

# Small Business and Broker- Dealer Auditor Forum

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November 20, 2024

# WELCOME AGENDA

- Disclaimer
- Learning Objectives and Course Description
- Forum Information
  - Evaluation
  - Polling
  - Q&A
  - CPE Codes

# DISCLAIMER

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 the views we express are in our official capacity as PCAOB Board or staff members but are our own and do not necessarily reflect the views of the Board, other Board Members, or other members of the staff.

# LEARNING OBJECTIVES

- To discuss important information concerning PCAOB activities with registered public accounting firms that audit the financial statements of public companies operating in the small business community or broker-dealers. The forum also provides an opportunity for Board members and PCAOB staff to hear comments, concerns and questions from auditors
- PCAOB presentations will include updates from the PCAOB's Standards and Enforcement groups. Additionally, staff from the PCAOB's Division of Registration and Inspections will provide an overview of inspections and discuss recent inspection findings
- In addition, staff from the Securities and Exchange Commission and FINRA will provide updates on topics of current interest

# COURSE DESCRIPTION

The PCAOB Small Business and Broker-Dealer Forum is a one-day program that will offer attendees the opportunity to interact with the PCAOB and learn more about its programs and activities, including updates on current activities.

# FORUM CHECK-IN

<https://pcaobea.cnf.io/>



# FORUM CHECK IN

**Wednesday, November 20**

**Jersey City Forum**

9:30am - 5:30pm in Jersey City, NJ

-  Tony Thompson
-  Tim Sikes
-  Shirley Wee
-  Kyra Armstrong
-  Alan Kerwin
-  Andrew Cleve
-  Lisa Calandriello
-  Nick Jenner
-  Michael Tanzosh
-  Kate Ostasiewski

# FORUM CHECK IN



HOME WEBCAST SUPPORT STREAM TEST LOG OUT

NEW PRESENTATION NAME

CERTIFICATION AGENDA

Check In To This Session

First Name

Last Name

Email Address



Check In To This Session

First Name


Last Name

Email Address

**Check In Now**




# POLLING




Check Out   
You are checked in


Codewords  
0 submitted so far


Session evaluation will automatically unlock  
Thursday, October 26th at 3:30 pm


Polls  Create

View results by clicking on a Poll

What is your favorite season?  Locked  0 

Social Q&A  Ask

Sorted By **Upvotes** Showing **All** 

 There are no questions right now. Why not ask one?



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# Q&A AND COMMENTS

The screenshot shows a user interface with several components:

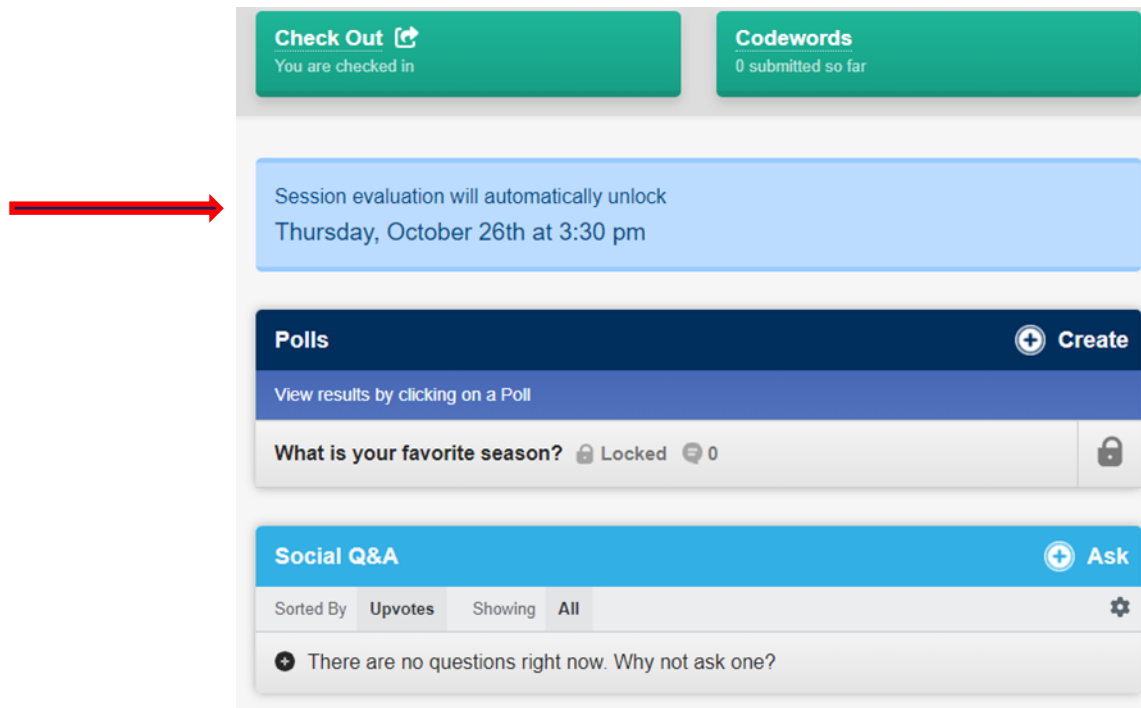
- Check Out** (green button): You are checked in
- Codewords** (green button): 0 submitted so far
- Session evaluation** (light blue box): Session evaluation will automatically unlock Thursday, October 26th at 3:30 pm
- Polls** (dark blue header): Includes a **Create** button and a sub-header "View results by clicking on a Poll". A poll titled "What is your favorite season?" is shown as "Locked" with 0 responses.
- Social Q&A** (light blue header): Includes an **Ask** button circled in red. Below the header, there are sorting options: "Sorted By", "Upvotes", "Showing", and "All". A message "There are no questions right now. Why not ask one?" is displayed, with a plus icon circled in red. A red arrow points from the left towards the "Social Q&A" section.

# CPE CREDIT

The screenshot displays a user interface for CPE credit. At the top, there are two green buttons: 'Check Out' with a checkmark icon and 'Codewords' with the text '0 submitted so far'. A red arrow points to the 'Codewords' button. Below these is a light blue notification box stating 'Session evaluation will automatically unlock Thursday, October 26th at 3:30 pm'. The 'Polls' section has a dark blue header with a '+ Create' button and a sub-header 'View results by clicking on a Poll'. A poll question 'What is your favorite season?' is shown as 'Locked' with 0 comments. The 'Social Q&A' section has a light blue header with a '+ Ask' button and a sub-header 'Sorted By Upvotes Showing All'. A message below reads 'There are no questions right now. Why not ask one?'.

