

Aug. 19, 2013

Fact Sheet

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

Why the Board is Issuing this Report:

The Public Company Accounting Oversight Board released its second report on the progress of the interim inspection program for auditors of brokers and dealers registered with the Securities and Exchange Commission. The interim program began in the fall of 2011 in response to the Board's new oversight authority provided in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The interim inspection program:

- Enables the Board to assess the compliance of registered firms and their associated persons conducting audits of brokers and dealers with the Sarbanes-Oxley Act, Board and SEC rules, and professional standards.
- Informs the Board's eventual determinations about the scope and elements of a permanent inspection program.

The Board issued its [first progress report](#) in August 2012. In that first look, PCAOB inspectors reviewed 10 audit firms covering portions of 23 audits of brokers and dealers registered with the Securities and Exchange Commission, and identified deficiencies in all of the audits inspected.

Second Progress Report:

- Encompasses inspections performed from March 2012 - December 2012.
- Inspects 43 audit firms reviewing portions of 60 audits of SEC-registered broker-dealers.
- Finds deficiencies in all of the firms and 57 of the 60 audits inspected.

- Of the 43 audit firms inspected:
 - 19 firms were already subject to PCAOB inspection because they audited public companies (nine annually inspected firms and 10 triennially inspected firms).
 - 24 firms were not subject to inspection other than under the interim inspection program.

Audit Deficiencies:

Audit deficiencies were noted in each of the firms inspected, and in 95 percent (57 of 60) of the audits selected for inspection.

The report describes deficiencies observed in the following areas:

- Audit procedures related to customer protection and net capital under the Exchange Act rules:
 - Accountant's supplemental report on material inadequacies
 - Compliance with customer protection rule
 - Compliance with net capital rule
- Audit procedures related to financial statement areas:
 - Revenue recognition
 - Risks of material misstatement due to fraud
 - Reliance on records and reports from service organizations
 - Financial statement disclosures
 - Related party transactions
 - Auditor's report
 - Fair value measurements
 - Evaluation of internal control deficiencies
 - Understanding the entity

Independence Findings:

Inspections staff found that, contrary to the requirements of SEC independence rules, some auditors were involved in the preparation of the financial statements that they audited.

Independence findings were identified:

- in more than one-third (22 of 60) of the audits selected for inspection.

- in approximately 80 percent of the audits selected for inspection that were performed by firms that audited brokers and dealers but did not audit issuers.
- in approximately eight percent of the audits selected for inspection that were performed by firms that audited brokers and dealers and also audited issuers.

Determining the Scope of a Permanent Inspection Program:

The Board is taking a careful and informed approach to promote investor protection in establishing a permanent inspection program.

The Exchange Act rules related to the work required of auditors of brokers and dealers is an important component of the SEC's oversight of brokers and dealers.

The Board is working to identify ways that the risk of loss to customers can be differentiated through various attributes that characterize a broker or dealer. The risk of loss to customers can occur through misappropriation of customer assets, such as unauthorized trading or embezzlement, among other ways. The Board is considering this risk of loss to customers in relation to the auditor's responsibilities under the Exchange Act rules.

Attributes being considered include whether or not a broker or dealer:

- Receives, handles or holds securities or cash from the purchase or sale of securities by customers;
- Carries customer accounts;
- Engages in lines of business that transact with customers;
- Reports financial measurements of net capital, revenues or assets that, on a combined basis, represent a differentiation of risk of loss to customers;
- Has characteristics that may indicate heightened fraud risk or has received regulatory sanctions;
- Is a member of the Securities Investor Protection Corporation (SIPC).

Recent Developments:

- On July 30, 2013, the SEC approved amendments to Exchange Act Rule 17a-5 that affect certain annual reporting, audit, and notification requirements for brokers and dealers.

- These amendments include the requirement that the audits of brokers and dealers be conducted in accordance with PCAOB standards for fiscal years ending on or after June 1, 2014.

Next Steps:

- During 2013, the Board plans to inspect approximately 60 firms and portions of approximately 90 audits.
- The Board currently expects that by the end of 2013, the interim inspection program will include inspections of portions of more than 170 audits conducted by approximately 100 registered public accounting firms.
- The Board currently anticipates presenting a rule proposal for a permanent inspection program in 2014 or later.