Pages/ContactUsWebForm.aspx?Contact=Standard-related%20Inquiries>

# Questions?



# FINRA Perspectives

## PCAOB Broker Dealer Forum

July 10, 2018

**Ann Duguid**, Senior Director  
Risk Oversight and Operational Regulation, FINRA



# Overview of Today's Discussion

- **FINRA's Risk Based Exam and Surveillance Programs**
- **FINRA's Regulatory Initiatives & Exam Priorities**
- **FINRA Examination Observations & Industry Challenges**

# FINRA's Risk Based Exam and Surveillance Programs

## Financial Surveillance Program

- Emphasis on firm's periodic financial reporting including submission of FOCUS Reports, Supplemental Schedules, Annual Audits, Form Custody
- Alert Reporting: FINRA Regulatory Notice 10-44
  - Certain conditions warrant accelerated reporting
- Supplemental Schedules/Reports: Rule 4524
  - Supplemental Schedule to the Statement of Income
  - Supplemental Schedule for Derivatives and Off-Balance Sheet Items
    - Expanded to certain non-carrying/clearing firms: FINRA Reg Notice 16-11
  - Supplemental Inventory Schedule
- Upcoming: Regulatory Notice 18-02: Liquidity Reporting and Notification
  - Supplemental Liquidity Schedule

# FINRA's Risk Based Exam and Surveillance Programs

- **Scope, content, frequency and nature of a firm's examination depends on the characteristics of the firm**
  - Characteristics include, but are not limited to, firm size & 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**

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ FINRA Rule 4210 (Margin Requirements)

### • FINRA Regulatory Notice 16-31

*SEC Approves Amendments to FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for Covered Agency Transactions*

- Risk Limit Determinations Requirements: December 15, 2016

### • FINRA Regulatory Notice 17-28

*FINRA Makes Available Frequently Asked Questions and Guidance and Extends the Effective Date of Margin Requirements for Covered Agency Transactions*

- Effective date of all other requirements extended to June 2018

### • FINRA Regulatory Notice 18-18

*FINRA Extends Effective Date of Margin Requirements for Covered Agency Transactions*

- Effective date of all other requirements: March 25, 2019

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ Funding and Liquidity

### *Guidance on Liquidity Risk Management Practice*

- FINRA Regulatory Notice 10-57: Funding and Liquidity Risk Management Practices
- FINRA Regulatory Notice 15-33: Guidance on Liquidity Risk Management Practices

## ■ FINRA Regulatory Notice 18-02: Liquidity Reporting and Notification

- Proposed amendments to FINRA Rule 4521 (Notifications, Questionnaires and Reports)
  - Would require specified member firms to notify FINRA no more than 48 hours after specified events that may signal an adverse change in liquidity risk.
- Proposed new Supplemental Liquidity Schedule (SLS) that member firms with the largest customer and counterparty exposures would file as a supplement to the FOCUS Report.
  - firms would report information related to specified financing transactions and other sources or uses of liquidity
    - Examples: financing term, collateral types and large counterparties
- Applicable Firms
- Comment Review Process

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ Liquidity

- FINRA will continue to focus on firms' liquidity planning
  - compare strengths and weaknesses across firms' liquidity plans and share effective practices,
  - evaluate whether a firm's liquidity planning is appropriate for the firm's business and customers,
  - whether liquidity planning includes scenarios that are consistent with its collateral resources and client activity,
  - adequacy of firms' material stress testing assumptions.

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ Customer Protection & Verification of Customer Assets

- Verification of customer and proprietary assets
- Assess the validity of reported positions at custodial banks
- Review controls and supervision to protect customer assets and assess their compliance with the specific requirements (*e.g.*, possession or control calculations)
- Review documentation, especially for securities held at foreign custodians
- Review underlying arrangements with foreign custodians

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ Technology Governance

- Change management policies & procedures
  - New systems
  - Enhancements/modifications to existing systems
- Prevention of inaccurate, incomplete, untested or unauthorized changes to production environments

## ■ Cybersecurity

- Evaluate effectiveness of firm's cybersecurity programs to protect sensitive information, including personally identifiable information from both internal and external threats
- Review firm's preparedness, technical defenses and resiliency measures
- FINRA's Exam Findings Report – observations & effective practices
- Policies & procedures for filing a SAR when they identify a cybersecurity event

# FINRA's Regulatory Initiatives & Exam Priorities

## ■ Business Continuity Planning

- Maintenance of written BCPs addressing continued access to critical systems, including where firms may not have physical access to locations
- FINRA Rule 4370
- Focus on implementation
  - How and under what circumstances will BCP be activated
  - Systems classification: mission-critical or secondary
  - Data backup and recovery
  - Where applicable, how firm's coordinate with their affiliates and vendors
- Restoration of systems, procedures and records
  - How those decisions are made

# Examination Observations & Trends

## ■ SEA Rule 15c3-1 Net Capital

- Minimal Credit Risk Assessments – Non-Convertible Debt
  - Written policies
  - SEC No-Action Letters
- Open contractual commitments

## ■ Funding & Liquidity

- Stress testing
- Available collateral

## ■ SEA Rule 17a-4 Preservation of Books and Records

- Notification letters from third party vendors
- WORM format
- Agreements

# Examination Observations & Trends

- **Technology Governance/Cybersecurity**
  - Supervisory Controls: Infrastructure changes
  - Written procedures
  - Data Loss Prevention controls
  - Risk Management
  - Regular risk assessments with follow-up action plans
  - Regular testing

# Examination Observations & Trends – Small firm FOCUS

- **Related Party transactions**
  - Expense Sharing
  - Management Services agreements
  - Transfer pricing agreements
- **Netting and offsetting of balances**
- **Accrual and footnote disclosures related to litigation and arbitrations**

## Observations & Trends

- **ASC 606: Revenue from Contract with Customers**  
Division of Trading and Markets No-Action Letter  
(January 4, 2018)
- **Lease Accounting**  
Division of Trading and Markets No-Action Letter  
(November 8 2016)

# Upcoming

## ■ **FINRA Rule 4210**

- FINRA Regulatory Notice 18-18: Covered Agency Transactions
- Implementation extended to March 25, 2019
  - Maintenance Margin
  - Variation Margin
  - Limits on concentration exposures
  - Exceptions for certain counterparties, products and transactions

## ■ **FINRA Regulatory Notice 17-30: Qualification & Registration**

### *SEC Approves Consolidated FINRA Registration Rules*

- Restructured Representative-Level Qualification Examinations
  - General Knowledge Exam: “Securities Industry Essentials”
  - Special Knowledge Exams for Representative Level Exams
- Changes to Continuing Education Requirements
- Effective Date October 1, 2018

# Upcoming

## ■ **FINRA Regulatory Notice 18-10: Retrospective Rule Review**

*FINRA Requests Comment on the Effectiveness and Efficiency of its Carrying Agreements Rule*

- FINRA Rule 4311: Carrying Agreements
- Comment Period extended to June 22, 2018

