

# SPOTLIGHT

## Insights Into the PCAEOB's Interim Inspection Program Related to Audits of Broker-Dealers

---

January 2024

---

# CONTENTS

Overview	3
The Interim Inspection Program Related to Audits of Broker-Dealers	3
Insight Into Inspection Results	5
Insufficient Understanding of the Broker-Dealer Industry	6
Lack of Professional Skepticism	8
Lack of Rigor in Risk Assessment and Consideration of Internal Controls	9
Inexperience With PCAOB Standards	10
Ineffective Engagement Quality Review	12
Overreliance on Standardized Audit Programs	13
Low-Cost Providers and the Pace of Auditor Changes	13
Reminders for Auditors	15
Industry Expertise	15
Exercising Professional Skepticism	15
Planned Approach to Risk Assessment	16
Planned Audit Response	16
Client Acceptance and Continuance	17

## OVERVIEW

There are approximately 3,400 brokers and dealers (“broker-dealers”) registered with the U.S. Securities and Exchange Commission (SEC). When these broker-dealers file their annual reports with the SEC, they are typically required to include their financial statements and supporting schedules, along with audit reports prepared by PCAOB-registered public accounting firms. During the most recently completed inspection period, 305 PCAOB-registered firms provided audit services to broker-dealers.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 granted the PCAOB oversight of auditors of those broker-dealers registered with the SEC that are required to file financial statements under Section 17(e)(1)(A) of the Securities and Exchange Act of 1934 (“Exchange Act”) and whose financial statements are required to be certified by a registered public accounting firm.<sup>1</sup>

In June 2011, the PCAOB established an interim inspection program to inspect those broker-dealer auditors and to identify and address any significant issues observed.<sup>2</sup> A key milestone in the interim inspection program was the SEC’s implementation of changes to the broker-dealer financial reporting rules, which required broker-dealer audits and related attestation engagements to be performed in accordance with PCAOB standards, beginning with fiscal years ended on or after June 1, 2014. PCAOB attestation standards, AT No. 1 and AT No. 2,<sup>3</sup> set forth a

framework of specific procedures that are required in order for auditors to provide their opinion or conclusion on the statements of broker-dealers as presented in compliance reports or exemption reports, in accordance with the requirements of Exchange Act Rule 17a-5.

Overseeing broker-dealer audits is a key component of the PCAOB’s mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. As evidenced by results from the PCAOB interim inspection program,<sup>4</sup> PCAOB staff believes there is a need for significant improvement in the quality of broker-dealer audit and attestation engagements.

This Spotlight is intended to be read alongside the annual reports described in footnote 2 and provides additional insights into Inspection staff’s inspection results, including potential contributing factors to the high deficiency rates, and related reminders for auditors.

## THE INTERIM INSPECTION PROGRAM RELATED TO AUDITS OF BROKER-DEALERS

Since PCAOB standards became effective for broker-dealer audits in 2014, the PCAOB has inspected 325 registered audit firms conducting broker-dealer audits as of the most recently completed inspection period.

---

<sup>1</sup> As used hereinafter, the term “broker-dealer” refers only to those broker-dealers that fall into this category.

<sup>2</sup> Under the requirements of PCAOB Rule 4020T, the PCAOB publishes annually a report that describes the progress of the interim inspection program, including data about the number of registered public accounting firms and the number of broker or dealer audits that have been subjected to inspection procedures and any significant observations from those procedures. Please refer to the [Information for Auditors of Broker-Dealers](#) page to view those reports.

<sup>3</sup> AT No. 1 is PCAOB Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, and AT No. 2 is PCAOB Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*.

<sup>4</sup> See supra note 2.

The selection of audit firms for inspection has been based on the audit firm and broker-dealer characteristics.

While the number and mix of audit firms and broker-dealers selected in any given year has varied over time, prominent in Inspection staff's selections process are potential risks associated with the protection of customer funds and securities. While this naturally results in a focus on broker-dealers that maintain responsibility for the custody/control of customer funds and securities ("clearing" or "carrying" broker-dealers), other broker-dealers by nature of their operations may also receive customer funds and securities before transmitting them to carrying broker-dealers. Accordingly, Inspections staff selects for review a number of those "exempt" broker-dealers each year as well. Exempt broker-dealers comprise the significant majority of SEC registered broker-dealers.

## Filing Requirements of Broker-Dealers

Under the Exchange Act Rule 17a-5, broker-dealers are generally required, among other things, to file annually:

1. A "financial report" that includes both financial statements and supporting schedules (referred to as "supplemental information");
2. Either a "compliance report" (if the broker-dealer did not claim it was exempt from the Customer Protection Rule<sup>5</sup> or an "exemption report" (if the broker-dealer claimed it was exempt from the Customer Protection Rule or was otherwise eligible under SEC rules to file an exemption report)<sup>6</sup>; and
3. "Reports prepared by an independent public accountant" based on (a) an audit of the financial report in accordance with PCAOB auditing standards ("audit engagement" or "audit"), as well as (b) a report based on either an examination of certain statements in the broker-dealer's compliance report ("examination engagement") or on a review of the broker-dealer's exemption report ("review engagement") in accordance with PCAOB attestation standards,<sup>7</sup> as applicable (audit engagements, examination engagements, and review engagements are referred to collectively as "broker-dealer engagements").