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# EVALUATION



The screenshot displays a user interface for a session evaluation. At the top, there are two green buttons: "Check Out" with a location pin icon and the text "You are checked in", and "Codewords" with the text "0 submitted so far". Below these is a light blue notification box containing the text "Session evaluation will automatically unlock Thursday, October 26th at 3:30 pm". A red arrow points from the left towards this notification. Underneath the notification is a "Polls" section with a "Create" button. It includes a sub-header "View results by clicking on a Poll" and a poll question "What is your favorite season?" which is marked as "Locked" and has "0" responses. At the bottom is a "Social Q&A" section with an "Ask" button, a sorting menu set to "Upvotes", and a message stating "There are no questions right now. Why not ask one?"

# Board Member Perspectives

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Tony Thompson, Board Member

Kent Bonham, Office of Communications and Engagement

November 20, 2024

# PCAOB Inspections Overview and Illustrative Examples: Issuers

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Tim Sikes, Nick Jenner and Shirley Wee  
Division of Registration and Inspections  
November 20, 2024



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# OBJECTIVES

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

- Discuss some of the observations from the 2023 inspections
- Understand audit requirements, deficiency examples, and good practices for selected areas
- Understand our current 2024 inspection procedures
- Describe the general requirements of AS 2501, Auditing Accounting Estimates, Including Fair Value Measurements
- Describe the general requirements of Audits Involving Other Auditors

# 2023 INSPECTIONS

- In 2023, the PCAOB completed inspections of 227 audit firms and reviewed portions of 793 public company audits.
- The aggregate deficiency rates have continued to increase across all inspection programs, and 46% of the engagements reviewed in 2023 had at least one Part I.A deficiency.
- Outliers are also influencing the deficiency rate among U.S. Non-Affiliate Firms (NAF) inspected **annually**, where the aggregate Part I.A deficiency rate reached 51% in 2023.
- Over half of the U.S. NAF triennially inspected firms showed no significant changes in Part I.A deficiency rates compared to their previous inspections and 32% experienced an increase in Part I.A deficiency rates.

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# 2023 AREAS OF COMMON DEFICIENCIES

- **Internal Controls over Financial Reporting (ICFR)**
  - Risk Assessment
  - Selecting Controls to Test
  - Testing Design Effectiveness
  - Testing Management Review Controls
- **Financial Statement Areas**
  - Revenue and Related Accounts
  - Inventory
  - Accounts Impacted by Business Combinations
  - Investment Securities

# 2023 AREAS OF COMMON DEFICIENCIES

- **Other PCAOB Standards and Rules**
  - Fraud
  - Critical Audit Matters (CAMs)
  - Auditor Tenure
  - Audit Committee Communications
  - Form AP Reporting
- **System of Quality Control**
  - Independence
  - Engagement Quality Review (EQR)
  - Monitoring

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# 2024 INSPECTIONS

- We are continually improving our inspection program, using a data-driven and risk-based approach, with a focus on riskier engagements and certain audit areas.
- Enhancements to our inspection program include:
  - Increasing the number of engagements reviewed
  - Expanding inspection procedures
  - Increasing focus on a firm's culture
  - Improving the timeliness of inspection reports
- For more information, please see *Spotlight, Staff Priorities for 2024 Inspections and Interactions with Audit Committees (Dec 2023)*.



## SPOTLIGHT

Staff Priorities for 2024  
Inspections and Interactions  
With Audit Committees

December 2023

This document represents the views of PCAOB staff ("we") and not necessarily those of the Board. It is not a rule, policy, or statement of the Board. The PCAOB does not set standards for, or provide authoritative guidance on, audit committee conduct.

# SELECTED AREAS FOR ILLUSTRATIVE EXAMPLES

## Areas selected for illustrative examples:

- Auditing Accounting Estimates, Including Fair Value Measurements
- Audits Involving Other Auditors

# KEY ASPECTS OF AS 2501

- Applies to estimates in significant accounts and disclosures
- Focuses auditors on estimates with greater risk of material misstatement
- Emphasizes the application of professional skepticism, including addressing potential management bias
- Includes three substantive approaches to auditing estimates
- Provides direction on auditing fair value of financial instruments, particularly when pricing information is obtained from third parties

# SELECTING AN APPROACH FOR TESTING

In performing substantive procedures, the auditor should test an accounting estimate using one or a combination of the following approaches:

- Test the company's process used to develop the accounting estimate;
- Develop an independent expectation for comparison to the company's estimate; and
- Evaluate audit evidence from events or transactions occurring after the measurement date related to the accounting estimate for comparison to the company's estimate.

# TESTING THE COMPANY'S PROCESS

- Evaluate whether the method used by the company to develop the accounting estimate is (1) in conformity with the requirements of the applicable financial reporting framework; and (2) appropriate for the nature of the related account or disclosure, taking into account the auditor's understanding of the company and its environment. (AS 2501.10)
- Test the accuracy and completeness of data produced by the company (AS 2501.12; AS 1105.10)
- Evaluate the relevant and reliability of data from external sources (AS 2501.13; AS 1105.04 and .06)

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# TESTING THE COMPANY'S PROCESS

- Identify significant assumptions used by the company (AS 2501.15)
- Evaluate the reasonableness of the significant assumptions (AS 2501.16 - .18)

# DEVELOPING AN INDEPENDENT EXPECTATION

- A reasonable basis for the auditor derived assumptions and method used (AS 2501.22)
- Evaluate the relevant and reliability of data or assumptions obtained from a third party (AS 2501.23; AS 1105.04 and .06)
- Test the accuracy and completeness of data produced by the company (AS 2501.12 and .24; AS 1105.10)
- Evaluate the reasonableness of the significant assumptions used that were developed by the company (AS 2501.24; AS 2501.16 - .18)
- Evaluate the appropriateness of company's method (AS 2501.24; AS 2501.10)