## Other Helpful Links

- [Report on FINRA Examination Findings](#)
- [2018 Holiday Trade Date, Settlement Date and Margin Extension Schedule](#)
- [FINRA Financial Responsibility Rule Amendments Resource Page](#)
  - Rule Amendments, No-Action Letters, FINRA Regulatory Notices and SEC FAQ's
- **FINRA Key Topics:**
  - [Books And Records](#)
    - Applicable SEC and FINRA rules and guidance
  - [Liquidity and Funding](#)
    - Rule, guidance and notices
  - [FinTech](#)
    - News, reports & events

# Sources of Information

- **Interpretations of Financial and Operational Rules**

- <http://www.finra.org/industry/interpretationsfor>

- **What to expect in a cycle exam**

- [https://www.finra.org/sites/default/files/14\\_0453%20What%20to%20Expect\\_Cycle%20Exam.pdf](https://www.finra.org/sites/default/files/14_0453%20What%20to%20Expect_Cycle%20Exam.pdf)

- **FINRA's Annual Regulatory and Examination Priorities Letter**

- <http://www.finra.org/industry/2018-regulatory-and-examination-priorities-letter>

- **FINRA Targeted Examinations page**

- <http://www.finra.org/industry/targeted-examination-letters>

# Case Study: Revenue and Tests of Controls

Kate Ostasiewski, Inspections

Greg MacCune, Inspections

Mike Walters, Inspections

Lisa Calandriello, Standards

# PCAOB Standards

## 2100 Audit Planning and Risk Assessment

- AS 2101: *Audit Planning*
- AS 2105: *Consideration of Materiality in Planning and Performing an Audit*
- AS 2110 : *Identifying and Assessing Risks of Material Misstatement***

## 2300 Audit Procedures in Response to Risks – Nature, Timing, and Extent

- AS 2301: *The Auditor's Responses to the Risks of Material Misstatement***
- AS 2305: *Substantive Analytical Procedures*
- AS 2310: *The Confirmation Process*
- AS 2315: *Audit Sampling*

# Case Study: Treasured Securities, Inc.

# Risk Assessment

# Treasured Securities, Inc. (TSI) Overview

- ❑ Does not claim exemption from Rule 15c3-3.
- ❑ Provides execution and clearing services on a fully-disclosed basis.
- ❑ Primary business is executing orders from retail customers introduced through an affiliated, exempt BD.
- ❑ Operates essentially at breakeven given the competitive market for execution and clearing services.
- ❑ \$250,000 minimum dollar net capital requirement, but operates with a thin capital margin.
- ❑ No recent history of regulatory violations. FINRA is the designated examining authority.
- ❑ December 31 fiscal year-end.
- ❑ Key personnel include the Chief Financial Officer, Accounting Manager, Operations Manager, and Accounting Staff.

# TSI - Preliminary Information

- ❑ Revenues
  - ❑ Through June 30, clearing revenue accounted for 70% of total revenues
  - ❑ Generated from executing and clearing U.S. equity and fixed-income security transactions
- ❑ Receivable & Payable to Customers
  - ❑ Related to customer cash and margin accounts

As the auditor, which of the facts presented so far may prompt you to identify one or more risks of material misstatement?

1. Clearing revenue accounted for 70% of revenue
2. TSI operates essentially at breakeven
3. No recent history of regulatory violations
4. \$250,000 minimum net capital
5. Customer receivables and payables are quantitatively material as of June 30

# TSI - Risk Assessment

- No new lines of business; revenues remained consistent with prior years.
- New control related to revenue recognition, specifically retail customer trade activity.
- No customer complaints and no regulatory issues.

# Understanding Internal Control Over Financial Reporting (ICFR)

- ❑ Sufficient understanding to:
  - ❑ Identify types of potential misstatements
  - ❑ Assess factors that affect the risks of material misstatement
  - ❑ Design further audit procedures
- ❑ Necessary procedures depend on various factors
- ❑ Includes evaluating design and implementation of controls

# TSI – Understanding ICFR

Controls identified during walkthrough procedures performed by the auditor:

1. Daily, the Accounting Manager reviewed reconciliations prepared by the Accounting Staff of clearing revenue to trading activity.
2. Weekly, the Operations Manager reviewed customer accounts for evidence of under-margined, partially secured, or unsecured accounts.
3. Monthly, the Accounting Manager re-performed the Accounting Staff's tracing of customer receivable and payable balances to customer statements.
4. Any changes to the Clearing Agreement are approved by the CFO.
5. Monthly, the CFO verifies completion of a sample of the daily, weekly, and monthly controls.

# What did the auditor fail to consider when evaluating the design effectiveness of the identified controls?

1. Whether discrepancies identified during the customer receivables & payables review are investigated, explained or resolved
2. Controls over the accuracy and completeness of information used in the performance of controls
3. The frequency, nature and extent of the CFO's review of the approved daily revenue reconciliations

# What did the auditor fail to consider when evaluating the design effectiveness of the identified controls?

1. Whether discrepancies identified during the customer receivables & payables review are investigated, explained or resolved
2. **Controls over the accuracy and completeness of information used in the performance of controls**
3. The frequency, nature and extent of the CFO's review of the approved daily revenue reconciliations

# How would you assess inherent risk for Clearing Revenue and Customer Receivables and Payables?

1. High for both
2. High for Clearing Revenue only
3. High for Customer Receivables and Payables only
4. Low for both

# How would you assess control risk for Clearing Revenue and Customer Receivables and Payables?

1. High for both
2. High for Clearing Revenue only
3. High for Customer Receivables and Payables only
4. Low for both

# Would you identify any significant risks, including fraud risks?

1. Yes, for Clearing Revenue and Customer Receivables and Payables
2. Yes, for Clearing Revenue only
3. Yes, for Customer Receivables and Payables only
4. No

# Planned Risk Assessment

Account & Assertions	Inherent Risk	Significant/ Fraud Risk?	Planned Control Risk	Planned Overall RoMM
Clearing Revenue (E/O, V/A, P&D, C)	High	Yes	Low	Moderate
Customer Receivable & Payable (E/O, V/A, C, R&O, P&D)	Moderate	Yes	Low	Moderate

LUNCH (70 minutes)

# Audit Responses to the Risks of Material Misstatement

# Clearing Revenue – Tests of Controls

- ❑ Selected sample of daily reconciliations performed by Accounting Staff
- ❑ Re-performed work of Accounting Staff
- ❑ Observed Accounting Manager's signature on each reconciliation indicating that a review was performed of the reconciliation

Has the engagement team obtained sufficient evidence of the Accounting Manager's review to conclude that this control is operating effectively?

1. Yes
2. No

During its tests of detail of the clearing fee rates, the auditor detected that rates applied to trades from May through the end of the year for most security types did not agree with the executed clearing agreement. Which is true?

1. There is risk of a material error in Clearing Revenues.
2. The auditor should re-assess control risk.
3. Both 1 and 2.

During its tests of detail of the clearing fee rates, the auditor detected that rates applied to trades from May through the end of the year for most security types did not agree with the executed clearing agreement. Which is true?