The PCAOB's interim inspection program generally covers both the audit engagement and either the examination engagement or the review engagement of the broker-dealer.

<sup>5</sup> Exchange Act Rule 15c3-3, *Customer Protection – Reserves and Custody of Securities* ("Customer Protection Rule"). Paragraph (e) of the Customer Protection Rule is referred to as the "Reserve Requirements Rule."

<sup>6</sup> Broker-dealers that carry customer accounts, maintain custody or control of customer cash and securities, or clear securities transactions on behalf of customers are among the broker-dealers that likely do not claim exemption from the Customer Protection Rule and therefore file compliance reports. A significant majority of broker-dealers, including introducing broker-dealers, do not perform these activities and generally file exemption reports.

<sup>7</sup> See *supra* note 3. AT No.1 applies to examination engagements and AT No. 2 applies to review engagements (collectively, "attestation engagements").

## INSIGHT INTO INSPECTION RESULTS

The overall deficiency rates in broker-dealer engagements remain unacceptably high. The PCAOB's most recent *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* states that deficiency rates observed in 2022 inspections of broker-dealer engagements generally increased or remained elevated across engagement types and areas.

### Audit Firm Characteristics Used in This Spotlight

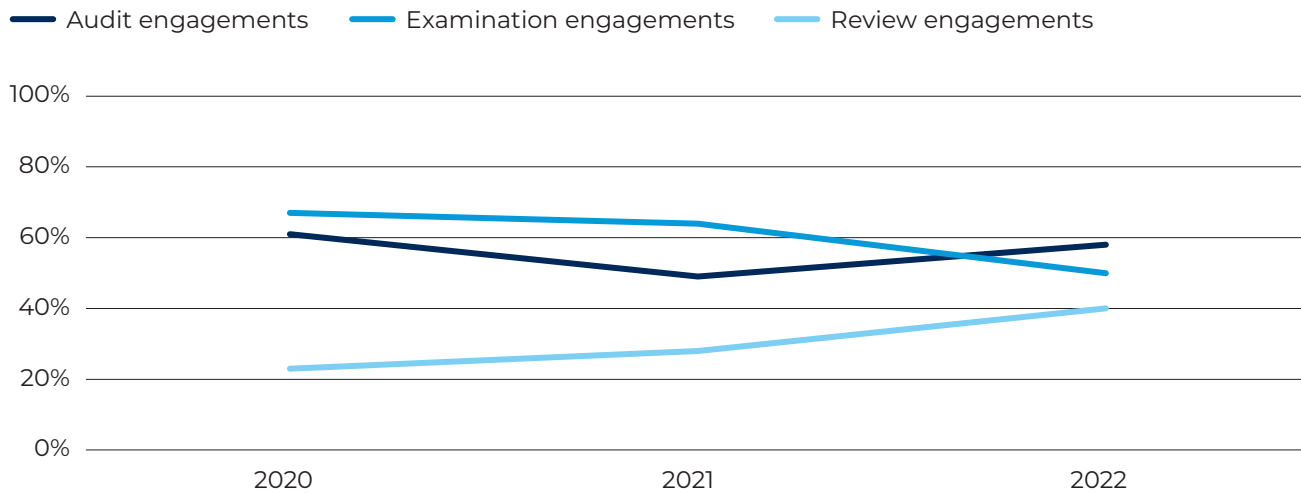
For the *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers*, we stratify inspection results using various audit firm and broker-dealer characteristics, some of which we also used herein in connection with certain insights.

- **Audit firms that do not audit public companies** – These firms are subject to inspection only through the interim inspection program for auditors of broker-dealers. Many of these firms are smaller and may audit relatively few broker-dealers.
- **Audit firms that audit 100 or more public companies** – These firms are subject to periodic inspection through the interim inspection program for auditors of broker-dealers and annual inspection through the issuer inspection program.
- **Audit firms that audit fewer than 100 broker-dealers** – These firms are subject to inspection through the interim inspection program for auditors of broker-dealers, some of which are also inspected through our issuer inspection program. These firms have diverse levels of experience auditing broker-dealers, yet the majority do not audit broker-dealers that file compliance reports.
- **Audit firms that audit 100 or more broker-dealers** – These firms are subject to inspection through the interim inspection program for auditors of broker-dealers, the majority of which are also inspected through our issuer inspection program. These firms have significant experience auditing broker-dealers and have been inspected regularly throughout the history of the interim inspection program. Most audits of broker-dealers that file compliance reports are performed by these firms.

The 2022 inspection year marked the eighth year of inspections of audit firms that audit broker-dealers under the interim inspection program since broker-dealer audits and the related attestation engagements were required to be performed in accordance with PCAOB standards. In that light, these poor results are a cause for significant concern.

The following chart provides the deficiency rates for all audit and attestation engagements for inspected audit firms for each of the last three inspection years (2020–2022).