# SUBSEQUENT EVENTS AND TRANSACTIONS

- Evaluate whether the audit evidence is sufficient, reliable, and relevant to the accounting estimate and whether the evidence supports or contradicts the company's estimate (AS 2501.28)
- Take into account changes in the company's circumstances and other relevant conditions between the event or transaction date and the measurement date (AS 2501.29)

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# ALL EXERCISE – PART 2

The auditor's approach to test the qualitative reserve component of the ALL is to test management's process. The auditor performed the following procedures:

1. Obtained and read the company's quarterly qualitative factors adjustments, including commentary for each factor (focused on changes in the adjustments from prior periods), and the company's ALL Memo;
2. Identified which of the qualitative factors were significant assumptions;
3. Evaluated the changes in the significant assumptions in relation to the prior periods and, for certain factors, certain external or internal loan data obtained by the engagement team; and
4. Compared the company's reserves and ratios to those of peers, including the total collective reserve and other reserves to the total ALL, and the total collective reserve and other reserves to total loans.

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# INVENTORY RESERVES EXERCISE

- The company reported several types of inventory and disclosed in its financial statements that inventory reserves are recorded for obsolete or slow-moving inventory based on assumptions about future demand and marketability of products, new product introductions, and specific identification of items.
- The auditor's approach to test inventory reserves was to develop an independent expectation by applying a historical write-off percentage to the total current year inventory.
- The auditor performed procedures to test the accuracy and completeness of the historical write-off percentage.
- The auditor compared its expectation to the company's reserve and the variance was below tolerable misstatement.

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# KEY TAKEAWAYS

- Identifying significant assumptions such that the audit effort is focused on those assumptions that are important to the recognition or measurement of the accounting estimate.
- When testing the company's process, addressing all applicable requirements in evaluating the reasonableness of assumptions – included in AS 2501.16, .16a, and .17 (if applicable).
- When developing an independent expectation and using independent assumptions and methods, having a reasonable basis for the assumptions and methods used.

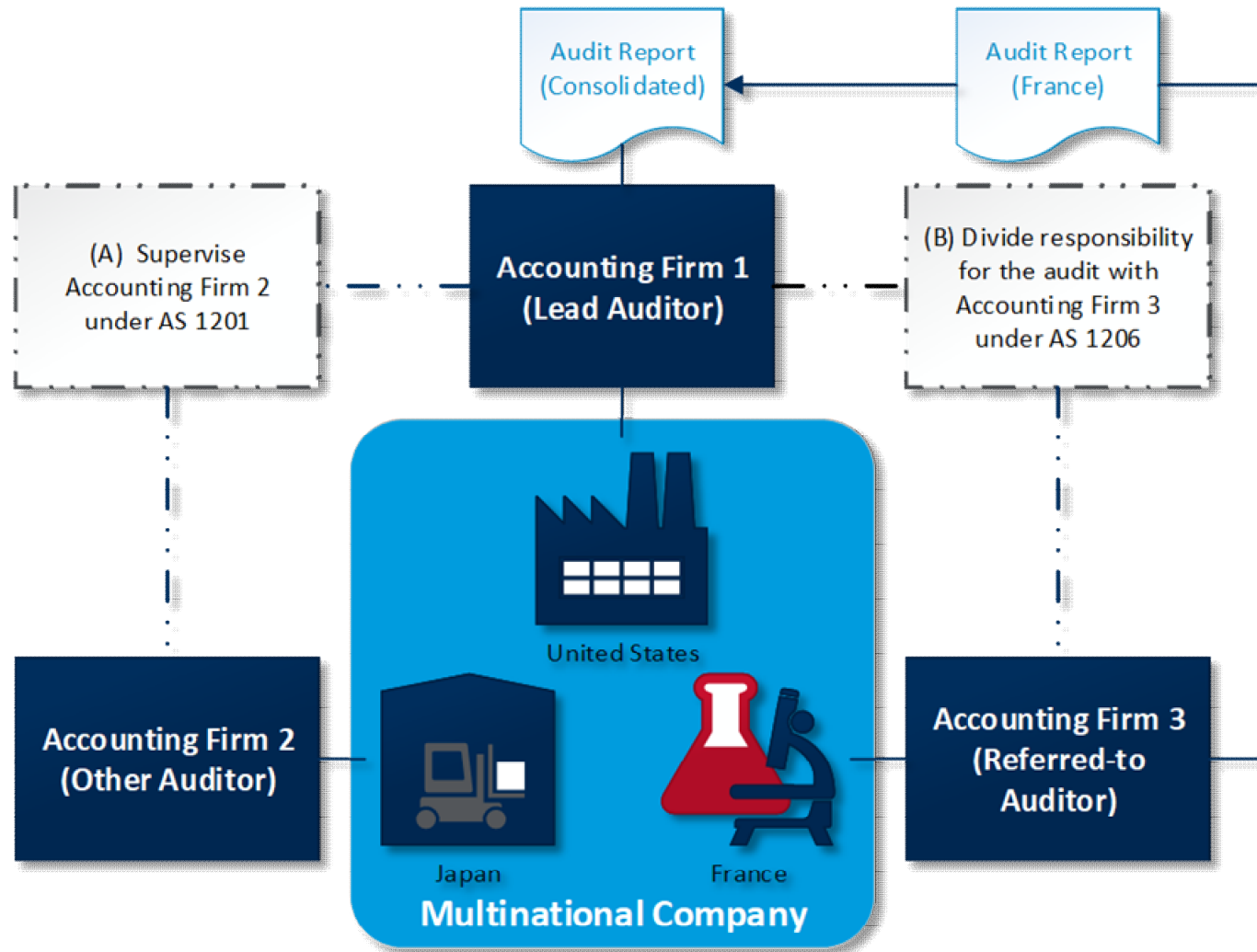


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# AUDITS UNDER AMENDED STANDARDS



# ENGAGEMENT TEAM

## Part of the “Engagement Team”

- Engagement partner
- Personnel from the engagement partner’s firm who perform audit procedures
- Personnel of accounting firms outside the engagement partner’s firm who perform audit procedures
- National office or centralized group personnel who perform audit procedures or assist in planning or supervising the audit

## Not part of the “Engagement Team”

- Auditor-engaged specialists
- Engagement quality reviewer
- Appendix K or filing reviewer
- Personnel of a Referred-to Auditor
- Third-party service organization auditors
- Individuals employed or engaged by the company being audited (e.g., internal auditors, company’s specialists)

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# FINDINGS RELATED TO THE USE OF OTHER AUDITORS

## FACTS

- The Lead Auditor engaged an outside accounting firm to perform an **inventory observation** at one of the issuer's warehouses. Inventory held at this warehouse represented 70% of the issuer's total inventory.
- The Other Auditor observed the warehouse staff's inventory procedures, performed test counts on selected inventory items on hand, and provided the Lead Auditor with the work papers related to this observed count.