1. There is risk of a material error in Clearing Revenues.
2. The auditor should re-assess control risk.
3. Both 1 and 2.

# Customer Balances – Tests of Details

For a sample of customer accounts, sent requests to positively confirm the customer payable or receivable balance per the customer trial balance as of September 30:

- Prior to sending the confirmation the customer name and address was verified to the account opening agreement;
- For those confirmations returned, the auditor did not identify any exceptions. Certain replies were signed by someone other than the account holder.
- For non-replies, traced balances to the customer sub-ledger.

Certain replies were signed by someone different than the name on the account. The auditor concluded these confirmations were returned without exception. Do you agree with that conclusion?

1. Yes
2. No

# Customer Balances – Year-End Procedures

- ❑ Reconciled the December 31 customer sub-ledger to the general ledger.
- ❑ Inquired regarding a significant increase in customer payables balances between September 30 to December 31.
- ❑ For customer accounts confirmed at September 30, compared September 30 balances per the customer sub-ledger to December 31 and investigated differences exceeding a judgmental threshold.
- ❑ For a sample of accounts opened since September 30, sent positive confirmation requests.

Do the year-end procedures provide a reasonable basis for extending the conclusions regarding Customer Receivables and Payables from the interim date to the period end?

1. Yes – The procedures collectively provide sufficient evidence to extend the audit conclusions.
2. Yes – The procedure to extend the conclusion for the sampled accounts was sufficient.
3. No – A three-month rollforward period is too long.
4. It depends on the nature of the rollforward procedures for the sampled accounts.

# Do the year-end procedures provide a reasonable basis for extending the conclusions regarding Customer Receivables and Payables from the interim date to the period end?

1. Yes – The procedures collectively provide sufficient evidence to extend the audit conclusions.
2. Yes – The procedure to extend the conclusion for the sampled accounts was sufficient.
3. No – A three-month rollforward period is too long.
4. It depends on the nature of the rollforward procedures for the sampled accounts.

# Attestation Engagements

# AT 1 Examination Engagements

Obtain appropriate audit evidence sufficient to obtain reasonable assurance whether:

- One or more material weaknesses existed during the fiscal year specified in the broker's or dealer's assertion ("fiscal year")
- One or more material weaknesses existed at the end of the fiscal year
- One or more instances of non-compliance with the net capital rule or the reserve requirements existed as of the end of the fiscal year

# Which of the following audit procedures performed may provide evidence relevant to the auditor's objectives related to ICOC under AT 1?

1. Accounting Manager's review of balances, positions, and transactions per customer statements
2. Test of sub-ledger to Security Master File reconciliations
3. Customer confirmations
4. Both 1 & 2
5. All of the above

# ICOC –The Account Statement Rule

FINRA Rule 2340 establishes customer statement requirements for Broker-Dealer's for whom FINRA is the Designated Examining Authority. The rule requires that:

- Statements should be sent to the customer no less frequent than once per calendar quarter
- Statements should include a description of positions, money balances, or account activity
- Statements should include guidance for how to report discrepancies

Based on the information presented in the case, controls over which of the following have been tested by the engagement team?

1. Controls over the production and delivery of customer statements
2. Controls over the completeness and accuracy of required guidance for how to report discrepancies
3. Controls over the completeness and accuracy of position, balance, and activity information
4. All of the above.

Based on the information presented in the case, controls over which of the following have been tested by the engagement team?

1. Controls over the production and delivery of customer statements
2. Controls over the completeness and accuracy of required guidance for how to report discrepancies
- 3. Controls over the completeness and accuracy of position, balance, and activity information**
4. All of the above.

# Relevant PCAOB Standards

- ❑ AS 2101: Audit Planning  
<https://pcaobus.org/Standards/Auditing/Pages/AS2101.aspx>
- ❑ AS 2105: Consideration of Materiality in Planning and Performing an Audit  
<https://pcaobus.org/Standards/Auditing/Pages/AS2105.aspx>
- ❑ AS 2110: Identifying and Assessing Risks of Material Misstatement  
<https://pcaobus.org/Standards/Auditing/Pages/AS2110.aspx>
- ❑ AS 2301: The Auditor's Responses to the Risks of Material Misstatement  
<https://pcaobus.org/Standards/Auditing/Pages/AS2301.aspx>

# Questions



# Division of Enforcement and Investigations Update

R. Davis Taylor, Associate Director  
Division of Enforcement and  
Investigations

# Division of Enforcement & Investigations

What do we do.....



## Investor Protection

# Agenda

- ❑ Today we would like to discuss:
  - ❑ Range of Sanctions and effects of bars/suspensions
  - ❑ Association with a registered firm
  - ❑ Enforcement Program statistics and outlook
    - ❑ 2017 Settled enforcement actions and adjudicated actions made public
    - ❑ Certain types of enforcement actions and their consequences
    - ❑ Recent matters involving attestation standards violations
  - ❑ Extraordinary cooperation credit
  - ❑ Termination of bars

# Range of Possible Sanctions

- ❑ In a disciplinary proceeding, the Board may:
  - ❑ suspend or permanently bar an individual from association with a registered public accounting firm
  - ❑ temporarily or permanently revoke a firm's registration
  - ❑ appoint an independent monitor
  - ❑ impose a civil monetary penalty
  - ❑ temporarily or permanently limit the activities, functions, or operations of a firm or person
  - ❑ require undertakings, such as additional professional education or training, changes to policies
  - ❑ impose a censure, and/or any other sanction per Board rules

# Effect of Suspensions and Bars From Being An Associated Person

- ❑ It is unlawful for any person that is suspended or barred to become or remain associated with any registered firm or with any issuer, broker, or dealer in an accountancy or a financial management capacity
  - ❑ See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301
  
- ❑ It is unlawful for any registered firm, issuer, broker, or dealer that knew, or, in the exercise of reasonable care should have known, that a person is suspended or barred from association to permit such association
  - ❑ See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301

# Association with a Registered Firm

- ❑ An individual associates with a registered firm if he or she, in connection with the preparation or issuance of any audit report:
  - ❑ Shares in the profits of, or receives compensation in any other form from, that firm; or
  - ❑ Participates as agent or otherwise on behalf of such accounting firm in any activity of that firm
  
- ❑ See Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301; Rules on Investigations and Adjudications, PCAOB Release No. 2003-015 (Sept. 29 2003), at A2-80-81

# Disclaimers

- ❑ Unless otherwise noted, in settled disciplinary proceedings, the firms and the associated persons neither admitted nor denied the Board's findings, except as to the Board's jurisdiction over them and the subject matter of the proceedings.
- ❑ The data and charts in this slide deck are intended to assist the public understanding the PCAOB enforcement program. It is possible inaccuracies or other errors were introduced into the data sets during the process of extracting the data and compiling the data sets. The data and charts presented are not a substitute for reading, analyzing and understanding each litigated and settled order.