## Percentage of Engagements With Deficiencies



## Insufficient Understanding of the Broker-Dealer Industry

The broker-dealer industry is subject to Generally Accepted Accounting Principles (GAAP) for financial reporting and regulatory requirements that are unique to the industry. Auditors will likely require a combination of technical and on-the-job training, self-study, and experience to be proficient in these areas. Auditors of broker-dealers need to have a sufficient understanding of the Net Capital Rule.<sup>8</sup> Additionally, auditors of broker-dealers that file a compliance report need to be technically proficient with regard to the Customer Protection Rule, the Quarterly Security Counts Rule,<sup>9</sup> and the applicable Account Statement Rule<sup>10</sup> (which are referred to collectively, along with the Net Capital Rule, as the “Broker-Dealer Financial Responsibility Rules.”<sup>11</sup>)

<sup>8</sup> Exchange Act Rule 15c3-1, *Net Capital Requirements for Brokers or Dealers* (the “Net Capital Rule”).

<sup>9</sup> Exchange Act Rule 17a-13, *Quarterly Security Counts to be Made by Certain Exchange Members, Brokers and Dealers* (“Quarterly Security Counts Rule”).

<sup>10</sup> Any rule of a broker-dealer designated examining authority that required the broker dealer to send account statements to customers (“Account Statement Rule”). See, e.g., FINRA Rule 2231, *Customer Account Statements*.

<sup>11</sup> See AT No. 1, at footnote 10.

## Broker-Dealer Financial Responsibility Rules

It is important for broker-dealer auditors to have a strong understanding of how customer assets are protected. Broker-dealers that maintain custody of customer securities and cash are subject to strict requirements under the Exchange Act that are designed to protect and account for these assets. These requirements include:

- **Net Capital Rule** – Requires a broker-dealer to maintain more than a dollar of highly liquid assets for each dollar of liabilities. If the broker-dealer fails, this rule helps to ensure that the broker-dealer has sufficient liquid assets to pay all liabilities to customers.
- **Customer Protection Rule** – Broker-dealers sometimes use their own funds to conduct trades and other transactions. When engaging in such “proprietary business activities,” this rule prohibits broker-dealers from using customer securities and cash to finance their own business. By segregating customer securities and cash from a broker-dealer’s proprietary business activities, the rule increases the likelihood that customer assets will be readily available to be returned to customers if a broker-dealer fails.
- **Quarterly Security Counts Rule** – This rule requires a broker-dealer on a quarterly basis to count, examine, and verify the securities it actually holds for customers and for itself. It must compare that count with the amounts of such securities it should be holding as indicated by its records. If there are differences between the actual amounts held and the amounts that records indicate should be held, the broker-dealer must take capital charges until the differences are resolved.
- **Account Statement Rule** – Each self-regulatory organization (e.g., the Financial Industry Regulatory Authority (FINRA)) has rules that require a broker-dealer to send a statement – at least quarterly – to each customer reflecting the customer’s securities and cash positions held at the broker-dealer, as well as the activity in the account.

The service offerings of broker-dealers and related revenue recognition policies can vary. A broker-dealer may engage in multiple service offerings that require a careful assessment by the auditor to ensure a thorough understanding of the broker-dealer’s operations. Some offerings involve contractual agreements with customers subject to the recognition and disclosure requirements of FASB ASC 606, *Revenue from Contracts with Customers*.<sup>12</sup> Lines of business that may appear to be similar across broker-dealers may be conducted differently in a manner that presents varying audit risks. For example, one broker-dealer may conduct sales and redemptions of mutual fund products through an arrangement with a clearing broker, while another conducts direct-way sales with the mutual funds themselves. Such differences will affect how the auditor tests revenues and should alter the assertions made by the broker-dealer in its exemption report.

<sup>12</sup> See FASB Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers* (Topic 606) (May 2014) (“FASB ASU 2014-09”), as codified in FASB Accounting Standards Codification (“ASC”) Topic 606, *Revenue from Contracts with Customers*, and additional ASUs that link to the transition guidance in FASB ASC paragraph 606-10-65-1.

Certain auditing risks are more prevalent in the broker-dealer industry. For example, many broker-dealers conduct securities transactions through arrangements with clearing brokers and use information from clearing brokers for financial reporting and regulatory purposes. Auditors of these broker-dealers may choose to use information from clearing brokers as sources of audit evidence for substantive or controls testing. These auditors should assess the reliability of that information for its intended use, which may involve considerations regarding service auditor reports, identifying and testing complementary user entity controls, and completeness and accuracy of information.

In addition, broker-dealer specific training for auditors is not widely available. Typically, only larger audit firms offer in-house training and have acquired extensive broker-dealer audit experience that is shared with audit firm personnel. While there are a few vendors who offer quality training, course offerings are limited throughout the year.

## Lack of Professional Skepticism

Due professional care should be exercised in the planning and performance of broker-dealer audit and attestation engagements. Due professional care requires the auditor (of public companies and broker-dealers) to exercise professional skepticism. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest. The auditor should

assess whether conditions exist that create incentives or pressures for management and others to commit fraud, provide the opportunity for fraud to be perpetrated, or indicate a culture or environment that enables management to rationalize committing fraud.

Inspection staff continues to identify through inspections that audit and attestation engagements exhibit a lack of due care and professional skepticism. Examples that inspection staff has seen over the years include one or more omitted or insufficient risk assessment procedures, no testing of one or more significant accounts, reliance on management inquiries without corroboration, errors and omissions from auditor reports, and not identifying departures from GAAP in broker-dealer financial statements. Further, engagement teams often do not inquire of broker-dealer management relating to business operations and practices, including processes and controls, and customer complaints and any specific incidents that have occurred, to identify questionable ethical behavior.