## DEFICIENCIES

- The Lead Auditor did not (i) obtain independence representations from the other auditors that performed the inventory observation and (ii) include information related to the participation of this other auditor in its report on Form AP.

# FINDINGS RELATED TO THE USE OF OTHER AUDITORS

## FACTS

- The Lead Auditor engaged an outside accounting firm to perform audit procedures primarily related to **interim reviews**.

## DEFICIENCY

- The Lead Auditor did not communicate to the issuer's audit committee the name, location, and planned responsibilities of the other auditor.

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# QUESTIONS



# Break



# Standard-Setting Update

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Lisa Calandriello and Andrew Cleve  
Office of the Chief Auditor  
November 20, 2024

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# OVERVIEW

- Part I – Standard-Setting Projects
  - Standard-Setting Activities and Agenda
  - Recently Issued Proposals
- Part II – Recently Completed Projects
  - Amendments Related to Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form
  - AS 1000, General Responsibilities of the Auditor in Conducting an Audit
  - QC 1000, A Firm's System of Quality Control
  - Part III – AS 2310, The Auditors Use of Confirmation

# STANDARDS-RELATED ACTIVITIES



Standard-Setting Process

Standard-Setting, Research, and  
Rulemaking Projects

Implementation of PCAOB  
Standards and Rules

Post-Implementation Review

Standard-related activities can be found at:  
<https://pcaobus.org/oversight/standards>

# STANDARDS-SETTING AGENDA

- Recently Issued Standard-Setting Proposals
- Recently Completed Standard-Setting Projects
- Short-Term Standard-Setting Projects
- Mid-Term Standard-Setting Projects
- Research Projects
- Rulemaking Projects

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## Quality Control

Subject to approval by the SEC, the final standard and related amendments to auditing standards, rules, and forms would take effect on December 15, 2025.

May 13, 2024

Pending

The first evaluation period will be for the period beginning on the effective date of the standard (i.e., December 15, 2025) and ending on September 30, 2026. The firm's first evaluation must be reported to the PCAOB on Form QC no later than November 30, 2026.



[CLICK HERE FOR PROJECT PAGE](#)

# STANDARD-SETTING AND RULEMAKING PROPOSALS

Substantive  
Analytical  
Procedures

Firm and  
Engagement  
Metrics

Noncompliance  
with Laws and  
Regulations

Registration

Firm Reporting

Standard-Setting, Research, and Rulemaking Projects:  
<https://pcaobus.org/oversight/standards/research-standard-setting-projects>

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# RECENTLY COMPLETED PROJECTS

- *Amendments Related to Aspects of Designing and Performing Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form*
- *AS 1000, General Responsibilities of the Auditor in Conducting an Audit*
- *QC 1000, A Firm's System of Quality Control*
- *AS 2310, The Auditors Use of Confirmation*

# RECENTLY COMPLETED PROJECTS

## ***Amendments Related to Aspects of Designing and Performing Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form***

- Board voted to approve on June 12, 2024
- Amendments to AS 1105, *Audit Evidence*:
  - Specify auditor responsibilities when using an audit procedure for more than one purpose
  - Specify auditor responsibilities for evaluating the reliability of certain audit evidence and emphasize the importance of appropriate disaggregation of information

# RECENTLY COMPLETED PROJECTS

## ***Amendments Related to Aspects of Designing and Performing Procedures that Involve Technology-Assisted Analysis of Information in Electronic Form (Cont'd)***

- Amendments to AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*:
  - Specify the auditor's responsibilities when performing tests of details
- Effective date
  - Audits of financial statements for fiscal years beginning on or after December 15, 2025



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# RECENTLY COMPLETED PROJECTS (CONT'D)

## *AS 1000, General Responsibilities of the Auditor in Conducting an Audit*

- Board voted to approve on May 13, 2024
- AS 1000 will modernize, clarify, and streamline the general principles and responsibilities of auditors
  - Amendments to other PCAOB standards will:
    - Clarify the auditor's responsibility to evaluate whether the financial statements are "presented fairly"
    - Clarify the engagement partner's responsibilities by adding specificity to certain audit performance principles
    - Accelerate the documentation completion date from 45 days to 14 days

# RECENTLY COMPLETED PROJECTS (CONT'D)

## ***AS 1000, General Responsibilities of the Auditor in Conducting an Audit (Cont'd)***

- Effective dates
  - Audits of financial statements for fiscal years beginning on or after December 15, 2024, except for the 14-day documentation completion date requirement, which is as follows:
  - Effective dates for the 14-day documentation completion date requirement:
    - For firms that, during the calendar year ending 12/31/24, issued audit reports with respect to more than 100 issuers – effective for audits of financial statements for fiscal years beginning on or after 12/15/24; and
    - For all other firms – effective for audits of financial statements for fiscal years beginning on or after 12/15/25

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# RECENTLY COMPLETED PROJECTS (CONT'D)

## *QC 1000, A Firm's System of Quality Control*

- Board voted to approve on May 13, 2024
- QC 1000 and related amendments will:
  - Strike a balance between a risk-based approach to QC and a set of mandates
  - Require all PCAOB-registered firms to design a QC system that complies with the new standard
  - Require for firms that perform audits of public companies or SEC-registered brokers and dealers to implement and operate the QC system<sup>3</sup>

# RECENTLY COMPLETED PROJECTS (CONT'D)

## *QC 1000, A Firm's System of Quality Control (Cont'd)*

- Annually evaluate the firm's QC system and report to the PCAOB on new Form QC
- Require firms that audit more than 100 issuers annually to establish an external oversight function for the QC system
- Take effect on December 15, 2025
  - The first evaluation period will be from December 15, 2025, to September 30, 2026
  - Form QC - No later than November 30, 2026