# Program Statistics for 2017

- ❑ The Board has imposed sanctions on auditors ranging from censures to monetary penalties and bars on association with registered firms in settled or public adjudicated disciplinary orders
- ❑ The Board issued **54** settled disciplinary orders
  - ❑ Sanctioning **42** registered firms and **45** associated persons in those proceedings, imposing a total more than **\$4.8 million** in monetary penalties
- ❑ Three orders were adjudicated during 2017
  - ❑ Sanctioning **three** associated persons and imposing **\$75,000** in monetary penalties

# Program Statistics for 2017

- ❑ The Board imposed sanctions in its first settled orders involving violations of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*
  - ❑ Fulvio & Associates, LLP., et al.
  - ❑ PricewaterhouseCoopers LLP

# Program Outlook

- ❑ The DEI continues to prioritize:
  - ❑ Investigations involving significant audit violations, including a lack of due professional care and professional skepticism
  - ❑ Audit matters relating to the independence and integrity of the audit
  - ❑ Matters threatening or eroding the integrity of the Board's regulatory oversight process
  - ❑ Investigations focusing on the risks associated with cross border audits

# Information about Enforcement Matters in Certain Areas

*Data inception to Dec. 31, 2017, unless otherwise indicated*

# Staff Practice Alert No. 14, *Improper Alteration of Audit Documentation*

- ❑ Issued in April, 2016
- ❑ Improper alteration of audit documentation in connection with an inspection or investigation can result in disciplinary actions with severe consequences (violation of duty to cooperate)
- ❑ Issues in recent oversight activities have heightened concerns about this at a range of firms, including global network affiliates
- ❑ Consequences of improper alteration, in many cases, are more severe than from the underlying perceived audit deficiency

# Matters involving Interference in Board Processes

- ❑ Violations of PCAOB Rules 4006 and 5110, which govern registered firms and associated person's conduct with respect to a Board inspection or investigation
  - ❑ ZERO tolerance for failing to provide information or interference with these processes
- ❑ These matters primarily involve providing improperly altered audit documentation to the Board in its inspections or enforcement processes
- ❑ These matters can be pursued in isolation, or in conjunction with other audit standards violations
- ❑ The Board has settled or finalized adjudication in **over 60** non-cooperation matters, involving **around 25 firms** and **more than 60** associated persons

# Matters involving Interference in Board Processes

- ❑ **About two-thirds** of the respondents were U.S. based firms and persons
- ❑ **About one-third** of the firms and persons involved in these matters were affiliated with the global network firms
- ❑ **Nearly one-half** of the respondents received a 5 year or permanent bar or revocation
  - ❑ **About one-third** also involved other violations of auditing standards in the associated audits

# Independence Matters

- ❑ A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period
  - ❑ To be recognized independent, an auditor must be free from any obligation to or interest in the audit client, its management or its owners
  
- ❑ The Board has found independence violations in several areas—one significant area is violations associated with maintaining the financial records or preparing financial statements for issuers and broker/dealers

# Independence Matters

- ❑ Since December 2014, the Board has entered into settled orders with certain associated persons for violations associated with maintaining the financial records or preparing financial statements of:
  - ❑ Broker-dealer audit clients – *about 25 orders*
  - ❑ Issuer audit clients – *about 10 orders*
- ❑ Sanctions included:
  - ❑ Firms: censures, monetary penalties of \$2,500 - \$20,000, remedial measures, one year prohibitions on new clients
  - ❑ Associated Persons: censures, monetary penalties of \$2,500- \$15,000, bars with a right to reapply of typically one or two years

# Independence Matters – Sanctionable Conduct

- For one or more of its audit clients, members of the audit firm
  - Prepared and filed Focus reports
  - Prepared all or a portion of the financial statements, including notes
  - Prepared draft statements with placeholders for dollar amounts
  - Obtained drafts, but made extensive changes
  - Directed or supervised professionals from another firm to prepare all or a portion of the financial statements that were the subject of the firm's audit opinion
  - Maintained and prepared accounting records, including journal entries
  - Prepared the tax provision
  - Provided valuation services

# Independence Matters – Factors in Severity of Sanctions

- ❑ Range of Conduct
  - ❑ Audits of multiple issuers or broker-dealers over multiple years resulted in more severe sanctions
- ❑ Context of Conduct
  - ❑ More severe sanctions resulted from:
    - ❑ Specific awareness of independence rules
    - ❑ Continued conduct after specific notice of previous violations
  - ❑ Less severe sanctions when firms or associated person made changes with the intent to comply, but efforts fell short

# Engagement Quality Review Matters

- ❑ Engagement quality reviews are required for issuer audits and interim reviews, broker-dealer audits, and examinations/ reviews of broker-dealer compliance/exemption reports
- ❑ EQR violations were also present in 2017 settlements where other audit standard or regulation violations were also present
- ❑ The Board settled disciplinary orders in 2017 against more than **15** firms and **20** associated persons for conduct substantially relating to violations of EQR requirements

# Engagement Quality Review Matters – 2017 Settlements

- ❑ Of the 2017 settlements substantially related to EQR –
  - ❑ No concurring approval of an EQR was obtained prior to granting permission to the client to use the firm’s report in about one-half
  - ❑ Engagement Quality Reviewer violated the mandatory two year “cooling off” period in about one-third
  - ❑ Each registered firm and associated person was censured
    - ❑ Monetary penalties ranged from \$5,000 to \$40,000 (in some matters there were no monetary penalties)
    - ❑ Where misconduct was more severe, a bar or revocation with right to reapply after one to five years

# Engagement Quality Review Matters – Weaver and Tidwell, L.L.P.

- ❑ On October 26, 2017, Board sanctioned the firm for failing to comply with the mandatory two year “cooling off” period for engagement partners serving as EQ Reviewer’s on their former clients on two broker-dealer financial statement audits
  - ❑ The firm had been previously sanctioned for similar conduct with respect to an issuer audit
- ❑ Firm was censured received a \$30,000 monetary penalty and required to undertake certain remedial measures
- ❑ Remedial measures (undertakings) include establishment of policies and procedures to
  - ❑ provide reasonable assurance of compliance with AS 1220, *Engagement Quality Review*
  - ❑ Ensure training at least annually on AS 1220

# Engagement Quality Review Matters – Brace & Associates, PLLC, et al.

- ❑ On November 26, 2017, Board sanctioned the firm and its sole owner for repeated failures to obtain EQRs for 19 broker-dealer audit clients
- ❑ Firm was censured, had its registration revoked with a right to reapply after three years and received a \$10,000 monetary penalty
- ❑ Sole owner was censured, and was barred with a right to reapply after three years

# Certain Recent Matters involving Attestation Standards Violations

- ❑ In the Matter of Fulvio & Associates, et al. – Jun. 27, 2017
- ❑ In the Matter of PricewaterhouseCoopers LLP – Aug. 2, 2017

