

Forum for Auditors of Broker-Dealers

November 2, 2018

Jersey City, NJ

Welcome

Greg Scates, Director
Office of Outreach

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 case studies covering the auditing of revenue, going concern, and the supplemental schedule for net capital and the review procedures for exemption reports. 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.

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	60
New Auditor's Report	30
SEC Update	45
Inspections Update and Case Studies-Part 1	60
Inspections Update and Case Studies-Part 2	70
FINRA Update	45
Standards Update	15
Enforcement Update	30
CPA	25
Total Minutes (400)	400
Total Minutes Divided by 50	8
MAXIMUM RECOMMENDED CPE CREDIT – 8.0 Hours	

Signature _____ Date _____

Polling and Messaging

- ❑ Use the following URL in your internet browser:

<https://web.meetoo.com/m#/123757922>

OR

- ❑ Download the Meetoo app (iOS and Android) and enter meeting ID
123-757-922

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

Jim Kaiser
Board Member

Panel Discussion: Engagement Quality Review

Greg Scates, Office of Outreach

Greg MacCune, Inspections

Mike Walters, Inspections

Discussion Topics

- Inspection findings and experience
- Possible root causes
- Qualifications to serve
- Significant judgments
- 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

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	5	4	0
Insufficient review by the engagement quality reviewer	50	10	4
Engagement quality reviewer qualifications	1	0	0

Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers issued on August 20, 2018.

Panel Discussion: Engagement Quality Review

What is the greatest challenge in having an effective EQR on broker-dealer 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

Panel Discussion: Engagement Quality Review

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	4	5	2
Documentation of significant findings or issues	8	0	0
Other documentation matters	6	0	0

Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers issued on August 20, 2018.

Panel Discussion: Engagement Quality Review

Questions



New Auditor's Report

Jennifer Rand
Deputy 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



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

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 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.

- 1 1990
- 2 1991
- 3 1992

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.

1. 1990

2. 1991

3. 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 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.

1 1997

2 2002

3 2017

4 2018

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.

1. 1997

2. 2002

3. 2017

4. 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 has been corrected (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?

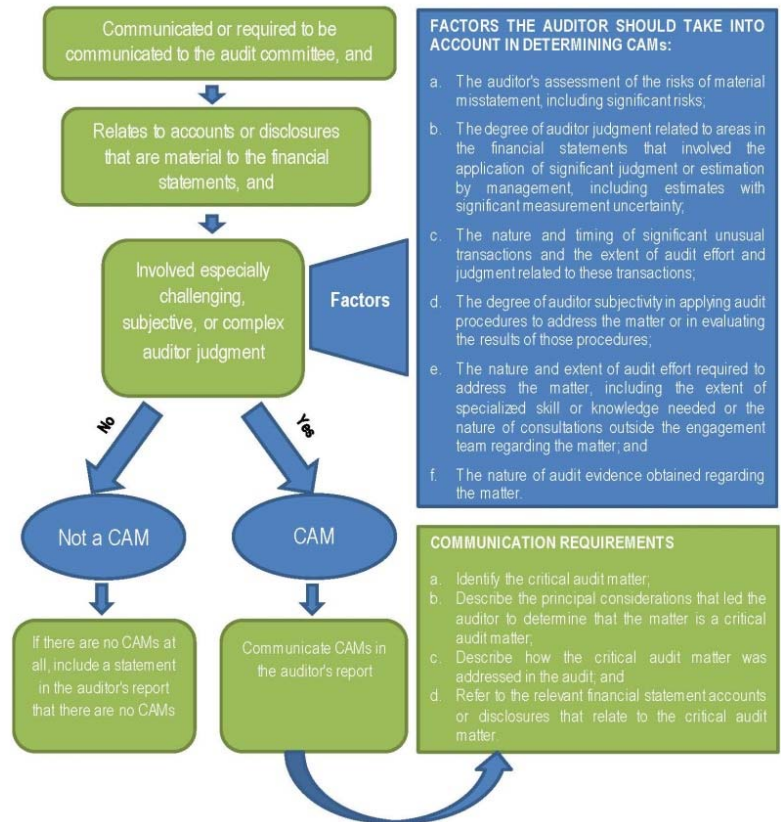
1. Critical Accounting Matter
- 2. Critical Audit Matter**
3. Current Audit Matter
4. Certified Audit Magician

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 Aug. 23, 2018)
- ❑ 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



BREAK (15 minutes)



PCAOB Forum for Auditors of Broker-Dealers: SEC Update

November 2, 2018

Michael Berrigan, Professional Accounting Fellow – Accounting
Godfrey Murangi, Associate Chief Accountant – Professional Practice
Office of the Chief Accountant
U.S. Securities and Exchange Commission

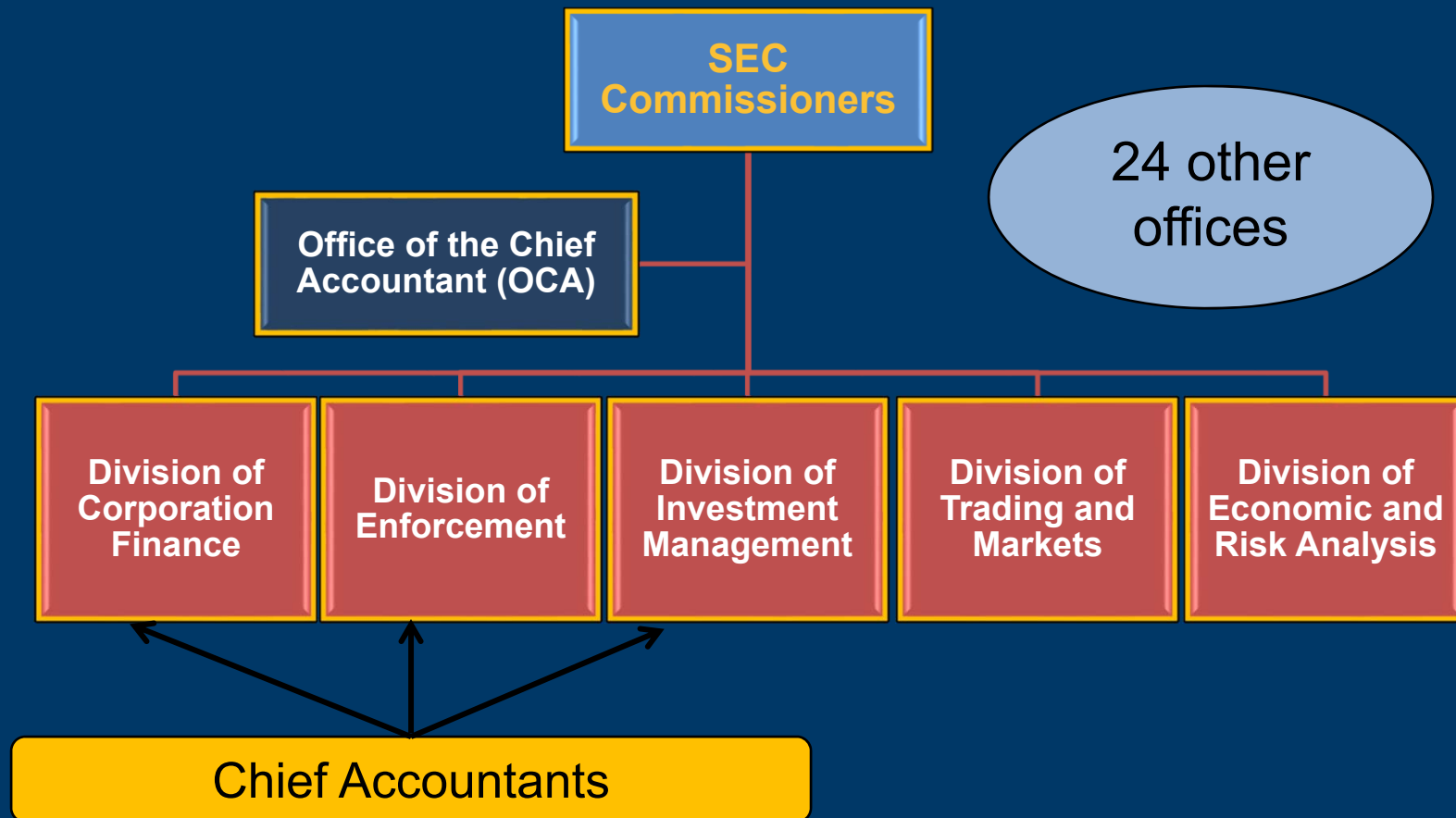
Disclaimer

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

Professional Practice: Responsibilities

- Assist in Commission oversight of the PCAOB
- ICFR
- Audit committee disclosure and communications
- Auditor independence
- Other activities:
 - Enforcement assistance
 - Rulemaking support
 - Liaison with SEC's Trading & Markets and FINRA