# IMPLEMENTATION OF NEW STANDARDS



Standard-Setting Process

Standard-Setting, Research, and  
Rulemaking Projects

Implementation of PCAOB  
Standards and Rules

Post-Implementation Review

Standard-related activities can be found at:  
<https://pcaobus.org/oversight/standards>

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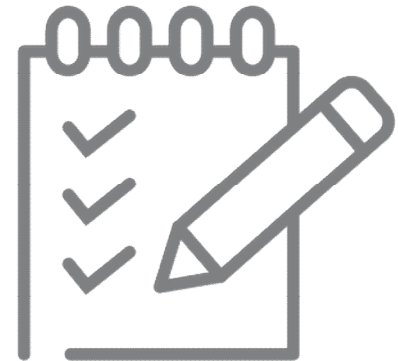
# ***AS 2310, The Auditor's Use of Confirmation***

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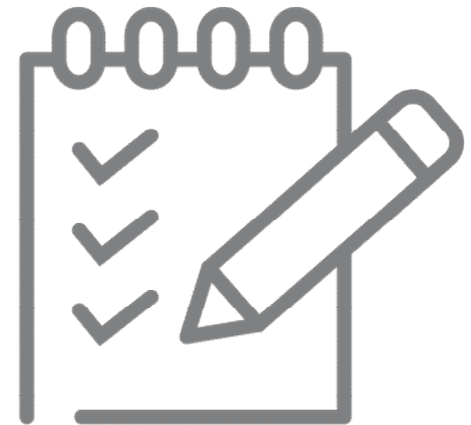
# NEW CONFIRMATION STANDARD

- Board approved September 28, 2023;  
SEC approved December 1, 2023
  - New standard (AS 2310, The Auditor's Use of Confirmation) will replace the current standard (AS 2310, The Confirmation Process) in its entirety
  - Effective for audits of financial statements for fiscal years ending on or after June 15, 2025



# NEW CONFIRMATION STANDARD (CONT'D)

- Topics covered in this session:
  - Confirming parties
  - Use of negative confirmations
  - Confirmation of cash
  - Confirmation of accounts receivable
    - Addresses situations when it is not feasible to perform confirmation procedures



# CONFIRMING PARTIES

Requirement: AS 2310.09 states that, “The auditor should direct confirmation requests to confirming parties (individuals or organizations) who are knowledgeable about the information to be confirmed and **determine that the confirmation requests are properly addressed.**”

## Examples

Compare all or some addresses to physical addresses or e-mail domains on the confirming party’s website

When using an intermediary, consider if controls exist at the intermediary related to validating addresses of confirming parties and, if so, perform procedures in accordance with Appendix B

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# NEGATIVE CONFIRMATION REQUESTS

Requirement: AS 2310.12 states that, “Generally, the auditor obtains significantly less audit evidence when using negative confirmation requests...Therefore, the use of negative confirmation requests alone does not provide sufficient appropriate audit evidence for addressing the risk of material misstatement to a financial statement assertion.”

# NEGATIVE CONFIRMATION REQUESTS (CONT'D)

So, when might an auditor still elect to use negative confirmation requests as part of their planned audit response?

## Examples

Low risk of material misstatement AND sufficient appropriate audit evidence regarding the design and operating effectiveness of controls

Population composed of small, homogenous items

Expectation of a low exception rate in response to negative confirmation requests and reasonable basis for expectation



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# CONFIRMING CASH & ACCOUNTS RECEIVABLE

Requirement: AS 2310.24 – for cash & accounts receivable, “the auditor should perform confirmation procedures...or otherwise obtain relevant and reliable audit evidence by directly accessing information maintained by a knowledgeable external source.”

# CASH PROCEDURES

Company has cash balances deposited at a financial institution.  
What substantive audit procedures could satisfy the requirements in AS 2310.24?

## Examples

Auditor sends confirmation requests directly

Intermediary facilitates direct transmission of confirmation requests & responses

Auditor directly accesses information maintained by financial institution

# CASH ALTERNATIVE PROCEDURES

- Requirement: AS 2310.23 states that, “In the case of a nonresponse or an incomplete response, the **auditor should perform alternative procedures.....**”
- Auditor sends confirmation request(s) to confirming party, e.g., financial institution, no confirmation response(s) received. What follow up could satisfy the requirements in AS 2310.23?

## Example

Auditor verifies company’s cash balances by viewing information directly on a secure website of financial institution.

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# ACCOUNTS RECEIVABLE

Requirement: AS 2310.25 – For accounts receivable [only], “if the auditor **determines it is not feasible** to obtain audit evidence pursuant to paragraph 24 based on the auditor’s experience..., the **auditor should obtain external information indirectly** by performing other substantive procedures, including tests of details.”

# ACCOUNTS RECEIVABLE PROCEDURES

Auditor determines it is not feasible to obtain necessary audit evidence through confirmation procedures. What substantive audit procedures could satisfy the requirements in obtain external information indirectly?

## Examples

Examination of subsequent cash receipts

Examination of shipping documents from third-party carriers

Examination of customer purchase orders or signed contracts

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# REQUIRED AUDIT COMMITTEE COMMUNICATION

For significant risks of material misstatement associated with either ***cash*** or ***accounts receivable***, the auditor should communicate when the auditor did not perform confirmation procedures or otherwise obtain audit evidence by directly accessing information maintained by a knowledgeable external source.

# QUESTIONS



# Break



# Division of Enforcement and Investigations Update

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Kyra Armstrong

Division of Enforcement and Investigations

November 20, 2024

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# DIVISION OF ENFORCEMENT & INVESTIGATIONS

What we do.....