# Matter of Fulvio & Associates, et al. – June 27, 2017

- ❑ Matter involves, among other violations:
  - ❑ Failure to obtain sufficient appropriate evidence to support the Firm's audit opinion on a broker-dealer operating on a self-clearing basis
  - ❑ Firm violated *AT 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, by failing to identify and test the broker-dealer's key internal controls over compliance rules for safeguarding customer assets held
- ❑ As a result
  - ❑ Firm received censure, revocation of registration with right to reapply after one year, and \$20,000 penalty
  - ❑ A Partner received a censure, a bar with the right to reapply after 2 years, and a \$10,000 monetary penalty
  - ❑ Another Partner received a censure, and a one year limitation on activities
  - ❑ The Engagement Quality Reviewer received a censure, and a bar with the right to reapply after one year

# Matter of PricewaterhouseCoopers LLP – August 2, 2017

- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence regarding Merrill Lynch’s compliance with the SEC’s Customer Protection Rule prior to issuance of the Firm’s examination and audit opinion
  - ❑ Included violations of *AT 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, and *AS No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements*
- ❑ As a result
  - ❑ Firm received censure and \$1 million penalty

# Extraordinary Cooperation Credit

- ❑ Extraordinary cooperation is voluntary and timely action, *beyond compliance with legal or regulatory obligations*, that contributes to the mission of the Board
- ❑ Three types:
  - ❑ self-reporting
  - ❑ remedial or corrective action
  - ❑ substantial assistance to the Board's investigative processes or to other law enforcement authorities

# Extraordinary Cooperation Credit

- ❑ The Board has previously announced that two unnamed broker-dealer audit firms had prepared financial statements, but would not be sanctioned
  - ❑ The Board awarded credit for extraordinary cooperation based on the firms':
    - ❑ Timely and voluntary self-reporting to the PCAOB Tip Line
    - ❑ Timely, voluntary, and meaningful remedial actions, including, in one matter, communicating the violation to the client and discussing the conduct and violation at an annual firm training session

# Extraordinary Cooperation Credit – 2017 Settlements

- ❑ In Schild, et al., sanctions credit was given for the substantial assistance it provided the Division through timely and voluntarily providing information on independence and EQR violations
  - ❑ Disclosure that financial statements for an issuer had been prepared by Respondents
  - ❑ Disclosure that the Firm did not obtain concurring approval from engagement quality reviewer of issuance of an audit report before granting permission to use it

# Extraordinary Cooperation Credit – 2017 Settlements

- ❑ *In the Matter of Baum & Company, P.A., et al.*, sanctions credit was given for providing substantial assistance by
  - ❑ Self-reporting, at the start of the inspection, the improper adding and backdating of audit documentation in anticipation of the inspection
  - ❑ Providing a list identifying remembered added or altered documents and describing such changes in general terms

# Terminations of Bars

- ❑ PCAOB Rule 5302(b) governs petitions to terminate a bar
  - ❑ Specific items outlined in the PCAOB Rules 5302(b)(2), 5302(b)(3), and 5302(b)(4) must be addressed for the Board to consider a petitioner's request
  
- ❑ To date, six individuals have successfully terminated their bars
  - ❑ One each in 2009, 2010, 2016 and 2017
  - ❑ Two in 2018

# 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)

Post: PCAOB Complaint Center  
1666 K Street, NW  
Washington, DC 20006

Fax: 202-862-0757

Telephone: 800-741-3158

# Questions?



**BREAK (15 minutes)**

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFDEN2018>

# Inspections Update

Bob Maday and Kate Ostasiewski  
Division of Registration and Inspections

# Agenda

- Summary of Inspection Program
- 2018 Inspection Plan
- Inspection Observations
- Actions for Auditors
- Questions

The 2018 inspection year is the \_\_\_\_\_ year we are performing inspections of audits of brokers and dealers performed under PCAOB standards and also the \_\_\_\_\_ year we are performing inspections of attestation engagements under PCAOB attestation standards.

1. third, second
2. sixth, sixth
3. second, second
4. fourth, fourth

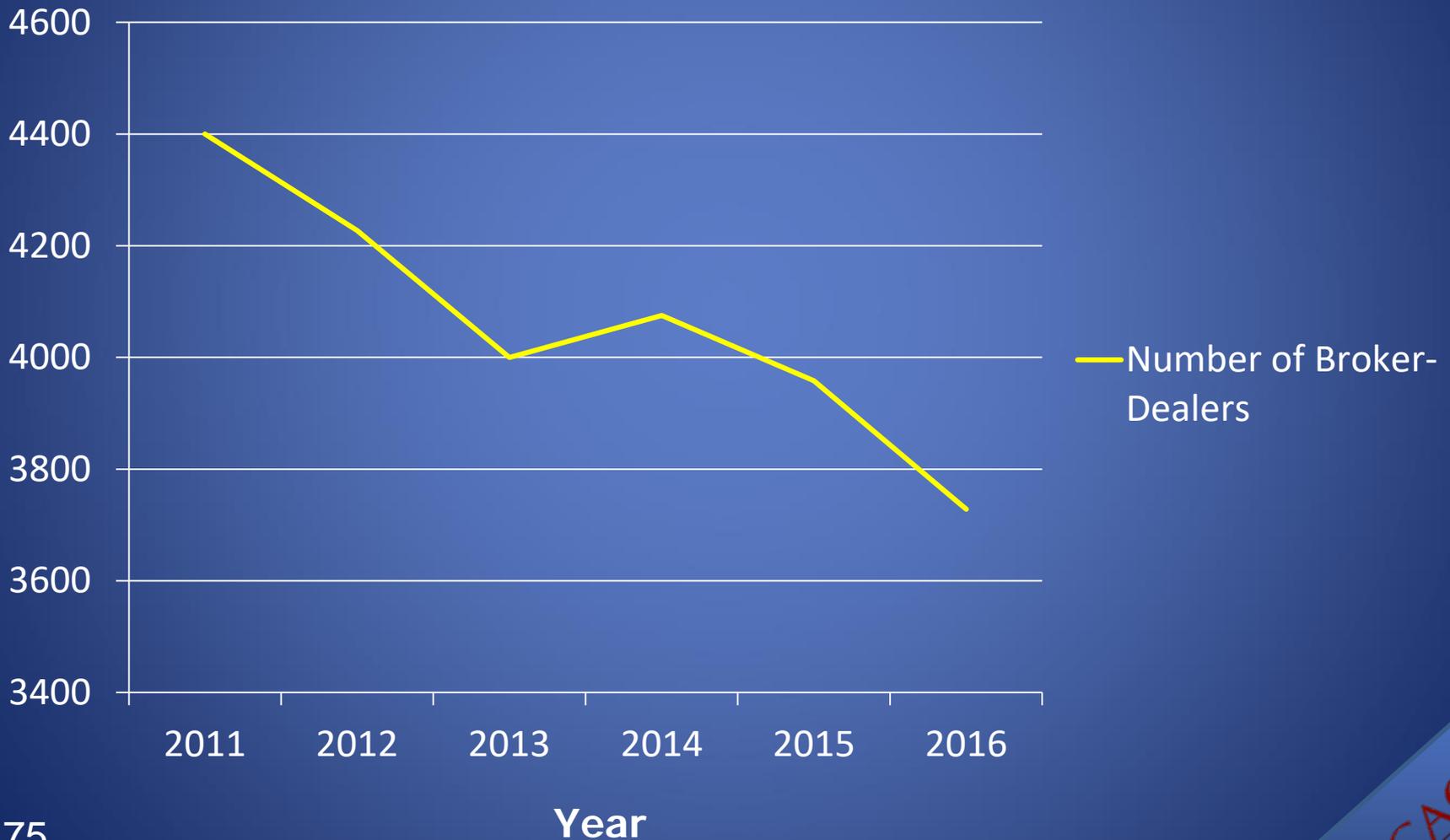
The 2018 inspection year is the \_\_\_\_\_ year we are performing inspections of audits of brokers and dealers performed under PCAOB standards and also the \_\_\_\_\_ year we are performing inspections of attestation engagements under PCAOB attestation standards.