Accounting: New standard implementation

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

New GAAP Implementation

- Cross-functional exercise
- Internal control over financial reporting (ICFR)
- Comparability across industries
- Evaluate specific facts and applicable literature
- Consistency in application of accounting
- Importance of disclosures (including SAB 74)
- Tone at the top/audit committee role

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: Credit Losses Standard

- OCA staff actively monitoring implementation
- Support transition resource group discussions
 - Registrants should escalate key implementation issues
- SAB 102 & FRR 28 concepts remain relevant
 - Development, documentation and application of a systematic methodology (procedural discipline)
 - Data reliability
 - Documentation of adjustments
- Consultation observations

Professional Practice: ICFR

- Importance of ICFR to:
 - Broker Dealers
 - Investors
 - Management
 - Audit Committees
- New GAAP standards
- Collaboration – all stakeholders

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: Other Updates

Professional Practice: Topics

- Auditor's reporting model
- Auditor independence

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, business 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
- 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
- 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>

Contact Information

- Division of Trading and Markets
 - Phone: (202) 551-5777
 - E-mail : tradingandmarkets@sec.gov
 - <https://www.sec.gov/divisions/marketreg/bdnotices.htm>

- Office of the Chief Accountant
 - Phone: (202) 551-5300
 - E-mail : OCA@sec.gov

Inspections Update and Case Studies – Part I

Division of Registration and Inspections

Bob Maday

Kate Ostasiewski

Greg MacCune

Mike Walters

Agenda

- ❑ Inspection Program Overview and Objectives
- ❑ 2018 Inspection Plan
- ❑ 2017 Inspection Results Overview
- ❑ 2017 Inspection Results and Case Studies - Selected Areas
 - ❑ AT No. 2 Review Procedures
 - ❑ Auditing the Supporting Schedules
 - ❑ Financial Statement Presentation and Disclosures
 - ❑ Auditing Revenue and Responding to the Risks of Material Misstatement Due to Fraud
- ❑ Other Topics

Inspection Program Overview

- ❑ 2010 – Dodd Frank Wall Street Reform and Consumer Protection Act
- ❑ 2011 – PCAOB adopts Rule 4020T, Interim Inspection Program Related to Audits of Brokers and Dealers
- ❑ 2013 – SEC adopts amendments to Rule 17a-5
- ❑ 2013 – PCAOB adopts AT No.1 and AT No. 2
- ❑ 2014 – For fiscal years ended on or after June 1
 - ❑ Broker-dealers required to file Compliance Reports or Exemption Reports
 - ❑ Audits and attestation engagements required to be performed under PCAOB standards

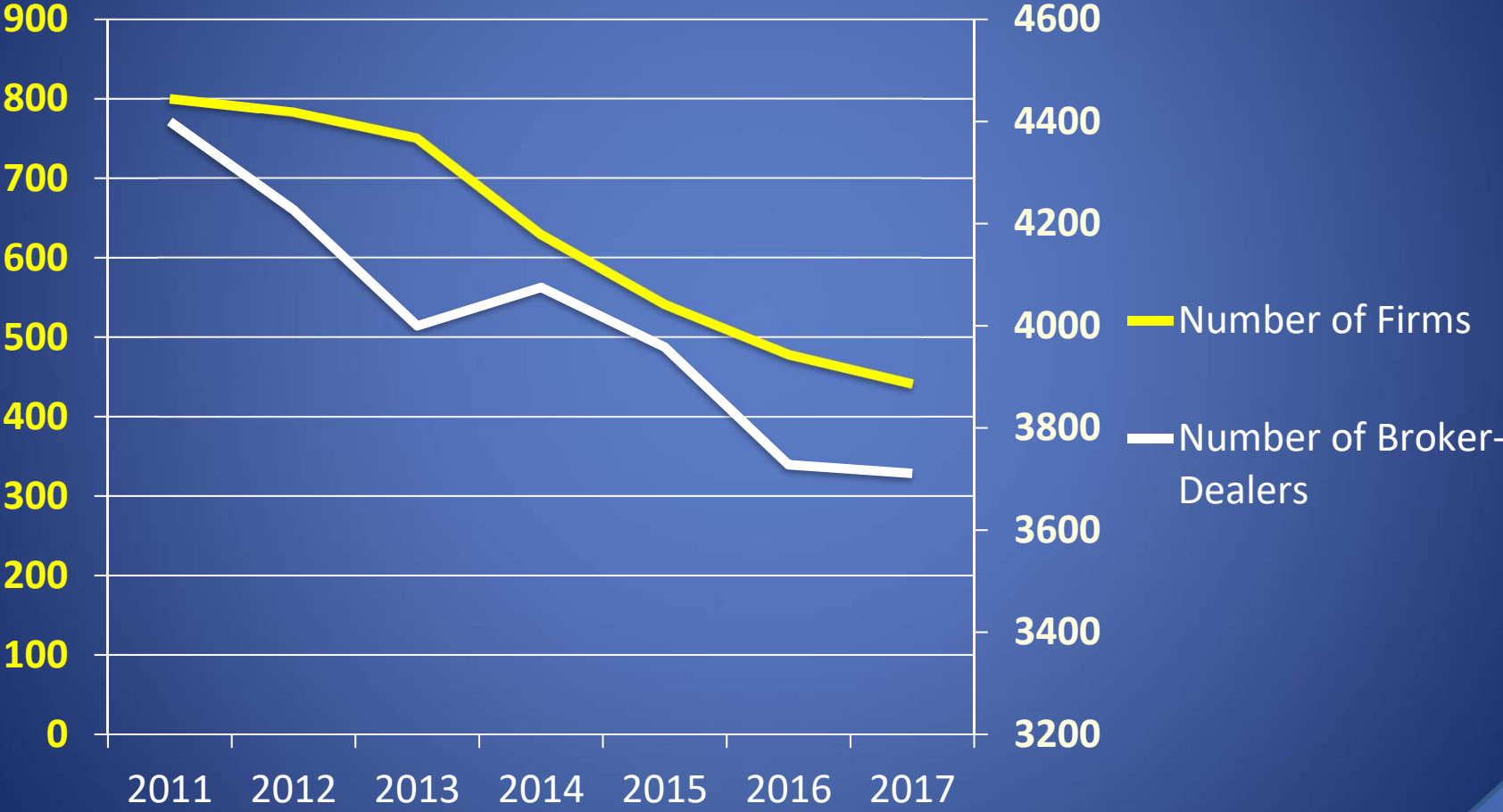
Inspection Program Objectives

- ❑ 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

PCAOB Broker-Dealer Auditor Webpage

- ❑ Information For Auditors of Broker-Dealers:
<https://pcaobus.org/Pages/BrokerDealers.aspx>
- ❑ Report on 2017 Inspections of Broker-Dealer Auditors
- ❑ Inspection Program Background
- ❑ Useful Links
 - ❑ Previous Inspection Reports and Staff Inspection Briefs
 - ❑ Standards and Staff Guidance
 - ❑ Other Releases and Guidance
 - ❑ Enforcement, Including Recent Settled Orders
 - ❑ Outreach, Including Forums and Webinars

Broker-Dealers and Firms Auditing Broker-Dealers by Year



Firms Auditing Broker-Dealers 2017 and 2012

Broker-Dealer Audits per Firm	Number of Firms - 2017	Percentage of Firms - 2017	Number of Firms - 2012	Percentage of Firms - 2012
1	144	33%	363	46%
2 to 5	170	39%	293	37%
6 to 20	89	20%	90	12%
21 to 50	24	5%	23	3%
51 to 100	9	2%	8	1%
More than 100	5	1%	6	1%
Total	441	100%	783	100%