Engagement teams should maintain skepticism when performing inquiries of management. Those inquiries should not only include broker-dealer management, but also include other individuals within the broker-dealer involved in the handling of customer transactions and related responses to complaints received. Engagement teams should inquire if those individuals have additional knowledge about fraud, alleged fraud, or suspected fraud or might be able to corroborate fraud risks identified.<sup>13</sup>

Engagement team responses to identified fraud risks should involve the application of professional skepticism in gathering and evaluating audit evidence. Examples include (a) modifying the planned audit procedures

---

<sup>13</sup> AS 2210, *Identifying and Assessing Risks of Material Misstatement*, paragraphs .56 through .58 describe the auditor's responsibility for performing inquiries regarding fraud risks.



to obtain more reliable evidence regarding relevant assertions and (b) obtaining sufficient appropriate evidence to corroborate management's explanations or representations concerning important matters.<sup>14</sup> In exercising professional skepticism in gathering and evaluating evidence, the auditor should not be satisfied with less than persuasive evidence because of a belief that broker-dealer management and staff are honest.

## Lack of Rigor in Risk Assessment and Consideration of Internal Controls

Engagement teams often assess the risk of material misstatement in broker-dealer financial statements to be low without properly completing the required risk assessment procedures at the financial statement and assertion levels. This may be due in part to the knowledge that broker-dealers are regulated by the SEC – and often by FINRA – which conduct periodic broker-dealer examinations. Engagement teams may consider that the SEC (and FINRA and/or other designated examining authorities) use the audited supplemental information related to net capital and customer reserve requirements (where applicable) included in broker-dealer annual reports in their oversight and conclude those are the areas of greater risk – and not the financial statements. Some engagement teams cite high degrees of automation and reliance on technology as factors that support lower-risk assessments.

During the risk assessment process, engagement teams appear to be reluctant to assess a broker-dealer's internal control environment, including internal control over

financial reporting (ICFR), and accordingly assess control risk as high. Unlike audits of certain public companies, there is no requirement for an engagement team to test a broker-dealer's ICFR. However, broker-dealer engagement teams still need to sufficiently assess the broker-dealer's internal control environment as part of identifying and assessing the risks of material misstatement<sup>15</sup> and designing the nature, timing, and extent of its audit procedures to address those risks, even if the control risk is assessed as high.

More specifically, while engagement teams may obtain a high-level understanding of the broker-dealer and its control environment, engagement teams often do not obtain a sufficient understanding of the risks related to how the broker-dealer's revenue transactions are initiated, authorized, processed, and recorded. Many broker-dealers are reliant on the controls and processes at service organizations (such as other broker-dealers) for these processes, which should also be understood and assessed during the risk assessment process.

Engagement teams may not be sufficiently focused on the broker-dealer's written supervisory procedures. These procedures often address, among other topics, broker-dealer supervision and oversight, financial reporting, handling of customer funds and securities, and internal controls that focus on customer activities. While many of these procedures may appear to be operational in nature, they are an essential element of the broker-dealer's control environment that ultimately affect the financial statements.

Larger broker-dealers are more likely to have dedicated staff that performs control procedures with the assistance of well-

---

<sup>14</sup> See AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph .07.

<sup>15</sup> AS 2110, *Identifying and Assessing Risks of Material Misstatement*, paragraphs .23 through .25 describe the auditor's responsibility for understanding an entity's control environment.

documented processes. Smaller broker-dealers, on the other hand, tend to have fewer staff and rely more on supervision and oversight, without necessarily documenting control procedures that they perform. These broker-dealers may also avail themselves of Financial and Operational Principals who work part-time, off-site, or hold multiple registrations with different FINRA member firms, and whose main responsibility involves compliance with requirements relating to the books and records and financial reporting. Many smaller broker-dealers are also introducing broker-dealers that rely on commissions reporting provided by their carrying and clearing broker-dealers and subscription-way business sponsors. As such, they may be reliant on the controls and processes at those entities. We encourage engagement teams to carefully consider these factors when assessing the risks of material misstatement for smaller broker-dealer clients.

Engagement teams can only properly assess the risk of material misstatement in the financial statements if they critically evaluate risks that may be present in the broker-dealer's control environment. This means that engagement teams must obtain an understanding of the key elements of the broker-dealer's operations and control procedures, including (i) the roles, responsibilities, and procedures that affect financial reporting, (ii) the flow of significant transactions, (iii) written supervisory procedures and other controls that affect these transactions, and (iv) the use of external reports and statements received from external entities.

## Inexperience With PCAOB Standards

Inspection staff continues to observe audit firms with personnel that may not have the technical competence or experience to perform the procedures required to comply with PCAOB standards. A significant portion of the broker-

## Good Practices and Recommended Actions for Audit Firms

The most recent *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* highlights good practices that may be effective at addressing deficiencies. These good practices are provided as examples and do not establish or modify PCAOB auditing or attestation standards, or PCAOB rules. Recommended actions for audit firms that may be effective at addressing deficiencies that were more frequently encountered during 2022 inspections compared to recent years are also highlighted.