# AGENDA

- Today I would like to discuss:
  - Enforcement program statistics for 2023-24
  - Range of potential sanctions and the effects of suspensions and bars and some consequences of allowing barred or suspended individuals to associate with registered firms
  - Coordination with the Securities and Exchange Commission and other regulators
  - Current program outlook and priorities
  - Selected recent settled matters involving quality control violations
  - Other noteworthy 2023-24 settlements

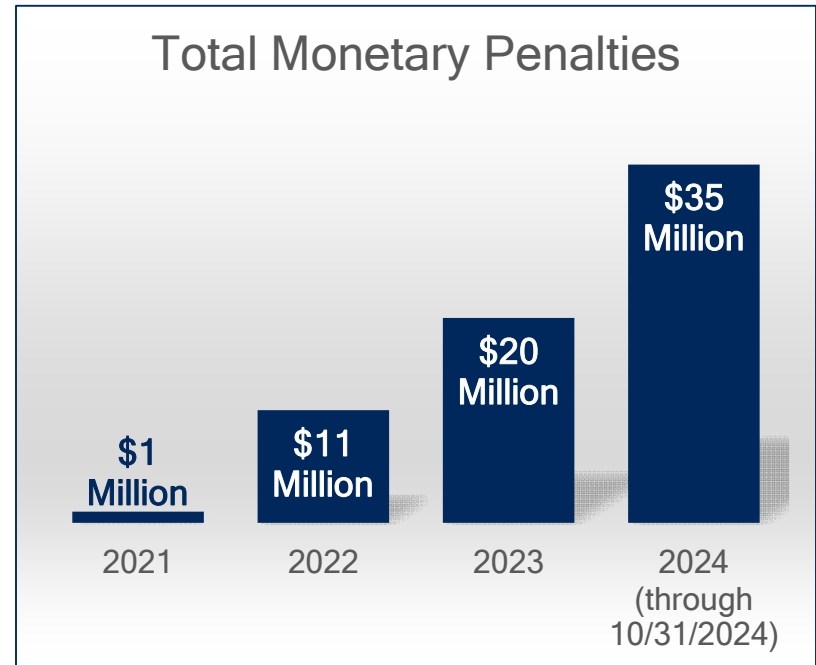
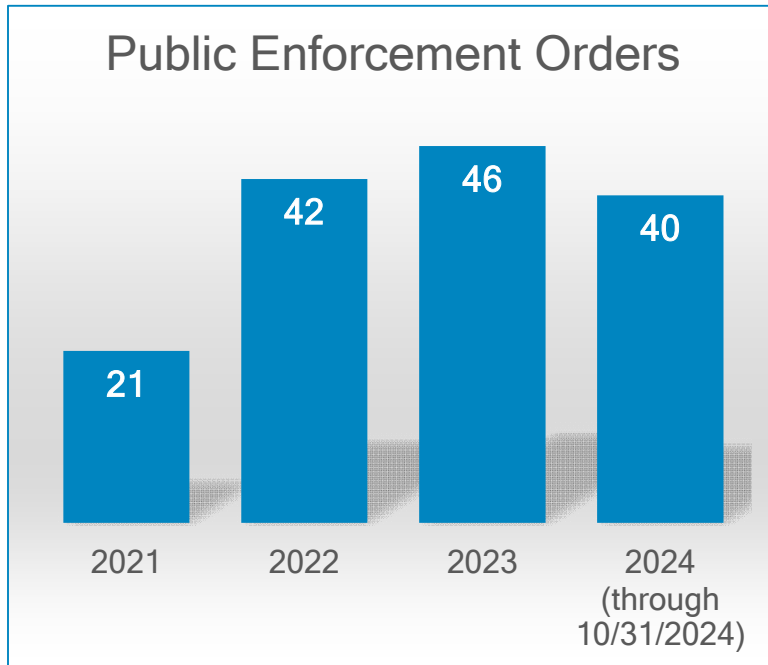


# PROGRAM STATISTICS FOR 2023 AND 2024

- Overview of 2023 Public Enforcement Orders:
  - 46 public enforcement orders issued, a slight increase from 2022 and a significant increase from 2021
  - Roughly half of the public enforcement orders issued in 2023 were against firms or individuals outside the United States
  - First enforcement orders against China-related firms since the Board secured historic access to inspect and investigate firms headquartered in China
- Progress on 2024 Public Enforcement Orders:
  - 40 public enforcement orders issued through October 31, 2024



# PROGRAM STATISTICS – ANNUAL TRENDS

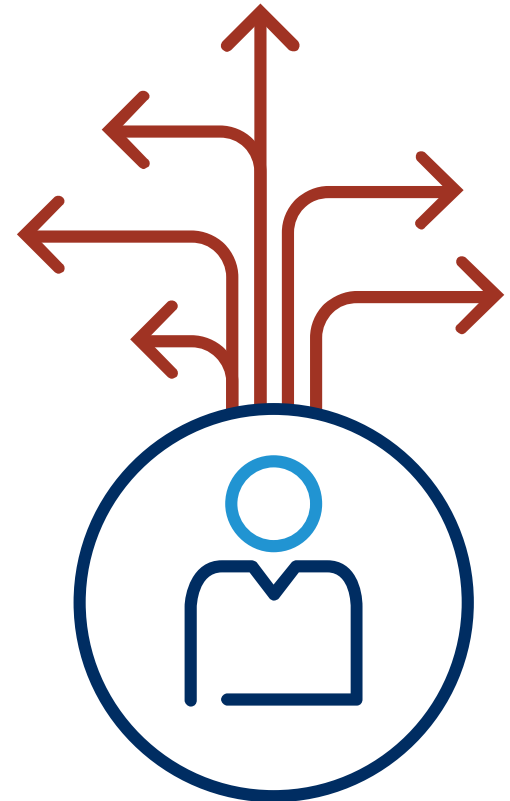


The PCAOB's 2022-2026 Strategic Plan seeks to strengthen the Enforcement Program, including through

- Rigorous enforcement of standards, rules, and laws
- More significant sanctions

# RANGE OF POSSIBLE SANCTIONS

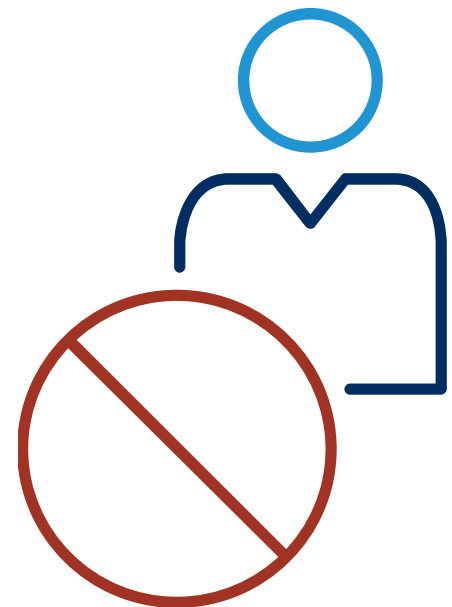
- In a disciplinary proceeding, the Board may:
  - impose a civil monetary penalty
  - suspend or permanently bar an individual from association with a registered public accounting firm
  - temporarily or permanently revoke a firm's registration
  - temporarily or permanently limit the activities, functions,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