1. third, second
2. sixth, sixth
3. second, second
4. **fourth, fourth**

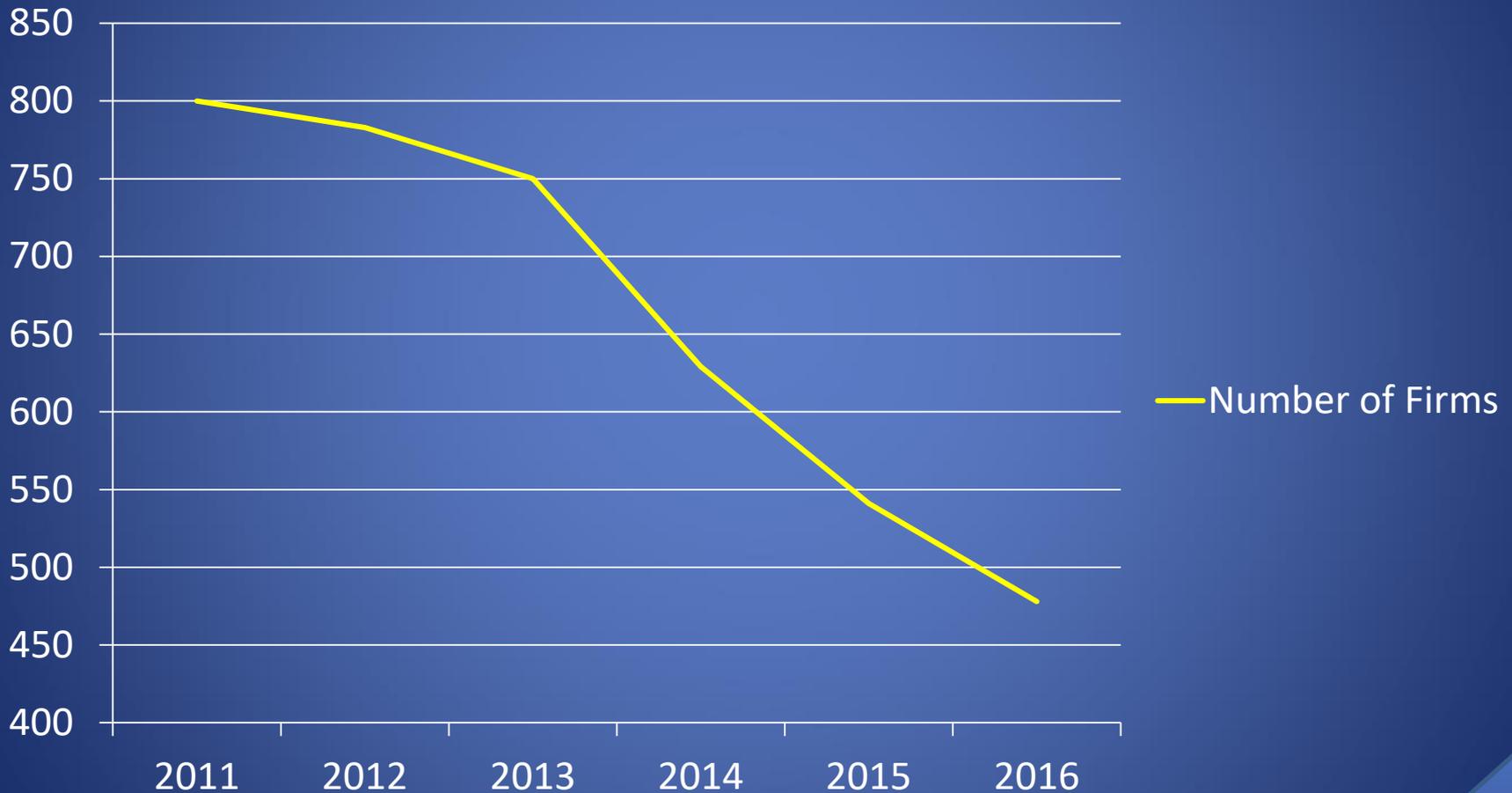
# Inspection Program – Objectives

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

# Number of Broker-Dealers by Year



# Number of Firms Auditing Broker-Dealers by Year



# Number of Firms Auditing Broker-Dealers 2016 versus 2012

Number of Broker-Dealer Audits per Firm	Number of Firms in 2016	Percentage of Firms in 2016	Number of Firms in 2012	Percentage of Firms in 2012
1	155	32%	363	46%
2 to 20	286	60%	383	49%
21 to 50	23	5%	23	3%
51 to 100	9	2%	8	1%
More than 100	5	1%	6	1%
<b>Total</b>	<b>478</b>	<b>100%</b>	<b>783</b>	<b>100%</b>