Please refer to the **Information for Auditors of Broker-Dealers** page on the PCAOB's website for both the most recent, and historical, annual reports on the interim inspection program related to audits of broker-dealers.

dealer population is audited by audit firms that audit no public companies and audit 50 or fewer broker-dealers. Of the approximately 3,400 SEC-registered broker-dealers, over 1,000 were audited by 162 such audit firms during the period covered by our 2022 inspections.

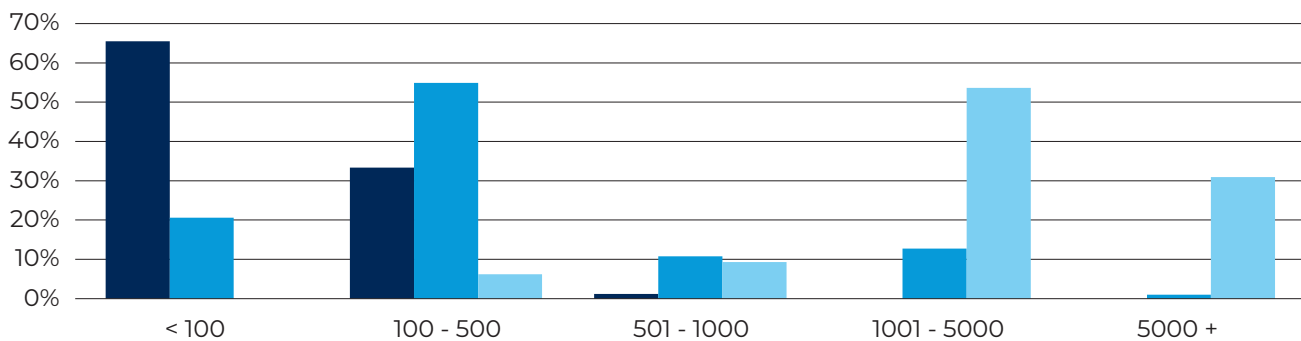
As part of our inspection process, the audit firms selected for inspection provide the PCAOB with data regarding total hours incurred conducting the audit and applicable attestation engagement for each of their broker-dealer clients. This data covers approximately half of the broker-dealer audits performed by registered firms during the most recent inspection period.

Based on that data, the majority of broker-dealer engagements performed by audit firms that do not audit public companies are performed in 100 or fewer hours. And of those, approximately one-third are performed in 40 or fewer hours. This compares to an average of over 185 engagement hours incurred for all broker-dealers in our data audited by firms that audit fewer than 100 broker-dealers and fewer than 100 public companies.

## Hours Reported by Audit Firms on Engagements Reviewed by the PCAOB

(Combined 2020–2022 inspection periods)

- Firms that audited broker-dealers, but did not audit public companies
- Firms that audited fewer than 100 broker-dealers and fewer than 100 public companies
- Firms that audited more than 100 broker-dealers and more than 100 public companies



The following table shows the distribution of broker-dealers amongst audit firms, stratified by the number of broker-dealer audits per audit firm, for the 2022 inspection period.

Number of broker-dealer audits per firm	Number of firms	Total number of broker-dealer audits across all firms in this category
1	80	80
2 to 20	181	1,045
21 to 50	30	986
51 to 100	9	639
More than 100	5	650
<b>Total</b>	<b>305</b>	<b>3,400</b>

There is a high rate of noncompliance with PCAOB standards for first-time inspections of audit firms performing broker-dealer audits that do not also audit public companies. Generally, results for these audit firms improve with subsequent inspections. Similarly, there is a high rate of noncompliance in examination engagements by audit firms that audit fewer than 100 broker-dealers. Audit firms that audit 100 or more broker-dealers and 100 or more public companies audit 64% of the 150 broker-dealers that do not claim exemption from the Customer Protection Rule (and therefore file a compliance report). The remaining 36% are audited by a total of 33 audit firms.

In 2022, 73% of examination engagements performed by audit firms that audit fewer than 100 broker-dealers were found to be noncompliant, compared to an 86% deficiency rate for these firms since the inception of the interim inspection program. Given the lack of experience some audit firms have with these engagements, audit firms may not be spending enough time developing their understanding of the requirements of Exchange Act Rule 17a-5, the Broker-Dealer Financial Responsibility Rules, and related internal controls over compliance at broker-dealers. Some audit firms assert during inspections that they obtained reasonable assurance about internal controls over compliance from substantive procedures, although AT No. 1 requires the auditor to obtain evidence that the controls are designed effectively and operating effectively to obtain reasonable assurance.

## Ineffective Engagement Quality Review

Many audit firms may not have partners or individuals in equivalent positions with the knowledge and experience in the broker-dealer industry to sufficiently evaluate significant judgments made by the engagement team and the related conclusions reached.

## Inspection Observations Related to EQR

For more observations, including common audit deficiencies, good practices, and other reminders that can help audit firms ensure EQRs are properly performed, please refer to "**Spotlight: Inspection Observations Related to Engagement Quality Reviews.**"

Deficiencies have been consistently reported over the years with respect to the engagement quality review (EQR) reviewer's failure to sufficiently evaluate the engagement team's responses to significant risks identified by the engagement team. Some of the EQRs performed were limited to little more than "proofreading" the final draft of the financial statements, supplemental information, and attestation reports and did not perform all the requirements of an EQR.