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# EFFECT OF SUSPENSIONS AND BARS

- 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
- 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



# PROGRAM OUTLOOK

- The DEI continues to prioritize
  - Investigations involving significant audit violations presenting risks to investors
  - Matters threatening or eroding the integrity of the Board's regulatory oversight process
  - Audit matters relating to significant independence violations
- The DEI is also focusing on
  - Expanding the types of cases we pursue (*e.g.*, a single act of negligence where conduct is serious)
  - Matters relating to deficiencies in firm quality control policies and procedures
  - Audit matters relating to new and evolving issues (*e.g.*, crypto assets, SPACs)



# MATTERS INVOLVING DEFICIENCIES IN FIRM QUALITY CONTROLS

- Since at least 2019, the DEI has focused on matters involving deficiencies in firms' quality control policies and procedures
  - Firms have responsibilities to ensure their personnel comply with the professional standards applicable to its accounting and auditing practice
  - A system of quality control provides firms with reasonable assurance that their personnel comply with applicable professional standards and the firm's standards of quality
- During 2023 through August 31, 2024, the Board issued public orders involving quality control standards violations with approximately thirty U.S. or International firms
  - These orders identified combinations of violations relating to quality control issues encompassing all five of the required elements of quality control

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# COORDINATION WITH OTHER REGULATORS

- PCAOB may share information with the SEC, DOJ, and other agencies enumerated in the Act
- Coordination with SEC Enforcement is a standard practice
  - Auditor investigations may be deferred from one to the other
  - May result in parallel investigations
- Coordination with foreign regulators through cooperative agreements
  - Facilitates evidence gathering and charging in foreign jurisdictions
  - May result in parallel investigations



# Recent Noteworthy Settled Matters



# IN THE MATTER OF WARREN AVERETT, LLC

*(PCAOB RELEASE NO. 105-2023-022 – AUGUST 29, 2023)*

- Warren Averett violated independence requirements during its 2019 and 2020 audits of an issuer, because it audited valuations performed by another accounting firm that sponsored an alliance of which it was a member
  - Warren Averett had a disincentive to question the reasonableness of the other accounting firm's valuation work, and thus, shared a mutual interest with the issuer
- Warren Averett also violated PCAOB quality control standards because it failed to implement and monitor adequate policies and procedures to reasonably ensure that its personnel would comply with applicable auditor independence requirements
- Sanctions included
  - \$200,000 civil money penalty
  - Requirement to certify auditor independence policies and procedures

# IN THE MATTER OF SMYTHE LLP

*(PCAOB RELEASE NO. 105-2023-026 – OCTOBER 24, 2023)*

- In four issuer audits, Smythe used the work of unregistered firms in a substantial role capacity
  - Failure to evaluate the professional reputation of the unregistered firms with due professional care, despite knowing these firms performed more than 20% of total audit hours or incurred more than 20% of the total audit fees - the threshold for substantial role participation requiring Board registration
  - Failure to adequately plan the audits and to adequately determine whether it could serve as principal auditor
  - Failure to establish adequate QC policies and procedures concerning the use of the work of other accounting firms
- Sanctions included
  - \$175,000 penalty and QC undertakings concerning the use of audit work performed by other accounting firms

# IN THE MATTERS OF HAYNIE & COMPANY, & RELATED

*(PCAOB RELEASE NO. 105-2024-001 – JANUARY 23, 2024)*

- Individuals violated PCAOB rules and standards while serving as engagement partner or EQR partner on two 2019 audits.
- Haynie violated PCAOB rules and standards on these audits, as well as PCAOB QC standards for failing to
  - Effectively implement policies and procedures to provide reasonable assurance that work performed by engagement personnel met professional standards and regulatory requirements
  - Establish policies and procedures to provide reasonable assurance that Haynie’s QC policies and procedures were suitably designed and effectively applied, and that its system of QC was effective

*Related Orders:* Tyson Holman, CPA, and Anna Hrabova, CPA (PCAOB Release No. 105-2024-002); Steven Avis, CPA, and Richard Fleischman, CPA (PCAOB Release No. 105-2024-003)

# IN THE MATTERS OF HAYNIE & COMPANY, & RELATED

*(PCAOB RELEASE NO. 105-2024-001 – JANUARY 23, 2024)*

- Audit Violations
  - Failures to evaluate fair presentation and respond to fraud risk because audit procedures were based on superseded GAAP (i.e., ASC 605 not ASC 606)
  - Despite notice from prior PCAOB inspection, failures to sufficiently test the valuation and disclosure of certain material investments
  - Failure to evaluate the valuation of a significant acquisition because valuation was based on untested management projections
  - Failure to obtain sufficient appropriate evidence for cryptocurrency mining revenue because procedures based on superseded GAAP
- Sanctions included
  - Firm: \$400,000 penalty and undertakings
  - Individuals: \$190,000 combined penalty, bars on engagement partners (2 years) and practice limitations on EQR partners (1 year)

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# IN THE MATTER OF WITHUMSMITH+BROWN, PC, (PCAOB RELEASE NO. 105-2024-010 – FEBRUARY 20, 2024)

- From Jan. 2020 to Dec. 2021, Withum accepted hundreds of SPAC audit clients, placing significant strain on its QC system
- The PCAOB found that the firm’s system of QC failed to provide reasonable assurance that the firm could execute audits with professional competence, including
  - To undertake only those engagements it could reasonably expect to complete with professional competence
  - To ensure that partner workloads allowed sufficient time for those individuals to discharge their responsibilities with professional competence and due care
- Sanctions included
  - \$2 million civil money penalty
  - Requirement to engage an independent consultant to review and make recommendations concerning QC policies and procedures