# 2018 Inspection Plan

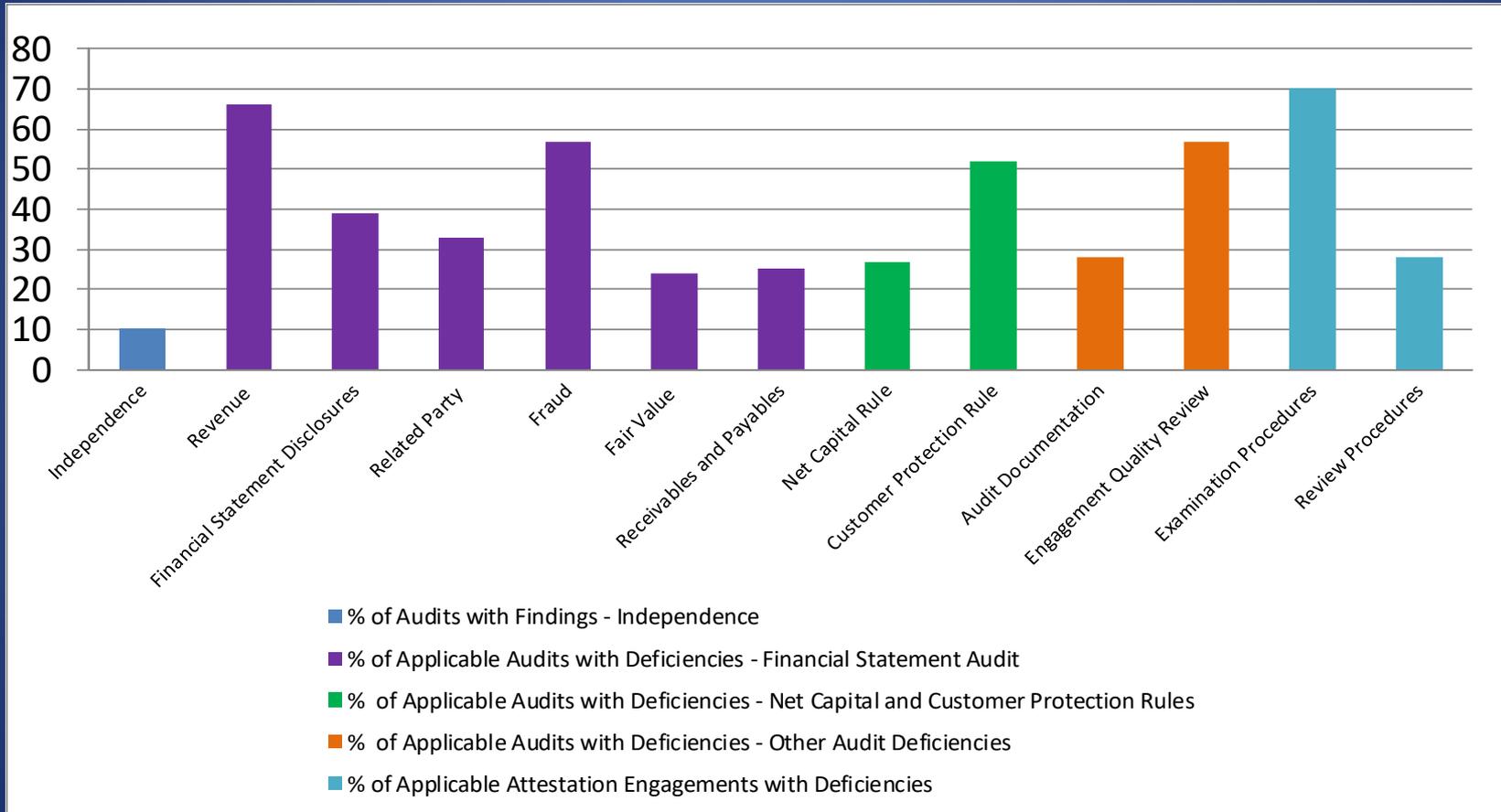
- Audits of the financial statements and supporting schedules of brokers and dealers, required to be performed in accordance with PCAOB standards
- Examination and review engagements, required to be performed in accordance with PCAOB standards
- Firm quality control procedures
- Other topics

# Inspection Observations

The information presented in the following slides is not necessarily indicative of the full population of firms, or of all audit and attestation engagements of brokers and dealers, because the selection of firms for inspection and the audit and attestation engagements for brokers and dealers covered by the inspections is not necessarily representative of these populations.

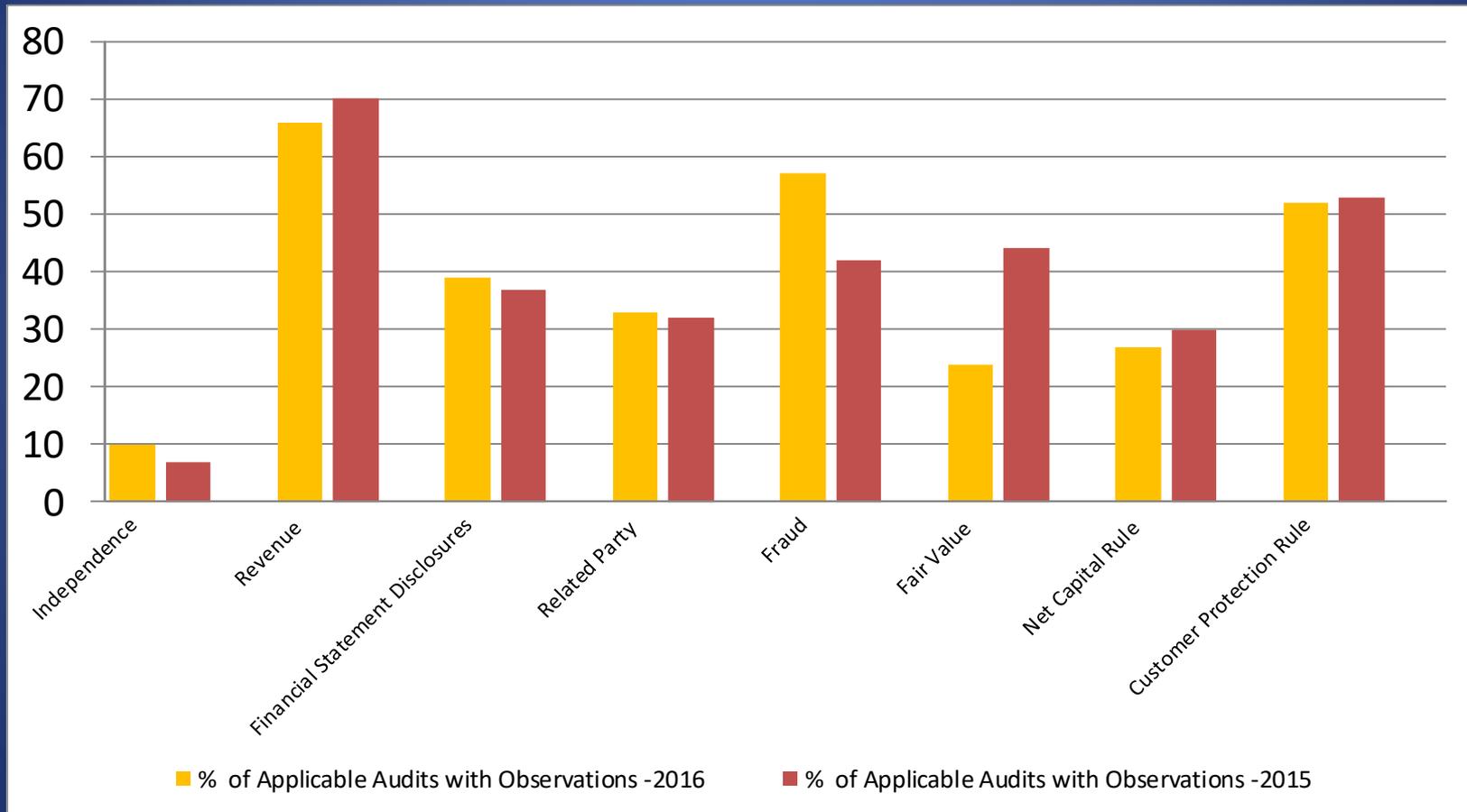
# Inspection Results by Area - 2016

## *Percentage of Applicable Engagements with Deficiencies*



# Inspections Observations by Audit Area 2016 Compared to 2015

## *Percentage of Applicable Audits with Observations*



# Perspective on Certain Audit Matters

- ❑ Risk Assessment
- ❑ Internal Controls
  - ❑ Controls Reliance Approach
  - ❑ Tests of Controls
  - ❑ Common Process
  - ❑ Use of Service Organization
  - ❑ Evaluation of Deficiencies
- ❑ Going Concern