The number of instances of noncompliance with PCAOB standards related to testing financial statement disclosures appears to indicate that some EQR reviewers are either not sufficiently knowledgeable of GAAP or the industry, not reading the financial statements carefully enough, or reluctant to challenge the engagement team. Smaller audit firms that don't have resources beyond the engagement partner with sufficient experience with PCAOB standards or broker-dealer accounting and reporting to perform an effective EQR have engaged qualified EQRs from outside the audit firm. While retaining a qualified EQR from outside the audit firm is an appropriate way of dealing with this situation, audit firms may also consider developing EQR capabilities in-house through a combination of on-the-job-

training, in-house and vendor training sessions, broker-dealer conferences, and dedicated self-study of the Broker-Dealer Financial Responsibility Rules.

## Overreliance on Standardized Audit Programs

Some audit firms regularly use standardized programs provided by external vendors to conduct engagements performed pursuant to PCAOB standards, including broker-dealer attestation engagements performed pursuant to AT No. 1 and AT No. 2. These programs generally provide the user with the text of a PCAOB requirement and associated references to the standards themselves. These tools, however, may not be all encompassing, may reflect only certain criteria in the standards, and may be limited in the scope of procedures to be completed.

The use of standardized audit programs can be highly effective in facilitating engagement planning and in the performance of procedures. Nevertheless, these programs typically must be tailored to reflect the nature of the broker-dealer's business operations, internal controls, and financial reporting and attestation risks. For example, the suggested audit procedures in revenue are likely to be written generally such that they can be applied to a wide range of revenue types. However, the nature of the necessary procedures to effectively test brokerage commissions will differ depending on type of securities sold and will differ even more so from the necessary procedures to test merger and acquisition advisory revenue, revenue from private placements, or other revenue sources. A more

rigorous risk assessment process that includes a sufficient understanding of the broker-dealer's operations, revenue transaction cycles, and related controls will enable auditors to tailor their planned audit procedures more effectively. Likewise, audit firms can reinforce an expectation that auditors appropriately tailor planned audit procedures through their audit methodologies and related quality controls.

While using standardized audit programs may assist with effectively addressing requirements found in PCAOB standards, it is important for the auditor to scrutinize suggested procedures to determine whether they properly reflect the risks identified during the planning and risk assessment process. Where necessary, the nature, timing, and extent of those procedures should be tailored to ensure that the audit response to the risks identified is consistent with applicable PCAOB standards. Reliance on standardized audit programs is not a substitute for auditor understanding of PCAOB standards.

## Low-Cost Providers and the Pace of Auditor Changes

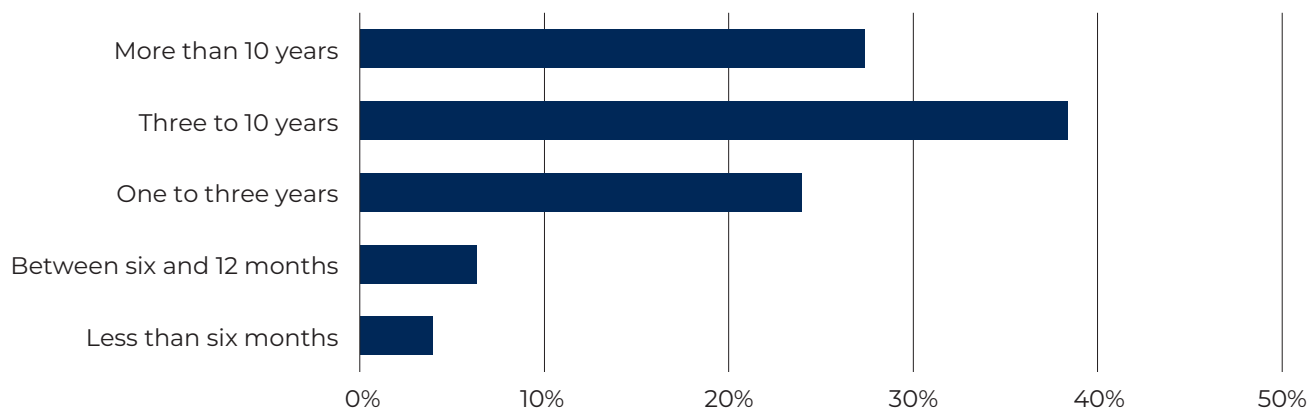
Smaller audit firms are called upon by smaller, cost-conscious broker-dealers, since engagement fees are often lower than those proposed by the larger audit firms.

The following chart provides the tenure across all broker-dealer engagements for every audit firm inspected during 2022, regardless of whether the engagement was reviewed during the inspection. Tenure is based on data reported to the PCAOB by the firms. Based on this data, approximately 34% of broker-dealers audited by these firms changed their audit firm in the last three years.

## Auditor Tenure Reported by Inspected Firms

(2022 inspection year)

■ Percentage of all broker-dealer clients



In addition, some audit firms appear to have taken on more broker-dealer clients, including those acquired from audit firms that had been previously sanctioned, than can be adequately served with the available resources. This is especially true considering the concentration of broker-dealers with December 31 fiscal year-ends and the corresponding filing deadlines.