2018 Inspection Plan

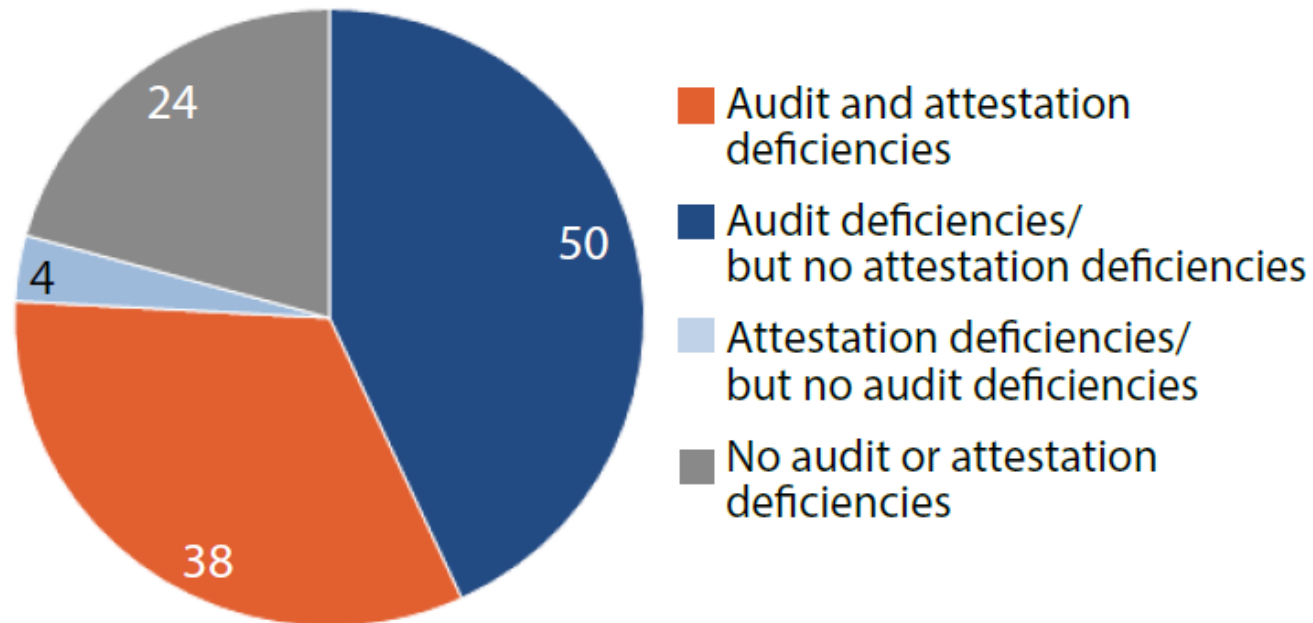
- ❑ Audits of the financial statements and supporting schedules of brokers and dealers, required to be performed in accordance with PCAOB standards
- ❑ Examination and review engagements, required to be performed in accordance with PCAOB standards
- ❑ Firm quality control procedures

Inspection Observations

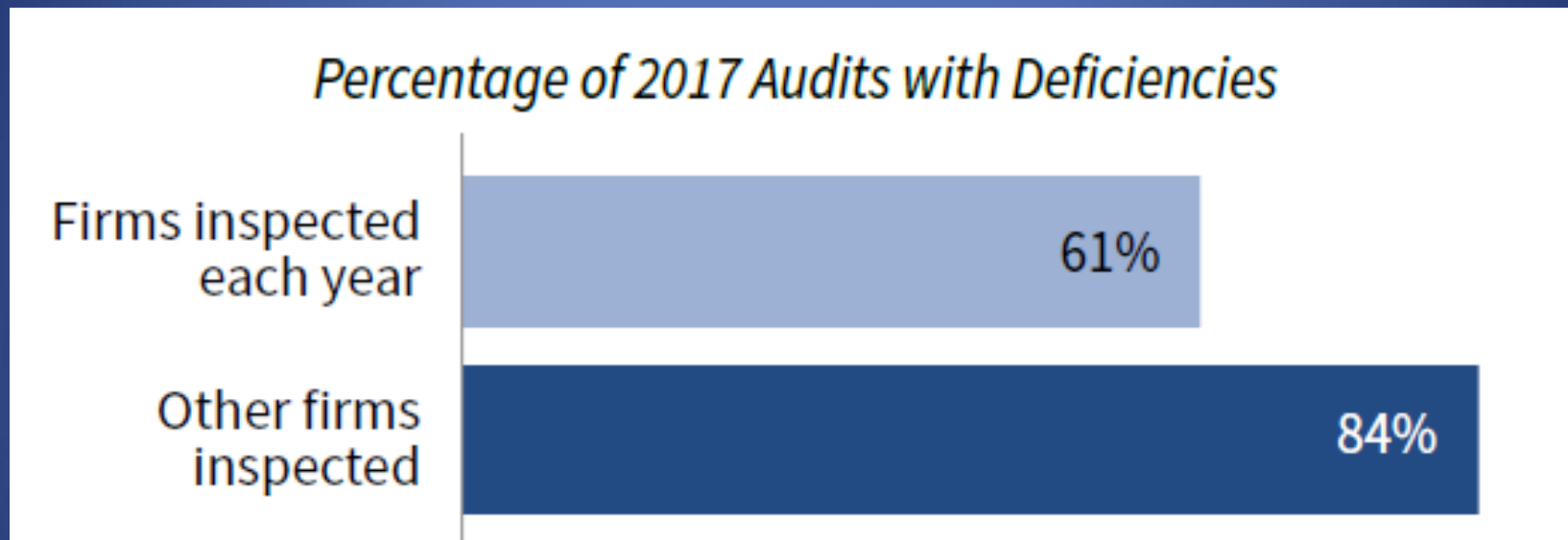
- ❑ The information presented in the following slides is not necessarily indicative of the full population of firms, or of all audit and attestation engagements of brokers and dealers, because the selection of firms for inspection and the audit and attestation engagements for brokers and dealers covered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

2017 Inspection Results

2017 Inspections Covering 116 Audits and the Related Attestation Engagements



2017 Inspection Results



Firms inspected each year refers to the years 2015, 2016, and 2017.

Audit and Other Deficiencies - 2017 and 2016

Audit and Other Deficiencies	2017			2016
	Number of Audits with Deficiencies	Number of Applicable Audits	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Audit Deficiencies Related to the Financial Statements				
Revenue	73	112	65%	66%
Assessing and Responding to Risks of Material Misstatement Due to Fraud	16	25	64%	57%
Financial Statement Presentation and Disclosures	38	116	33%	39%
Related Party Relationships and Transactions	21	66	32%	33%
Fair Value Measurements	7	25	28%	24%
Receivables and Payables	11	35	31%	25%
Audit Deficiencies Related to the Supporting Schedules				
Net Capital Rule	28	78	36%	27%
Customer Protection Rule	14	29	48%	52%
Other Deficiencies Related to the Audit				
Auditor's Reporting on the Financial Statements and Supporting Schedules	12	116	10%	13%
Audit Documentation	15	116	13%	28%
Engagement Quality Review	55	93	59%	57%
Evaluation of Control Deficiencies	8	116	7%	N/A
Deficiencies in Independence Communications to the Audit Committee (or equivalent)				
Independence Communications to the Audit Committee (or equivalent)	14	48	29%	19%

Attestation and Other Deficiencies - 2017 and 2016

Attestation and Other Deficiencies	2017			2016
	Number of Attestation Engagements with Deficiencies	Number of Applicable Attestation Engagements	Percentage of Attestation Engagements with Deficiencies	Percentage of Attestation Engagements with Deficiencies
Attestation Deficiencies				
Examination Procedures	19	27	70%	70%
Review Procedures	28	87	32%	28%
Other Deficiencies Related to Examination Engagements				
Examination Report	2	27	7%	10%
Examination Documentation	2	27	7%	5%
Engagement Quality Review	4	20	20%	20%
Other Deficiencies Related to Review Engagements				
Review Report	11	87	13%	14%
Review Documentation	5	87	6%	21%
Engagement Quality Review	14	54	26%	26%

AT No. 2 Review Procedures

Review Procedures – 2017 Deficiencies



- Gaining an understanding of exemption conditions
- Making required inquiries and performing other review procedures
- Evaluation of results
- Other required review procedures

Which of the following is NOT required to be included in the Exemption Report?

1. Identification of the provisions in paragraph (k) of SEC Rule 15c3-3 under which the BD claimed exemption
2. BD met the identified exemption provisions throughout the most recent fiscal year without exception OR BD met the identified exemption provisions throughout the most recent fiscal year except as described in the exemption report
3. Management of the BD is responsible for compliance with the identified exemption provisions throughout the fiscal year and for its assertions
4. Identification of exceptions during the most recent fiscal year in meeting the identified exemption provisions

Which of the following is NOT required to be included in the Exemption Report?

1. Identification of the provisions in paragraph (k) of SEC Rule 15c3-3 under which the BD claimed exemption
2. BD met the identified exemption provisions throughout the most recent fiscal year without exception OR BD met the identified exemption provisions throughout the most recent fiscal year except as described in the exemption report
- 3. Management of the BD is responsible for compliance with the identified exemption provisions throughout the fiscal year and for its assertions**
4. Identification of exceptions during the most recent fiscal year in meeting the identified exemption provisions

Review Procedures Case Study

Broker-Dealer Facts

- ❑ Nature of operations:
 - ❑ Introduces customer equity and fixed-income transactions to its clearing broker and earns commissions
 - ❑ Sells mutual funds and variable annuities which are transacted directly with the product sponsors (and not through the clearing broker) and earns up front and trail commissions
- ❑ Exemption Report included the following statements:
 - ❑ Claimed an exemption from Rule 15c3-3 under paragraph (k)(2)(ii)
 - ❑ Cleared all customer transactions through another broker-dealer on a fully disclosed basis
 - ❑ Met the exemption provisions under Rule 15c3-3 paragraph(k)(2)(ii) throughout the year without exception

Review Procedures Case Study

Review Procedures

- Read the Exemption Report
- Inquired of BD management regarding:
 - Whether the BD was in compliance with the exemption provisions throughout the year under review or whether exceptions have been identified
 - Controls in place to maintain compliance with exemption provisions
 - Regulatory examinations that are relevant to compliance with exemption provisions
- Read the report from the SEC examination of the BD
- Performed other review procedures:
 - Reviewed a check receipts blotter
- Obtained a signed management representation letter

The engagement team should make additional inquiries regarding which of the following?

