

DRI Broker-Dealer Firm Program Update

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OBJECTIVES

At the end of this session participants will be able to:

- Understand the content of the recently issued Rule 4020T annual report and supplemental information documents
- Discuss some of the findings from the 2021 broker-dealer firm PCAOB inspections
- Understand the status of the 2022 broker-dealer firm PCAOB inspection activities

OVERVIEW OF THE RULE 4020T ANNUAL REPORT

- Issued August 19th covering all 2021 BDF inspection activities
- Aggregates results across all firms inspected
- Addresses deficiencies related to:
 - Audits of financial statements, audits of supplemental information, examinations of compliance reports, reviews of exemption reports, and quality control
- Includes good practices and recommended actions for firms
- “Supplementary Information” document provides analysis of program results over time

POLLING QUESTION

Which type of engagement experienced an increase in the percentage of engagements with deficiencies in 2021 compared to 2020?

- a. Audit engagements
- b. Examination engagements
- c. Review engagements
- d. Agreed-upon procedures engagements

INSPECTIONS BY THE NUMBERS

	2021	2020	2019
Firms Inspected	50	65	66
- With deficiencies	39	51	59
- Without deficiencies	11	14	7
Audits	92	105	106
- With deficiencies	45	64	75
- Without deficiencies	47	41	31
Examination Engagements (AT No. 1 / Compliance Report Filers)	33	21	29
- With deficiencies	21	14	20
- Without deficiencies	12	7	9
Review Engagements (AT No. 2 / Exemption Report Filers)	58	83	74
- With deficiencies	16	19	38
- Without deficiencies	42	64	36

EXAMINATION ENGAGEMENTS

	2021			2020	2019
	Number reviewed	Number with deficiencies	%	%	%
Examination Engagements	33	21	64%	67%	69%

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RECOMMENDED ACTIONS FOR FIRMS: IMPORTANT CONTROLS

Enhance procedures to test important controls over compliance with the financial responsibility rules for broker-dealers that file compliance reports.

INFORMATION TECHNOLOGY CONTROLS SCENARIO

A broker-dealer used an internally developed application to support its business operations, including recording of customer securities transactions. The application was used in the broker-dealer's ICOC with the financial responsibility rules. The auditor determined the information technology controls over the application to be important to the auditor's conclusion about whether the broker-dealer maintained effective ICOC with the financial responsibility rules.

POLLING QUESTION

Which of the following is true under this scenario?

- a. Only IT controls associated with program development and program changes need to be assessed for relevance in addressing risks associated with financial responsibility rules
- b. The auditor should test both the design and operating effectiveness of the important IT controls
- c. The auditor should test the controls only as of the broker-dealer's fiscal year end
- d. Automated application controls would generally be expected to be higher risk if the important IT controls are effective

CUSTOMER RESERVE COMPUTATION SCENARIO

The auditor considered management's weekly reserve computation review control to be an important control for addressing compliance with the Reserve Requirements Rule. The auditor determined that the control owner used reports prepared by the broker-dealer as part of the review.

POLLING QUESTION

Which of the following is true in this scenario?

- a. Inquiries of the control owner should not include inquiries regarding criteria used to identify and correct errors
- b. Controls over the accuracy and completeness of the reports used by the control owner are not important controls
- c. A combination of reperformance and inspection procedures could provide sufficient, appropriate evidence regarding the operating effectiveness of management's weekly reserve computation review
- d. Evidence obtained through testing the reserve computation review control is not relevant to the auditor's objectives in testing the customer reserve computation under AS 2701

REVIEW ENGAGEMENTS

	2021			2020	2019
	Number reviewed	Number with deficiencies	%	%	%
Review Engagements	58	16	28%	23%	51%

RECOMMENDED ACTIONS FOR FIRMS: AUDIT EVIDENCE

Firms should take into account, during review engagements, relevant evidence from the audit of the financial statements, for broker-dealers that file exemption reports.

POLLING QUESTION

Which financial statement area was most frequently cited with deficiencies?

- a. Revenue
- b. Receivables and Payables
- c. Related Party Relationships and Transactions
- d. Fair Value Measurements

FINANCIAL STATEMENT AREAS

	2021			2020	2019
	Number reviewed	Number with deficiencies	%	%	%
Revenue	79	26	33%	47%	53%
Related Party Relationships and Transactions	18	4	22%	25%	27%
Going Concern	11	3	27%	30%	67%
Expenses and Related Accruals	12	3	25%	N/A	N/A
Fair Value Measurements	13	3	23%	4%	0%
Receivables and Payables	21	3	14%	22%	27%

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RECOMMENDED ACTION FOR FIRMS: REVENUE

Enhance procedures to identify, assess, and respond to risks of material misstatement.

REVENUE SCENARIO

A broker-dealer earned fees from the private placement of securities. The auditor took a substantive approach that included tests of details to address an identified fraud risk related to improper revenue recognition.

POLLING QUESTION

Which of the following is true under this scenario?

- a. Because the auditor's approach is substantive, no evaluation of controls is required
- b. Substantive analytical procedures, rather than tests of details, could be sufficient to respond to the identified fraud risk
- c. If the auditor's approach includes audit sampling, all items in the population should have the opportunity to be selected
- d. Evidence that a private placement transaction closed provides evidence related to the completeness assertion

FAIR VALUE MEASUREMENTS SCENARIO

A broker-dealer held a portfolio of equity and debt securities measured at fair value. The broker-dealer measured its equity securities based on prices quoted on an exchange and debt securities based on inputs other than quoted prices that were observable either directly or indirectly. The broker-dealer obtained its pricing information for both equity and debt securities from third-party pricing service A. The auditor chose to test the broker-dealer's estimated fair value of equity and debt securities by developing an independent expectation of fair value and used information from third-party pricing service B.

POLLING QUESTION

Which of the following is true under this scenario?

- a. Because the auditor is developing an independent expectation of fair value, the auditor does not need to understand the broker-dealer's process for developing the fair value estimate
- b. The auditor should understand the nature of any relationship that the broker-dealer might have with pricing service B
- c. The auditor's responsibilities are the same whether pricing service B used identical or comparable securities to price the debt securities
- d. Because the auditor chose to develop an independent expectation, it should not also use the other methods described in AS 2501

SUPPLEMENTAL INFORMATION AREAS

	2021			2020	2019
	Number reviewed	Number with deficiencies	%	%	%
Customer Protection Rule	26	12	46%	39%	42%
Net Capital Rule	34	6	18%	31%	31%

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QUALITY CONTROL

	2021		2020	2019
	Number with deficiencies	%	%	%
Engagement Performance	23	46%	66%	79%
Personnel Management	0	0%	2%	2%
Monitoring	0	0%	0%	3%
Independence, Integrity, and Objectivity	2	4%	0%	3%

RECOMMENDED ACTIONS FOR FIRMS: QC SYSTEMS

Strengthen QC systems, particularly engagement quality reviews.

SUPPLEMENTARY INFORMATION DOCUMENT

- Information about selected firms and engagements
- Results by firm characteristics
 - Audited broker-dealers that filed Compliance Reports or only audited broker-dealers that filed Exemption Reports
 - Audited issuers or did not audit issuers
 - Number of broker-dealer audits per firm
- Results by inspection frequency
- Results by broker-dealer characteristics
 - Filed a Compliance Report or filed an Exemption Report

2022 INSPECTION STATUS

- Selection of firms and broker-dealer audits
 - Number and mix of selections
 - Risk-based and random selections
 - Compliance report filers and exemption report filers
- Fieldwork
 - Continues into December
 - Remote and in-person inspections

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QUESTIONS