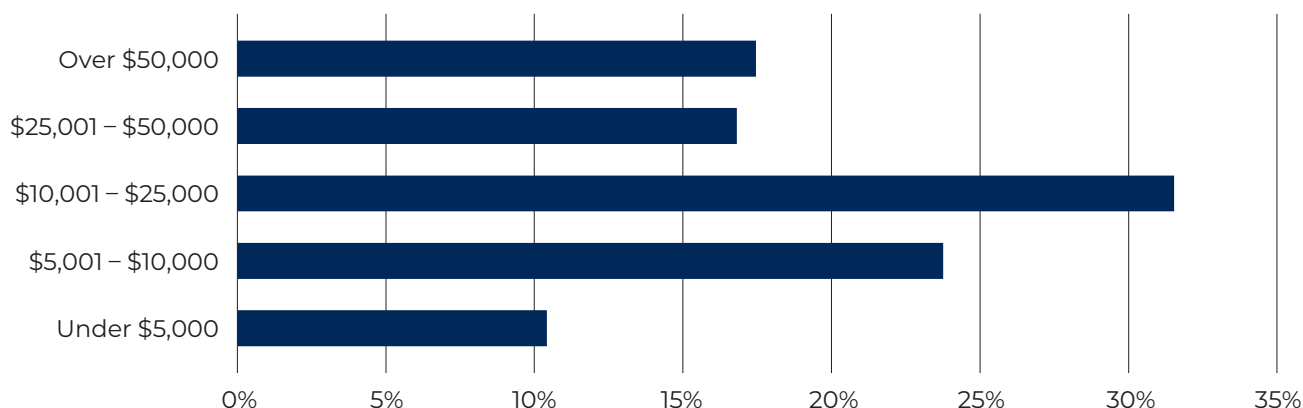
As part of our inspection process, the audit firms selected for inspection provide the PCAOB with data regarding fees for conducting the audit and applicable attestation engagement for each of their broker-dealer clients. This data covers approximately half of the broker-dealer audits performed by registered firms during the most recent inspection period. The charts below include fee data reported to the PCAOB by the audit firms.

The following chart provides the broker-dealer engagement fees for every audit firm inspected during 2022, regardless of whether the engagement was reviewed during the inspection.

## Engagement Fees Reported by Inspected Firms

(Excludes firms that audited 100 or more broker-dealers and 100 or more public companies)

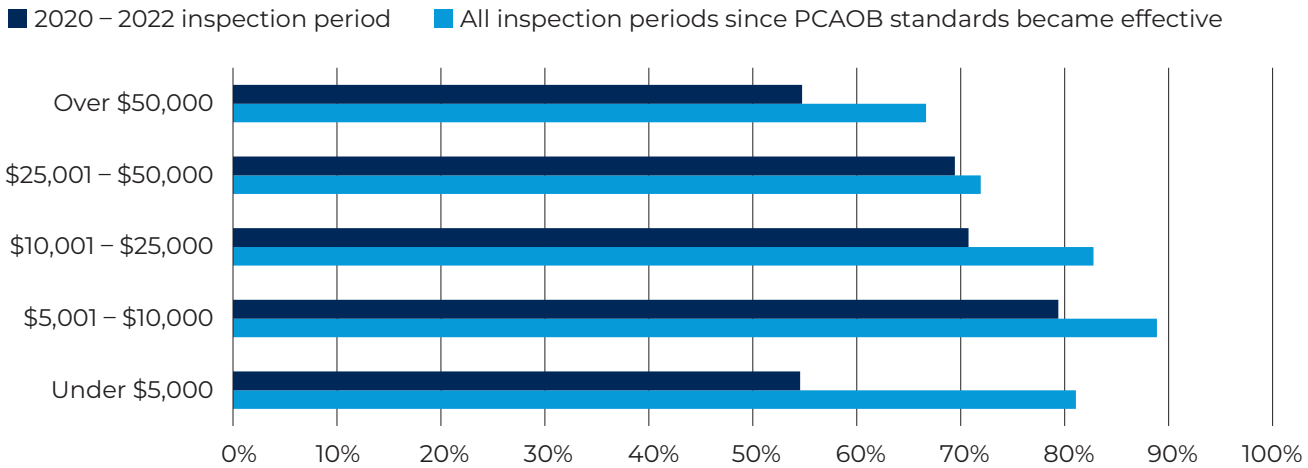
■ Percentage of all broker-dealer engagements



Excluding audits performed by audit firms that audit 100 or more broker-dealers and 100 or more public companies, approximately 65% of broker-dealer audits were performed for fees of less than \$25,000, 34% for less than \$10,000, and 10% for less than \$5,000.

## Audit Engagement Deficiency Rates by Fee Range

(Excludes firms that audited more than 100 broker-dealers and more than 100 public companies)



The chart illustrates that audit deficiency rates are high across all fee ranges during 2020–2022 inspection periods and for the period since broker-dealers have been required to undergo audits and examination or review engagements in accordance with PCAOB standards. The highest deficiency rates are in the \$5,001 to \$10,000 fee range, with 79% of audit engagements found to have at least one deficiency during the 2020–2022 inspection periods, compared to 89% for the period since PCAOB standards became effective for broker-dealer audits.

These percentages raise concerns that the audit firm's focus on achieving profitability on such engagements may adversely impact the number of hours partners and staff allocate to planning and field work, with heightened risks to audit quality.