1. The nature and frequency of monitoring activities relating to compliance with the exemption provisions or controls over compliance
2. The results of monitoring activities relating to compliance with the exemption provisions or controls over compliance, including details of any exceptions
3. The resolution of previously reported exceptions to the exemption provisions
4. The nature and frequency of customer complaints that are relevant to compliance with the exemption provisions

The engagement team should make additional inquiries regarding which of the following?

- 1. The nature and frequency of monitoring activities relating to compliance with the exemption provisions or controls over compliance**
- 2. The results of monitoring activities relating to compliance with the exemption provisions or controls over compliance, including details of any exceptions**
3. The resolution of previously reported exceptions to the exemption provisions
- 4. The nature and frequency of customer complaints that are relevant to compliance with the exemption provisions**

The engagement team reviewed the check receipts blotter. Which of the following statements is NOT true regarding review of the blotter?

1. It may provide additional assurance over prompt transmittal
2. It is a required review procedure for all review engagements per AT No. 2
3. It may result in identification of additional exceptions
4. It may be a procedure responsive to identified risk factors

The engagement team reviewed the check receipts blotter. Which of the following statements is NOT true regarding review of the blotter?

1. It may provide additional assurance over prompt transmittal
- 2. It is a required review procedure for all review engagements per AT No. 2**
3. It may result in identification of additional exceptions
4. It may be a procedure responsive to identified risk factors

Auditing the Supporting Schedules

Net Capital Supporting Schedule – 2017 Deficiencies



- Minimum net capital requirements
- Adjustments to net worth
- Allowable assets
- Haircuts
- Operational charges and other deductions
- Other procedures

Net Capital Case Study

Broker-Dealer Facts

- ❑ Statement of financial condition and net capital computation data:
 - ❑ Commissions receivable from broker-dealers of \$500,000
 - ❑ Non-allowable receivable - \$100,000
 - ❑ Advisory fees receivable from customers of \$300,000 and associated payable to representative of \$200,000
 - ❑ Non-allowable receivable - \$100,000
 - ❑ Minimum net capital of \$5,000
 - ❑ Excess net capital of \$100,000

Net Capital Case Study

Audit Procedures

- ❑ Established materiality at \$50,000

- ❑ Obtained the fourth quarter FOCUS report and:
 - ❑ Tested the mathematical accuracy of the net capital computation in the FOCUS
 - ❑ Traced the amounts from the FOCUS report to the audited financial statements and supplemental information
 - ❑ Recalculated the non-allowable portion of advisory fee receivable by netting the receivable with the related payable

- ❑ Audit conclusion:
 - ❑ All receivables were appropriately classified as allowable or non-allowable assets in the net capital computation

Based on the information provided, for which of the following receivables should the engagement team perform additional procedures to test the net capital treatment in accordance with AS 2701?

- 1 Commissions receivable from broker-dealers
- 2 Advisory fees receivable from customers
- 3 Both 1 and 2
- 4 None of the above

Based on the information provided, for which of the following receivables should the engagement team perform additional procedures to test the net capital treatment in accordance with AS 2701?

1. Commissions receivable from broker-dealers
2. Advisory fees receivable from customers
- 3. Both 1 and 2**
4. None of the above

Net Capital Case Study

Additional Audit Procedures

- ❑ Obtained the aging schedule for commissions receivable from broker-dealers at December 31:
 - ❑ Recalculated the commissions receivable aged greater than 30 days per the aging schedule
 - ❑ Traced the total receivables aged greater than 30 days to the amount reported as non-allowable on the fourth quarter FOCUS report

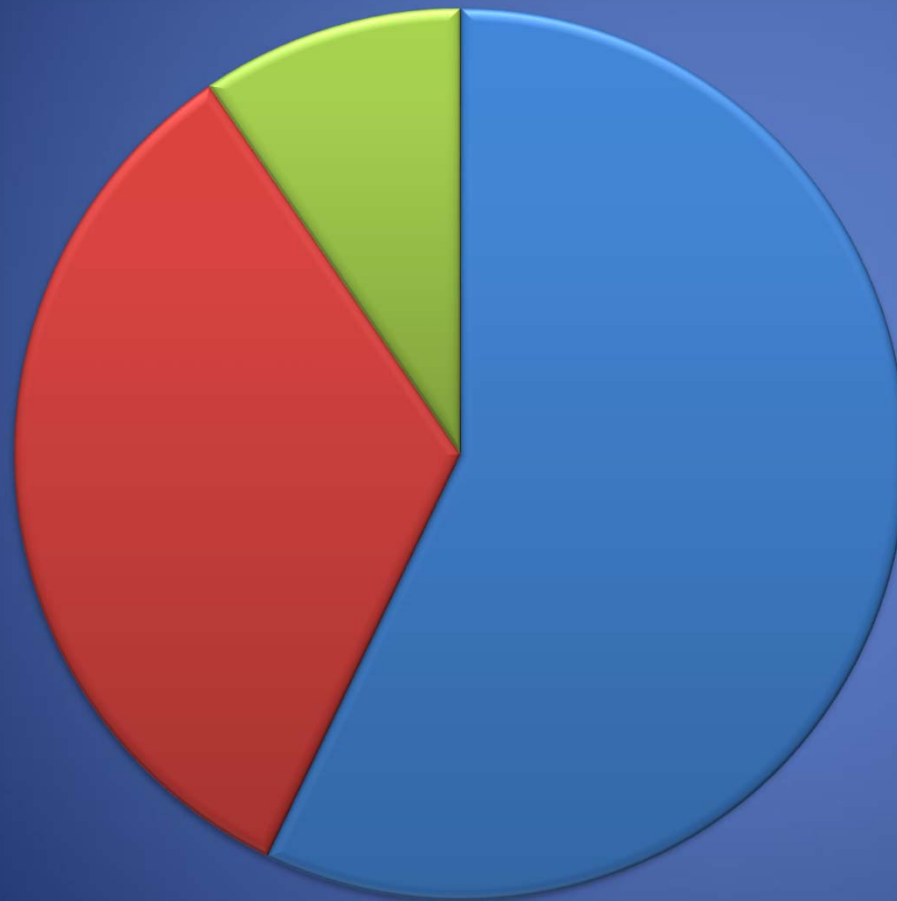
What should the engagement team consider in determining sufficiency of its evidence regarding the treatment of the commissions receivable from broker-dealers in the net capital computation?

1. Risk of material misstatement
2. Materiality considerations
3. Evidence obtained from the audit of the financials
4. All of the above

What should the engagement team consider in determining sufficiency of its evidence regarding the treatment of the commissions receivable from broker-dealers in the net capital computation?

1. Risk of material misstatement
2. Materiality considerations
3. Evidence obtained from the audit of the financials
4. **All of the above**

Customer Protection Rule - 2017 Deficiencies



■ Customer and broker-dealer debits or credits

■ Possession or control requirements

■ Other procedures

How many broker-dealers filed annual reports for fiscal years ending in 2017 and whose financial statements were audited by a registered public accounting firm?

1 2,551

2 3,711

3 3,958

4 4,400

How many broker-dealers filed annual reports for fiscal years ending in 2017 and whose financial statements were audited by a registered public accounting firm?