# Perspective on Certain Attestation Matters

- ❑ Examination Procedures
  - ❑ Internal controls over compliance
  - ❑ Net Capital
  - ❑ Reserves – customer and PAB
- ❑ Review Procedures
  - ❑ Exemption claimed
  - ❑ Extent of procedures

# Actions for Auditors

- ❑ Understanding of, and compliance with, independence requirements
- ❑ Undertake only those broker-dealer engagements the firm can complete with professional competence
- ❑ Be proactive—prevent similar deficiencies from occurring
- ❑ Maintain policies and procedures to meet applicable PCAOB standards
- ❑ Ensure all audits and attestation engagements have an engagement quality review performed
- ❑ Importance of effective practice monitoring, including root cause analysis
- ❑ Provide appropriate guidance and training

# Questions



# Standard-Setting Update

Lisa Calandriello

Associate Chief Auditor

# Agenda

- ❑ Recently Adopted Standards
- ❑ Ongoing Standard-Setting Projects
- ❑ Research Projects
- ❑ Resources
- ❑ Keeping current with PCAOB standards

# Recently Adopted Standards

Standards that Improve the Relevance and Transparency of Audits:

- New Audit Report
- Disclosure of Engagement Partners and Other Accounting Firms Participating in Audits

# Ongoing Standard-Setting Projects (as of June 30, 2018)

- Auditing accounting estimates, including fair value measurements
- Auditor's use of the work of specialists
- Auditor's use of other auditors
- Going concern

# Research Projects (as of June 30, 2018)

- ❑ Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities
- ❑ Changes in the Use of Data and Technology in the Conduct of Audits
- ❑ The Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures
- ❑ Auditor's Consideration of Noncompliance with Laws and Regulations
- ❑ Auditor Communications with Audit Committees Concerning Independence

# Resources

Standards   Registration & Reporting   Inspections   Enforcement   International   Economic & Risk Analysis   Careers

Home > Standards > Auditing Standards

## Auditing Standards

### General Auditing Standards

#### 1000 General Principles and Responsibilities

- AS 1001: Responsibilities and Functions of the Independent Auditor
- AS 1005: Independence
- AS 1010: Training and Proficiency of the Independent Auditor
- AS 1015: Due Professional Care in the Performance of Work

#### 1100 General Concepts

- AS 1101: Audit Risk
- AS 1105: Audit Evidence
- AS 1110: Relationship of Auditing Standards to Quality Control Standards

#### 1200 General Activities

- AS 1201: Supervision of the Audit Engagement
- AS 1205: Part of the Audit Performed by Other Independent Auditors
- AS 1210: Using the Work of a Specialist
- AS 1215: Audit Documentation

#### Resources

- Downloadable PCAOB Auditing Standards
- Current and Recent Standard-Setting Activities

#### Reference Tools

- Identifying ASB and IAASB Analogous Standards
- Reorganized and Pre-Reorganized Numbering for PCAOB Auditing Standards

- Downloadable PDF of all current PCAOB auditing standards

# Resources (cont'd)

- ❑ Auditing Standards in Effect: Final Rules, Amending Releases, and Related SEC Approval Orders

Standards | Registration & Reporting | Inspections | Enforcement | International | Economic & Risk Analysis | Careers

Home > Standards > Auditing Standards

General Auditing Standards

- 1000 General Principles and Responsibilities
- 1100 General Concepts
- 1200 General Activities
- AS 1201: Supervision of the Audit Engagement

## AS 1215: Audit Documentation

**Adopting Release:** [PCAOB Release No. 2004-006](#)

**Effective Date of Standard:** For audits of financial statements, which may include an audit of internal control over financial reporting, with respect to fiscal years ending on or after Nov. 15, 2004. For other engagements conducted pursuant to the standards of the PCAOB, including reviews of interim financial information, this standard takes effect beginning with the first quarter ending after the first financial statement audit covered by this standard.

**Amendments:** [Amending releases and related SEC approval orders](#)

**Guidance on AS 1215:** [Staff Guidance for Auditors of SEC-Registered Brokers and Dealers](#)

Summary Table of Contents +

Introduction

Standards | Registration & Reporting | Inspections | Enforcement | International | Economic & Risk Analysis | Careers

Home > Standards > Auditing Standards

## Auditing Standards in Effect: Final Rules, Amending Releases, and Related SEC Approval Orders

The following table lists the PCAOB auditing standards in effect, the standard's final rule, the release(s) that amended the respective standard since it was adopted by the Board, and the related SEC approval order(s).

The organizational structure and numbering of the auditing standards were amended on December 31, 2016. A reference table with the reorganized and pre-reorganized numbering can be found [here](#).

AUDITING STANDARD	PCAOB RELEASE	SEC APPROVAL ORDER
AS 1001, <i>Responsibilities and Functions of the Independent Auditor</i>	<a href="#">PCAOB Release No. 2015-002</a>	<a href="#">SEC Release No. 34-75935 (Sept. 17, 2015)</a>
	<a href="#">PCAOB Release No. 2010-004</a>	<a href="#">SEC Release No. 34-63606 (Dec. 23, 2010)</a>
	<a href="#">PCAOB Release No. 2003-006</a>	<a href="#">SEC Release No. 34-47745 (Apr. 25, 2003)</a>
AS 1005, <i>Independence</i>	<a href="#">PCAOB Release No. 2015-002</a>	<a href="#">SEC Release No. 34-75935 (Sept. 17, 2015)</a>



# Resources (cont'd)

- ❑ PCAOB Auditing Standards as of December 14, 2017

**Standards**   Registration & Reporting   Inspections   Enforcement   International & I

[Home](#) > [Standards](#) > [Archived Standards and Guidance](#)

## Archived Standards and Guidance

This archive consists of standards and guidance that are no longer in effect.

[Summary Table of Contents](#) 

### Auditing Standards

Below are past versions of PCAOB auditing standards. [View the current version of the auditing standards.](#)

- [PCAOB Auditing Standards as of December 14, 2017](#)   
(reflecting amendments effective January 31 and June 30, 2017)
- [PCAOB Auditing Standards before December 31, 2016](#)

# Keeping Current with PCAOB Standards

- ❑ PCAOB Standards website –  
<http://www.pcaobus.org/Standards/Pages/default.aspx>
  - ❑ PCAOB standards and rules
  - ❑ Guidance
  - ❑ Standard-related activities
  - ❑ Standing Advisory Group
- ❑ Contact the Standards Inquiry Line via the web form or at (202) 591-4395
- ❑ Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our website at:  
<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>

# Questions



# Q&A and Closing Remarks

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFDEN2018>