## REMINDERS FOR AUDITORS

The following are reminders for auditors of broker-dealers when performing broker-dealer audit and attestation engagements under PCAOB standards.

## Industry Expertise

Training of audit personnel in the broker-dealer industry is crucial to performing a quality audit. An audit of a broker-dealer requires that engagement teams be technically proficient with the Broker-Dealer Financial Responsibility Rules, particularly the Net Capital Rule and the Customer Protection Rule, and in the application of PCAOB standards. It may take time and multiple engagements for an auditor to become technically proficient in these areas, and this result is usually achieved through on-the-job training, in-house and vendor training sessions, broker-dealer conferences, and dedicated self-study of the Broker-Dealer Financial Responsibility Rules.

## Exercising Professional Skepticism

It is important for audit firms to consistently reinforce to audit personnel the essential nature of professional skepticism in the planning and performance of broker-dealer audit and attestation procedures with due

professional care. This includes exercising professional skepticism during procedures to identify, assess, and respond to risks of material misstatement due to fraud and risks associated with the misappropriation of customer assets. Procedures performed by engagement teams should include inquiries of management, among others, relating to the broker-dealer's business operations and practices, including processes, controls, and customer complaint logs for identifying and responding to questionable ethical behavior, including any specific incidents the broker-dealer has identified. It is also important that auditors corroborate the results of inquiries with persuasive audit evidence supporting the identification, assessment, and response to risks.

## Planned Approach to Risk Assessment

Planning the audit includes establishing the overall audit strategy for the engagement and developing an audit plan, which includes, in particular, planned risk-assessment procedures and responses to the risks of material misstatement. The nature and extent of planning activities that are necessary depend on the size and complexity of the broker-dealer, the auditor's previous experience with the broker-dealer, and changes in circumstances that occur during the audit. Engagement teams should sufficiently assess the broker-dealer's control environment as part of identifying and assessing the risks of material misstatement and designing the nature, timing, and extent of their audit procedures to address those risks.

## Planned Audit Response

It is important for audit firms to ensure appropriate time is spent planning and performing risk assessment procedures that are sufficient to provide a reasonable basis for designing further audit procedures. Appropriate, ongoing supervision and review

## Recommended Actions

Sound knowledge of PCAOB standards is fundamental to the conduct of a quality audit. Recommended actions to help firms comply with PCAOB standards and rules include:

- Read the **PCAOB's audit and attestation standards and rules**.
- Read the most recent ***Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers*** as well as Spotlights and other PCAOB staff publications as they are issued; revisit the audit firm's planned audit procedures and system of quality control, and promptly implement actions to avoid the types of deficiencies reported in these publications.
- Invest adequately in training on PCAOB standards and rules for staff assigned to broker-dealer audit and attestation engagements.
- Implement remedial actions under AS 2901 and AS 2905 for deficiencies identified during PCAOB inspections and the audit firm's internal inspections.
- Decline to accept or continue any engagement which the audit firm does not have the requisite expertise to successfully conduct (such as a broker-dealer that files a compliance report, which requires expertise in both the Broker-Dealer Financial Responsibility Rules and internal control over compliance, if the auditor cannot adequately prepare for such an engagement).



by engagement leadership throughout the engagement are essential to ensuring the procedures performed address the identified risks consistent with the applicable PCAOB standards. Audit firms typically develop an audit approach that is modeled after the PCAOB's standards, and it is the responsibility of engagement teams to understand and comply with these standards when they apply the audit firm's approach. Audit quality is strengthened when engagement teams continually assess whether the procedures that they complete are consistent with relevant PCAOB standards.

## Client Acceptance and Continuance

It is important for audit firms to regularly monitor their broker-dealer practices to ensure they have adequate resources and expertise at the engagement partner, EQR, and staff levels to serve existing and potential broker-dealer clients. Audit firms should ensure that the business arrangement (including audit hours) allows for adequate time for the audit firm to perform audit and attestation engagements that are fully compliant with PCAOB standards, including appropriate supervision and review.

## Stay Tuned and In Touch

For more resources for auditors of broker-dealers from the PCAOB, including the PCAOB's annual reports, standards and staff guidance, visit the **Information for Auditors of Broker-Dealers** page on the PCAOB's website. To receive periodic updates, please **join the PCAOB's mailing list**.

The PCAOB welcomes your questions and comments and invites you to fill out a short **reader survey** and/or to contact the staff at **info@pcaobus.org**.

Additionally, the PCAOB hosts forums to provide registered audit firms access to timely information. The PCAOB's Small Business and Broker-Dealer Forums provide updates about PCAOB activities to registered firms that audit public companies considered to be small businesses and that audit certain SEC-registered broker-dealers. Forums provide attendees with an opportunity to learn more about the work of the Board and current issues impacting the relevant sector of the auditing profession. Besides providing important updates, the forums are an opportunity for Board Members and PCAOB staff to receive input on issues related to the Board's work. There is no fee to participate in our forums, but advance registration is required. Firms are encouraged to subscribe to PCAOB updates and/or to reach out to **PCAOB staff directly** with any questions regarding the 2024 forums.

## STAY CONNECTED TO THE PCAOB



Contact Us



Subscribe



PCAOB



@PCAOB\_News