1. 2,551

2. 3,711

3. 3,958

4. 4,400

Questions

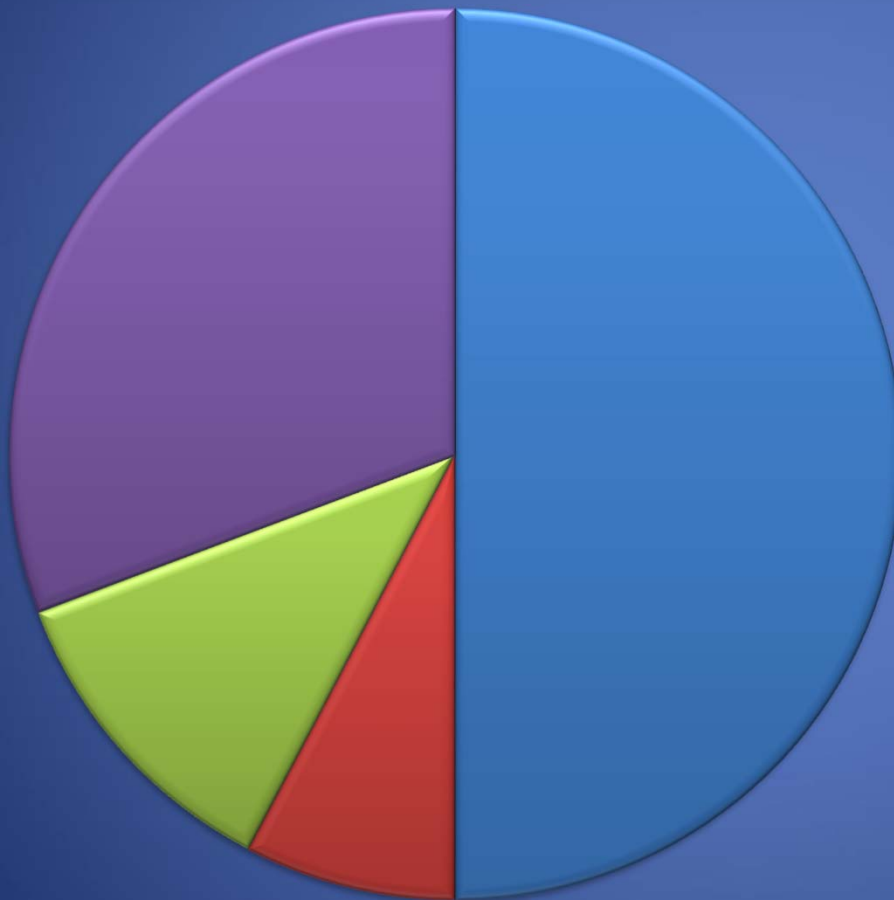


LUNCH (70 minutes)

Inspections Update and Case Studies – Part II

Financial Statement Presentation and Disclosures

Financial Statement Presentation and Disclosures – 2017 Deficiencies



- Identifying and evaluating omitted, incomplete or inaccurate disclosures
- Evaluating fair value disclosures
- Evaluating going concern disclosures
- Evaluating financial statement presentation

Going Concern Broker-Dealer Characteristics

- Limited operations
- Dependent on related parties
- Operates at or near breakeven
- Minimal excess net capital
- Customer / revenue concentration
- Regulatory findings or legal contingencies

Going Concern – ASC 205-40

- Now effective
- Management must perform its own going concern assessment
- Disclosure requirements

Substantial Doubt

- ❑ GAAP definition (ASC 205-40)
- ❑ AS 2415
 - ❑ Information that significantly contradicts the going concern assumption
 - ❑ Conditions and events
- ❑ SAPA No. 13

Going Concern Case Study

Broker-Dealer Facts – Scenario 1

- ❑ Selected BD financial statement data
 - ❑ Net operating losses for most recent two years
 - ❑ Negative cash flows from operations this year
 - ❑ Non-compliance with net capital requirements during the year
- ❑ BD's parent is an insurance company with stable operations and available capital to fund the BD
- ❑ BD did not perform a going concern assessment and made no financial statement disclosures regarding conditions and events or management's plans

Based on the information provided,
does it appear that the BD properly
applied ASC 205-40?

1. Yes
2. No

Based on the information provided, does it appear that the BD properly applied ASC 205-40?

1. Yes

2. No

Going Concern Case Study

Broker-Dealer Facts – Scenario 2

- ❑ Selected BD financial statement data:
 - ❑ Net operating losses for most recent two years
 - ❑ Negative cash flows from operations this year
 - ❑ Non-compliance with net capital requirements during the year
- ❑ BD's parent is an insurance company with stable operations and available capital to fund the BD
- ❑ BD performed a going concern assessment and concluded that substantial doubt existed, but was mitigated by management's plans
- ❑ BD made no financial statement disclosure regarding these conditions and events or management's plans

Going Concern Case Study

Audit Procedures – Scenario 2

- ❑ Reviewed the BD’s assessment, which concluded substantial doubt existed, but was mitigated by a support agreement from the Parent
- ❑ Read the agreement that stated the Parent would “...provide ongoing funding to ensure the BD would maintain sufficient capital to operate and meet net capital requirements”
- ❑ Noted the agreement was in effect at the financial statement date
- ❑ Auditor conclusion
 - ❑ Substantial doubt about the BD’s ability to continue as a going concern was mitigated by the support agreement from the Parent

Has the auditor performed sufficient procedures to support its conclusion that substantial doubt about the BD's ability to continue as a going concern was mitigated by the support agreement from the Parent?

1. Yes
2. No
3. It depends

Has the auditor performed sufficient procedures to support its conclusion that substantial doubt about the BD's ability to continue as a going concern was mitigated by the support agreement from the Parent?

1. Yes
- 2. No**
3. It depends

What should the BD disclose in its financial statements regarding its ability to continue as a going concern?

1. Nothing, because the auditor concluded that substantial doubt was mitigated
2. The principal conditions or events that raised substantial doubt and the BD's evaluation of the significance of these conditions or events
3. The BD's plans that alleviated substantial doubt
4. Both 2 and 3

What should the BD disclose in its financial statements regarding its ability to continue as a going concern?

1. Nothing, because the auditor concluded that substantial doubt was mitigated
2. The principal conditions or events that raised substantial doubt and the BD's evaluation of the significance of these conditions or events
3. The BD's plans that alleviated substantial doubt

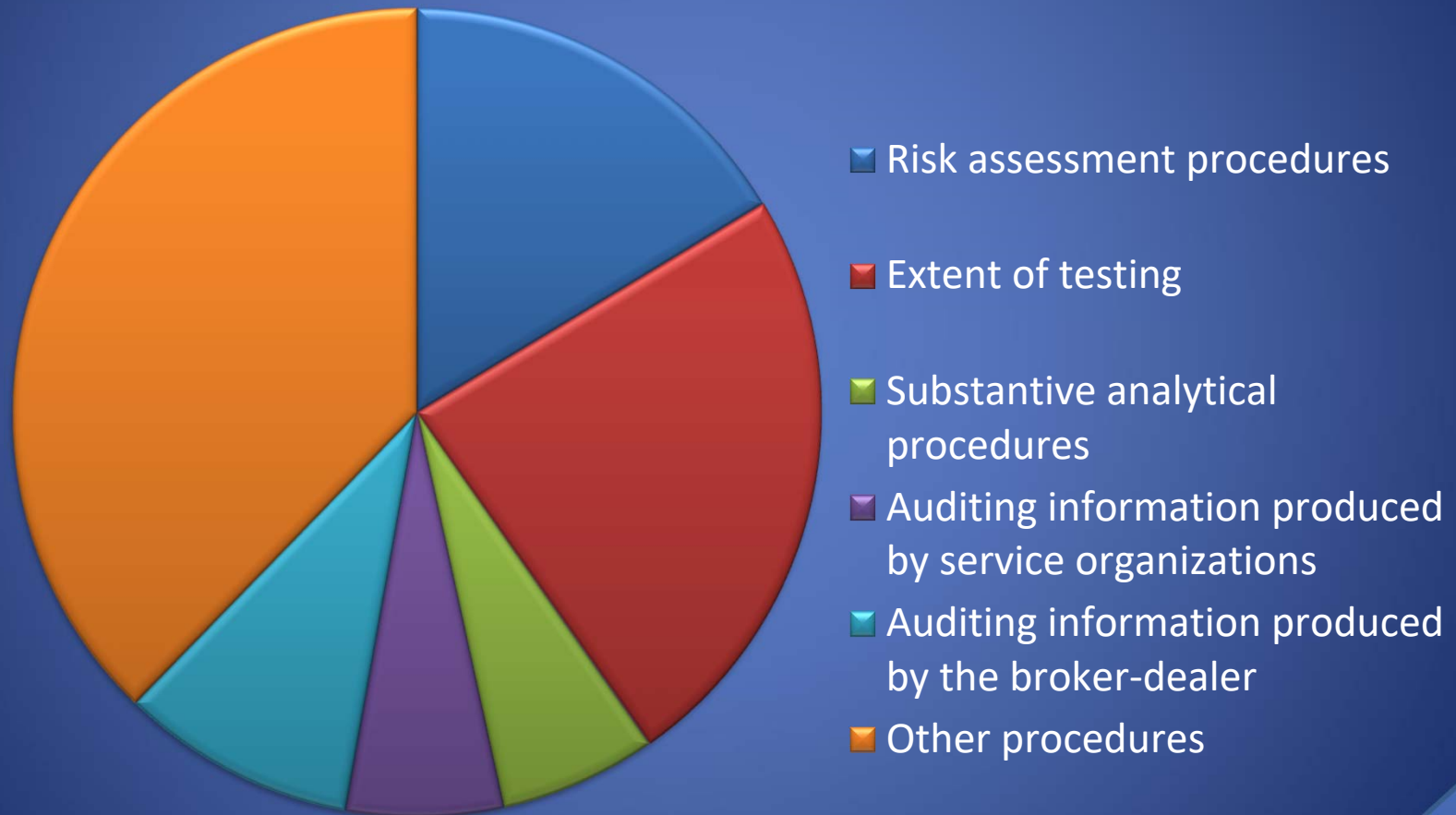
4. Both 2 and 3

Going Concern Disclosure Requirements

- ❑ ASC 205-40
 - ❑ Substantial doubt is overcome by management's plans
 - ❑ Conditions and events
 - ❑ Evaluation of the significance of conditions and events
 - ❑ Plans that alleviated substantial doubt
 - ❑ Substantial doubt is not overcome
 - ❑ Conditions and events
 - ❑ Evaluation of the significance of conditions and events
 - ❑ Plans intended to mitigate the conditions and events
 - ❑ Subsequent disclosures
 - ❑ Continued assessment in subsequent periods
- ❑ Other

Auditing Revenue and Assessing and Responding to Risks of Material Misstatement Due to Fraud

Auditing Revenue - 2017 Deficiencies



Auditing Revenue – 2017 Deficiencies

Risk Assessment Procedures

- Understand material sources of revenue
- Understand sources of revenue entries
- Walkthrough controls
- Evaluate the design of controls, including controls that address fraud or significant risks
- Assess risks at the assertion level
- Document risk assessment judgments

Auditing Revenue – 2017 Deficiencies

Extent of Testing

- ❑ Failures to test
 - ❑ Material account balances
 - ❑ Relevant assertions
- ❑ Unsupported controls reliance
 - ❑ Controls at the Broker-Dealer
 - ❑ Controls at service organizations

Auditing Revenue – 2017 Deficiencies

Other Procedures to Test Revenue

- Nature of procedures performed
- Accounting for revenue transactions
 - Contractual arrangement
 - GAAP Guidance (Currently ASC 605)
- Trade date versus settlement date accounting

When the auditor obtains Information Produced by the Company (IPC) for the purposes of performing substantive procedures, the auditor should obtain assurance over the accuracy and completeness of the IPC. Under PCAOB standards, which of the following can provide sufficient assurance over accuracy and completeness?

- 1 Testing controls over accuracy and completeness of the IPC
- 2 Substantive testing of accuracy and completeness of the IPC
- 3 Both 1 and 2
- 4 None of the above

When the auditor obtains Information Produced by the Company (IPC) for the purposes of performing substantive procedures, the auditor should obtain assurance over the accuracy and completeness of the IPC. Under PCAOB standards, which of the following can provide sufficient assurance over accuracy and completeness?

1. Testing controls over accuracy and completeness of the IPC
2. Substantive testing of accuracy and completeness of the IPC
- 3. Both 1 and 2**
4. None of the above

Using Information Produced by the Company - Auditing Standards



Assessing and Responding to Risks of Material Misstatement Due to Fraud - 2017 Deficiencies



- Identification and assessment of the risks of material misstatement due to fraud
- Responses to the assessed risks of material misstatement due to fraud – management override
- Responses to fraud risk related to improper revenue recognition

Revenue / Fraud Risk Case Study Broker-Dealer Facts

- ❑ Nature of operations:
 - ❑ Introduces customer security transactions to its clearing broker for a fee (commission) per transaction
 - ❑ Provides underwriting and asset management services
- ❑ Selected financial statement data (year-end December 31):
 - ❑ Commissions - \$3.0 million
 - ❑ Advisory fees - \$2.0 million
- ❑ Books and records:
 - ❑ Records commissions daily based on transaction data per its trade blotter
 - ❑ Records advisory fees based on reports provided by a related party registered investment adviser

Revenue / Fraud Risk Case Study

Audit Risk Assessment

- ❑ Control risk – high
 - ❑ The audit plan does not include relying on controls to modify nature, timing, and extent of substantive procedures

- ❑ Identified a fraud risk related to improper revenue recognition
 - ❑ Risk attributed to commissions
 - ❑ Concluded no fraud risk exists for advisory fees

Revenue / Fraud Risk Case Study

Commissions Audit Procedures

- ❑ Selected commissions from a sample of monthly trade blotters
- ❑ For each selection, performed the following tests of details:
 - ❑ Traced the commission amount for proper inclusion in the BD's general ledger entry to record commissions on the trade date
 - ❑ Compared trade details and commission amount to the corresponding monthly clearing broker statement
 - ❑ Vouched cash receipt to the BD's bank statement

Did the engagement team's procedures adequately address the risk of material misstatement related to completeness?

1. Yes
2. No

Did the engagement team's procedures adequately address the risk of material misstatement related to completeness?

1. Yes

2. No

Which of the following risks of material misstatement related to valuation (allocation) are not addressed through the engagement team's procedures?

- 1 BD's system does not accurately calculate commissions
- 2 Commission rates do not agree to underlying source (e.g., commission schedule, rate card, or customer agreement)
- 3 Both 1 and 2
- 4 All of the above risks are addressed

Which of the following risks of material misstatement related to valuation (allocation) are not addressed through the engagement team's procedures?

1. BD's system does not accurately calculate commissions
2. Commission rates do not agree to underlying source (e.g., commission schedule, rate card or customer agreement)
- 3. Both 1 and 2**
4. None - all of the above risks are addressed

The engagement team tested advisory fees through substantive analytic procedures. Could substantive analytic procedures provide sufficient assurance?

- 1 Yes
- 2 No
- 3 It depends

The engagement team tested advisory fees through substantive analytic procedures. Could substantive analytic procedures provide sufficient assurance?

1. Yes

2. No

3. It depends

Other Topics

ASC 606 – New GAAP Revenue Standard

Step 1

Identify the contract(s) with a customer

Step 2

Identify the performance obligations in the contract

Step 3

Determine the transaction price

Step 4

Allocate the transaction price to the performance obligations

Step 5

Recognize revenue when (or as) each performance obligation is satisfied

ASC 606 Concepts for Broker-Dealers

(Source: AICPA Brokers and Dealers in Securities Revenue Recognition Task Force)

Revenue Stream	Expected Overall Impact
Investment Banking M&A Advisory Fees	Moderate
Commission Income	Minimal
Selling and Distribution Fee Revenue	Minimal
Underwriting Revenue	Minimal

Other Inspection Observations

- Engagement quality review deficiencies
- Audit documentation deficiencies
- Independence findings

Actions For Audit Firms

- ❑ Improving Quality Control Systems
 - ❑ Addressing Identified Deficiencies
 - ❑ Strengthening Control Systems
- ❑ Performing Audits and Attestation Engagements
 - ❑ Auditing Revenue
 - ❑ Assessing and Responding to Risks of Material Misstatement Due to Fraud
 - ❑ Customer Protection Rule
 - ❑ Engagement Quality Review
 - ❑ Examination Procedures

Questions



FINRA Perspectives

PCAOB Broker Dealer Forum

November 2, 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**
- **Recent and Upcoming Changes**

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 Communications

- **Report on FINRA Examination Findings: December 2017**
- **2018 Regulatory and Examination Priorities Letter: Jan 8, 2018**
- **FinTech Topic Page**
 - Special Notice- 7/30/18
 - FINRA Requests Comment on Fintech Innovation in the Broker-Dealer Industry.

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)
- 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

FINRA's Regulatory Initiatives & Exam Priorities

■ Technology Governance

- Change management policies & procedures
 - Prevention of inaccurate, incomplete, untested or unauthorized changes to production environments
- Supervisory Controls
- Written procedures

■ 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
- Policies & procedures for filing a SAR when they identify a cybersecurity event
- FINRA's Exam Findings Report – observations & effective practices

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

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

Examination Observations

■ SEA Rule 15c3-1 Net Capital

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

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

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

Examination Observations

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

Recent and Upcoming Changes

- **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
(October 23, 2018 & November 8, 2016)

Recent and Upcoming Changes

■ **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

Recent and Upcoming Changes

- **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
- Comments received are being evaluated (Comment period ended June 22, 2018)

- **FINRA Regulatory Notice 18-31: Third Party Recordkeeping**

SEC issued guidance regarding contractual arrangements between broker-dealers and third-party recordkeeping service providers

Recent and Upcoming Changes

- eFOCUS updates:

- SEC Release 33-10532: Disclosure Update and Simplification

- Eliminate the line items related to extraordinary gains or losses and the cumulative effect of changes in accounting principles.
 - New line items added for the reporting of comprehensive income, including other comprehensive income and accumulated other comprehensive income.

<u>Ownership Equity</u>			
27. Sole proprietorship	\$ _____		1770
28. Partnership - limited partners	\$ _____	1020	1780
29. Corporation:			
A. Preferred stock			1791
B. Common stock			1792
C. Additional paid- in capital			1793
D. Retained Earnings			1794
E. Accumulated other comprehensive income			1797
F. Total			1795
G. Less capital stock in treasury .....		(	1796)
30. TOTAL OWNERSHIP EQUITY	\$ _____		1800
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY	\$ _____		1810

OMIT PENNIES

Recent and Upcoming Changes

■ eFOCUS updates:

SEC Release 33-10532: Disclosure Update and Simplification

STATEMENT OF INCOME (LOSS) or STATEMENT OF COMPREHENSIVE INCOME

(as defined in §210.1-02 of Regulation S-X), as applicable

NET INCOME/COMPREHENSIVE INCOME

29. Income (loss) before Federal income taxes and items below (Item 12 less Item 28)	.....	\$		4210
30. Provision for Federal Income taxes (for parent only)	.....			4220
31. Equity in earnings (losses) of unconsolidated subsidiaries not included above	.....			4222
a. After Federal income taxes of	.....		4238	
32. [RESERVED]				
a. [RESERVED]				
33. [RESERVED]				
34. Net income (loss) after Federal income taxes	.....	\$		4230
35. Other comprehensive income (loss)	.....			4226
a. After Federal income taxes of	.....		4227	
36. Comprehensive income (loss)	.....	\$		4228
MONTHLY INCOME				
37. Income (current month only) before provision for Federal income taxes	.....	\$		4211

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%201_What%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>

BREAK (15 minutes)

The 2017 inspections of broker-dealer audits covered 116 audits and related attestation engagements. How many of these inspections resulted in no observed audit deficiencies?

1 116

2 50

3 28

4 24

180

The 2017 inspections of broker-dealer audits covered 116 audits and related attestation engagements. How many of these inspections resulted in no observed audit deficiencies?

1. 116

2. 50

3. 28

4. 24

Program Evaluation

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

Standard-Setting Update

Jennifer Rand
Deputy Chief Auditor

Agenda

- Research and Standard-Setting Projects
- Standard-Setting Process
- Other Resources
- Standards Inquiries
- Staying current with PCAOB standards

Research and Standard-Setting Projects

- ❑ Updated the presentation of research and standard-setting projects on the website
- ❑ Mobile friendly design allows for easier viewing on your mobile devices

Research and Standard-Setting Projects

Home > Standards > Research and Standard-Setting Projects

PCAOB staff identifies current or emerging audit issues, develops a research agenda, and works on standard-setting projects. See recently completed standard-setting activities.

[Sign up to follow project updates](#)

[Learn more about our standard-setting process.](#)

Research Projects	Standard-Setting Projects
Quality Control	Auditing Accounting Estimates, including Fair Value Measurements
Data and Technology	Specialists
Other Information, Non-GAAP	Other Auditors
Noncompliance with Laws and Regulation	Going Concern
Communications with Audit Committees on Independence	

Research and Standard-Setting Projects

- ❑ Project pages will be updated as developments occur
- ❑ Sign up for project updates

Research and Standard-Setting Projects

Home > Standards > Research and Standard-Setting Projects

PCAOB staff identifies current or emerging audit issues, develops a research agenda, and works on standard-setting projects. See recently completed standard-setting activities.

Learn more about our standard-setting process.

[Sign up to follow project updates](#)

Research Projects	Standard-Setting Projects
Quality Control	Auditing Accounting Estimates, including Fair Value Measurements
Data and Technology	Specialists
Other Information, Non-GAAP	Other Auditors
Noncompliance with Laws and Regulation	Going Concern
Communications with Audit Committees on Independence	

Research and Standard-Setting Projects: Standard-Setting Project Pages

Auditing Accounting Estimates, Including Fair Value Measurements
(Updated Oct. 1, 2018) [Sign up to follow project updates](#)

Home > Standards > Research and Standard-Setting Projects > Auditing Accounting Estimates, Including Fair Value

Objective

Strengthen and enhance requirements for auditing estimates, including fair value measurements. This project is a companion to the project on the auditor's use of the work of specialists.

Most Recent Action

Proposed replacing the Board's existing standards on auditing accounting estimates and fair value measurements with a single standard, proposed standard AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements*, and amending the risk-assessment standards to more specifically address certain aspects of auditing accounting estimates. The proposal emphasizes that auditors need to apply professional skepticism and devote greater attention to potential management bias when auditing accounting estimates. The proposed standard also would include a special topics appendix that addresses certain matters relevant to auditing the fair value of financial instruments, including the use of information from pricing services.

Background

Accounting estimates are becoming more prevalent and significant as financial reporting frameworks evolve and require greater use of estimates, including those based on fair value measurements. They are some of the areas of greatest risk in the audit, requiring additional audit attention and appropriate application of professional skepticism. Auditing accounting estimates has proven challenging for auditors.

Status

The staff is developing a recommendation for Board consideration in Q4 2018.

Rulemaking Docket

- Docket 043: Proposed Auditing Standard for Auditing Accounting Estimates, Including Fair Value Measurements

2017 SAG Meeting

- SAG Discussion: Overview of Comments Received on Recent PCAOB Proposals, Including Auditing Accounting Estimates, Including Fair Value Measurements
- Slides: Overview of Proposal Comments
- Transcript: Standing Advisory Group Meeting

2017 Proposal

- News Release: PCAOB Proposes to Enhance Requirements for Auditing Accounting Estimates, Including Fair Value

2015 SAG Meeting

- SAG Discussion: Fair Value and Accounting Estimates
- Slides: Project Update and Discussion

- ❑ Include the objective, most recent action, background, and status of the project.
- ❑ Other public materials, e.g. rulemaking docket, SAG materials, and more.
- ❑ Ability to sign up for project updates here too.

Research and Standard-Setting Projects: Research Project Pages

Changes in Use of Data and Technology in the Conduct of Audits
(Updated Oct. 1, 2018)

Sign up to follow project updates

Home > Standards > Research and Standard-Setting Projects > Data and Technology

Objective

Explore whether there is a need for guidance, changes to PCAOB standards, or other regulatory actions in light of increased use of new and emerging technology-based tools.

Background

Significant advances in technology have occurred in recent years, including increased use by issuers and auditors of data analysis tools and emerging technologies. An increased use of these new technology-based tools could have a fundamental impact on the audit process, including the nature and amount of information available to auditors, significant judgments made by auditors in critical areas of the audit, and staffing of audit engagements. Staff considerations include, among other things, the new technology-based tools being used in audits and the impact on the audit of new technologies used by issuers, changes to firms' methodologies, academic research, outreach, and the activities of others, including auditing standard setters (e.g., the IAASB Data Analytics Working Group). The Board also approved formation of a Data and Technology Task Force of the SAG to assist the staff in obtaining insights into the use of data analytics and certain emerging technologies.

Status

The staff is researching whether impediments exist in PCAOB audit standards.

2018 SAG Discussion

- SAG Discussion: Data and Technology

2017 SAG Meeting (Nov.)

- SAG Discussion: Research Projects

Task Force

- Data and Technology Task Force

2017 SAG Meeting (May)

- SAG Discussion: Use of Data and Technology in the Conduct of Audits
- Briefing Paper: Use of Data and Technology in the Conduct of Audits

- ❑ Include the objective, background, and status.
- ❑ Other public materials, e.g. rulemaking docket, SAG materials, and more.
- ❑ Ability to sign up for project updates here too.

Standard-Setting Process

- Discussion of the standard-setting process have been added to the website

(3100) requires registered public accounting firms and their associated persons to comply with all applicable auditing and related professional practice standards.

PCAOB rules *Auditing Standards* (3200), *Interim Attestation Standards* (3300T), *Interim Quality Control Standards* (3400T), and *Interim Ethics and Independence Standards* (3500T) describe the PCAOB standards with which auditors are required to comply.

In the event of typographical or other technical errors in the standards presented on this website, the rule text adopted by the Board and approved by the SEC shall govern.

Standards and Rules

- Auditing Standards
- Ethics and Independence Rules
- Quality Control Standards
- Attestation Standards

Guidance

- Guidance Related to Standards

Related Information

- About the Standard-Setting Process
- Cost-benefit and Economic Analysis in PCAOB Standard Setting

Archives

- Archived Standards and Guidance

Standards Inquiries

- Form: Contact Us
- Phone: 202-591-4395

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

Home > Standards

About the Standard-Setting Process

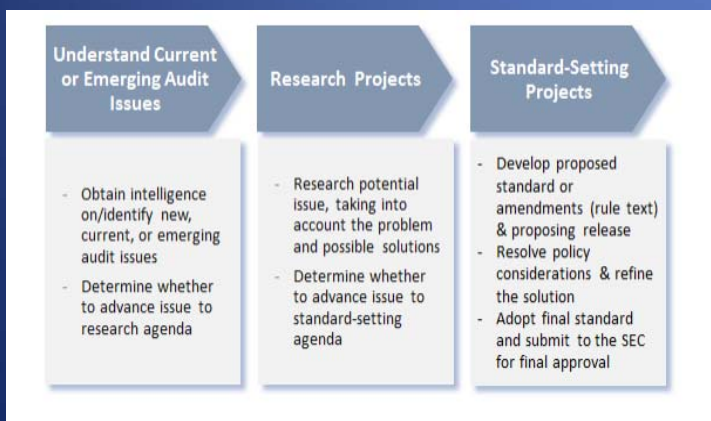
The PCAOB seeks to establish and maintain high quality auditing and related professional practice standards for audits of public companies and other issuers, and broker-dealers in support of the PCAOB mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB Office of the Chief Auditor — working with other PCAOB offices and divisions — assists the Board in establishing and maintaining PCAOB standards.

The PCAOB standard-setting activities include identifying current or emerging audit issues, developing the research agenda, and working on standard-setting projects. These are informed by a range of activities, such as the PCAOB's oversight activities, consultation with the Standing Advisory Group, input from the Investor Advisory Group, discussion with SEC staff, the work of other standard setters (for example, the International Auditing and Assurance Standards Board, the Financial Accounting Standards Board, and the International Accounting Standards Board), and other relevant inputs and developments.

The PCAOB takes a priority-based approach to standard-related projects. The timing of each phase may vary from project to project, depending on the nature and scope of audit issues involved. A high level overview of the standard-setting process follows.

Related Information

- Research and Standard-Setting Projects
- Recently Completed Standard-Setting Activities



Other Resources

- ❑ Downloadable PDF of all current PCAOB auditing standards

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

Other 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>	PCAOB Release No. 2015-002	SEC Release No. 34-75935 (Sept. 17, 2015)
	PCAOB Release No. 2010-004	SEC Release No. 34-63606 (Dec. 23, 2010)
	PCAOB Release No. 2003-006	SEC Release No. 34-47745 (Apr. 25, 2003)
AS 1005, <i>Independence</i>	PCAOB Release No. 2015-002	SEC Release No. 34-75935 (Sept. 17, 2015)

Other 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](#)

Standards Inquiries

- ❑ Contact the Standards Inquiry Line via the web form or at (202) 591-4395

PCAOB rule, *Compliance with Auditing and Related Professional Practice Standards (3100)* requires registered public accounting firms and their associated persons to comply with all applicable auditing and related professional practice standards.

PCAOB rules *Auditing Standards (3200)*, *Interim Attestation Standards (3300T)*, *Interim Quality Control Standards (3400T)*, and *Interim Ethics and Independence Standards (3500T)* describe the PCAOB standards with which auditors are required to comply.

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- [Guidance Related to Standards](#)


Related Information

- [About the Standard-Setting Process](#)
- [Staff Guidance on Economic Analysis in PCAOB Standard Setting](#)

Archives

- [Archived Standards and Guidance](#)

Standards Inquiries

- Form: [Contact Us](#)
- Phone: 202-591-4395 

Staying Current with PCAOB Standards

- ❑ PCAOB Standards website –
<http://www.pcaobus.org/Standards/Pages/default.aspx>
 - ❑ PCAOB standards and rules
 - ❑ Guidance
 - ❑ Standards-Related Activities
 - ❑ Standing Advisory Group
- ❑ 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



As of 2018, how many \$10,000 scholarships has the PCAOB awarded to accounting students?

1 246

2 929

3 484

4 715

As of 2018, how many \$10,000 scholarships has the PCAOB awarded to accounting students?

1. 246

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4. 715

Division of Enforcement and Investigations Update

Stephen D'Angelo
Assistant Director

Division of Enforcement & Investigations

What do we do.....



Investor Protection

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.

Agenda

- ❑ Today we would like to discuss:
 - ❑ Range of sanctions and effects of bars/suspensions
 - ❑ Enforcement Program statistics and outlook
 - ❑ Certain types of enforcement actions and their consequences
 - ❑ Association with a firm and effects of suspensions and bars
 - ❑ Interference in Board processes
 - ❑ Independence
 - ❑ Engagement Quality Review
 - ❑ 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

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 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

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

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

Violation of Board-ordered Bar – Brian D. Donahue, CPA; Leigh J Kremer CPA and Leigh J. Kremer, CPA

- ❑ On July 24, 2018, Board sanctioned Donahue for violating a Board-ordered bar and sanctioned Leigh J Kremer CPA for permitting Donahue's association with the firm while subject to a Board-ordered bar
- ❑ Kremer paid Donahue percentage of audit fees for two issuer and ten broker-dealer referred clients
- ❑ Donahue became associated person due to sharing in profits from audits
- ❑ Kremer firm was censured, had its registration revoked with a right to reapply after three years and received \$10,000 monetary penalty; Kremer was censured and barred with a right to reapply after three years
- ❑ Donahue was censured, barred with a right to reapply after five years and received \$15,000 monetary penalty

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

Interference in Board Processes – Baum & Company, P.A. and Joel S. Baum, CPA

- ❑ On February 27, 2018, Board sanctioned firm and Baum for violations of AS 1215, *Audit Documentation*, and PCAOB Rule 4006
- ❑ Baum added, backdated and otherwise altered work papers in advance of a 2017 inspection
- ❑ Baum self-reported conduct at the start of the inspection but was unable to specify exactly what changes had been made
- ❑ Baum's conduct interfered with the ability to inspect the work originally performed and documented
- ❑ Firm was censured, had its registration revoked with a right to reapply after one year and received \$10,000 monetary penalty
- ❑ Baum was censured, and was barred with a right to reapply after one year

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

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

Independence Matters – Richard J. Girasole, CPA PC and Richard J. Girasole, CPA

- ❑ On June 13, 2018, Board sanctioned firm and Girasole for violations of auditor independence, AT 2, and AS 1220, among other violations
- ❑ Respondents changed line item amounts and updated footnote disclosures in a broker-dealer audit client's financial statement; and prepared net capital calculation and exemption report
- ❑ Respondents failed to perform any procedures to identify exceptions to exemption provisions as required by AT 2
- ❑ Engagement quality reviewer was senior accountant at the firm – not a partner or an equivalent position
- ❑ Firm was censured, had its registration revoked with a right to reapply after two years and received \$10,000 monetary penalty
- ❑ Girasole was censured, and barred with a right to reapply after two years

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 – Shedjama, Inc. and Edward Opperman, CPA

- ❑ On March 13, 2018, Board sanctioned firm and Opperman for repeated failures to obtain EQRs for 23 broker-dealer audit clients with fiscal years ended in 2015 and 30 broker-dealer audit clients with fiscal years ended in 2016
- ❑ Firm was censured, had its registration revoked with a right to reapply after two years and received \$10,000 monetary penalty
- ❑ Opperman was censured, and barred with a right to reapply after two years

Engagement Quality Review Matters – Breard & Associates, Inc. Certified Public Accountants and Kevin G. Breard, CPA

- ❑ On August 9, 2018, Board sanctioned firm for repeated failures to obtain EQRs for 135 broker-dealer audit clients with fiscal years ended during 2014, 2015, and 2016
- ❑ Firm was censured, had its registration revoked with a right to reapply after five years and received \$75,000 monetary penalty
- ❑ Breard, who was the engagement partner on each of the 135 audits, was censured, and barred with a right to reapply after five years

Attestation Standards Violations – Tarvaran Askelson & Company, LLP et al.

- ❑ On February 27, 2018, Board sanctioned Respondents for violations of AS 2701 and AT 1, among other violations, in connection with an audit of carrying broker-dealer's financial statements and examination of compliance report
 - ❑ With respect to customer reserve / net capital, Respondents failed to test information produced by broker-dealer for completeness and accuracy
 - ❑ Respondents failed to perform any procedures to test broker-dealer's ICOC
- ❑ Firm was censured, had its registration revoked with a right to reapply after two years and received \$15,000 monetary penalty
- ❑ The engagement partner, Askelson, was censured, barred with a right to reapply after two years, and received \$5,000 monetary penalty
- ❑ The EQR, Tarvaran, was censured, barred with a right to reapply after one year, and received \$5,000 monetary 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 Settlement

- ❑ 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 – 2018 Settlement

- ❑ *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

Post: PCAOB Tip & Referral Center
1666 K Street, NW
Washington, DC 20006

Fax: 202-862-0757

Telephone: 800-741-3158

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.