# IN THE MATTER OF KPMG ACCOUNTANTS N.V., & RELATED

*(PCAOB RELEASE NO. 105-2024-022 – APRIL 10, 2024)*

- From 2017 to 2022, hundreds of KPMG Netherlands professionals, including partners and senior firm leaders, engaged in answer sharing on tests for mandatory firm training courses
- Despite notice, the firm failed to take appropriate steps to monitor, investigate, and identify potentially unethical conduct
- Firm also submitted false representations during the investigation, claiming no knowledge of answer sharing, even though certain firm leaders responsible for those representations had themselves engaged in answer sharing
- Sanctions included a \$25 million civil money penalty
- Parallel investigation by Dutch Authority for Financial Markets (AFM) resulted in separate sanctions under Dutch law

*Related Order: Marc Hogeboom (PCAOB Release No. 105-2024-023)*

# PCAOB CENTER FOR ENFORCEMENT TIPS, COMPLAINTS AND OTHER INFORMATION

E-mail: [TIPS@pcaobus.org](mailto:TIPS@pcaobus.org)

Post: PCAOB Tip & Referral Center  
1666 K Street, NW  
Suite 300  
Washington, DC 20006

Telephone: 800-741-3158

Website: <https://pcaobus.org/oversight/enforcement/tips-referrals>

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# QUESTIONS



# SEC Update

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November 20, 2024



# FINRA Perspectives

PCAOB Forum

Anthony Vinci, Senior Director - Office of Financial and Operational Risk Policy

Mark Ramler, Director - Office of Financial and Operational Risk Policy

November 20, 2024

# AGENDA

- 01 | Hot Topics
- 02 | Recent Regulatory Guidance
- 03 | Risk Monitoring & Examination Observations
- 04 | Regulatory Guidance on Exemption Reports
- 05 | FINRA FAQs and Key Topic Pages



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## Hot Topics

- SEC Daily 15c3-3 Computation Proposal
- SEC Electronic Filing Proposal
- SAB 121: Net Capital Implications
- Revenue Recognition: Net Capital Implications



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## Recent Regulatory Guidance

- [Information Notice 11/5/24 - 2025 and First Quarter 2026 Report Filing Due Dates](#)
- [Regulatory Notice 23-02 – Rule 2231 Customer Statement Amendments](#)
- [Regulatory Notice 23-21 – FINRA Reminds Member Firms of Net Capital, Recordkeeping and Financial Reporting Requirements in Connection with Revenue Recognition Practices](#)
- [Regulatory Notice 23-11 – FINRA Seeks Comment on Concept Proposal for a Liquidity Risk Management Rule](#)
- [Regulatory Notice 23-15 – Regulation T and Rule 15c3-3 Extension of Time Requests Under a T+1 Settlement Cycle](#)
- [Regulatory Notice 24-04 – FINRA Adopts Amendments to Conform its Rules to the T+1 Settlement Cycle](#)
- [Regulatory Notice 23-14 – Amendments to Covered Agency Transaction Requirements under FINRA Rule 4210; Effective Date May 22, 2024](#)
- [Regulatory Notice 24-11 - FINRA Announces Publication of Updated Interpretations of FINRA's Margin Rule With Guide to the Updates](#)

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# Regulatory Guidance on Exemption Reports

- Sources of Information about Exemption and Compliance Reporting:
  - [FAQs Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule](#)
  - [FAQs Concerning the Amendments to Certain Broker-Dealer Financial Responsibility Rules Reserve Formula Computation and Possession or Control: FAQ 18](#)
  - [FAQs about Exemption Reporting Under SEA Rule 15c3-3\(k\) for Purposes of FOCUS Reporting and Updating of Membership Agreements](#)  
FAQs 1, 2, and 3
- Exemption Report Considerations
  - Multiple Business Activities
  - Covered Firms-15c3-3(k)
  - Non-Covered Firms/Footnote 74
  - Compliance with 17a-5

# Risk Monitoring and Examination Observations

- [2024 FINRA Annual Regulatory Oversight Report](#)
- Other Observations



# FINRA FAQs and Key Topic Pages

- [FINRA FAQs](#)
- [FINRA Key Topics](#)
  - [Annual Reports](#)
  - [Books and Records](#)
  - [Business Continuity Planning](#)
  - [Crypto Assets](#)
  - [Cybersecurity](#)
  - [FINRA Examination and Risk Monitoring Programs](#)
  - [FinTech](#)
  - [Funding and Liquidity](#)





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# Break



# PCAOB Inspections Overview and Illustrative Examples: Broker-Dealers

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Alan Kerwin, Kate Ostasiewski, Michael Tanzosh  
Division of Registration and Inspections  
November 20, 2024

# DISCLAIMER

The views we express are in our official capacity as members of DRI but are our own and do not necessarily reflect the views of the Board, Board Members, or other members of the staff.

# OBJECTIVES

At the end of this session participants will understand:

- Relevant PCAOB publications for auditors of broker-dealers
- Selected observations from 2023 inspections and related requirements of PCAOB standards and illustrative examples
- Insights regarding recent inspection results
- Status of 2024 inspection activities

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# OVERVIEW OF RELEVANT PCAOB PUBLICATIONS

- Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers (“4020T Annual Report”) – July 2024
- Supplementary Information Related to Audits of Brokers and Dealers – July 2024
- Spotlight: Insights Into the PCAOB’s Interim Inspection Program Related to Audits of Broker-Dealers – January 2024
- Staff Guidance for Auditors of SEC-Registered Brokers and Dealers – June 2014



# INSPECTION RESULTS 2021 – 2023

Inspection year	Percentage of audits with deficiencies	Percentage of financial statement and regulatory areas with deficiencies	Percentage of other audit areas with deficiencies	Percentage of examination engagements with deficiencies	Percentage of review engagements with deficiencies	Percentage of audits with independence findings
2023	70%	20%	8%	66%	40%	1%
2022	58%	21%	9%	50%	40%	11%
2021	49%	18%	3%	64%	28%	0%

# FINANCIAL STATEMENT AREAS

Area	2023			2022	2021
	Number of audits	Number of audits with deficiencies	Percentage	Percentage	Percentage
Revenue	87	42	48%	34%	33%
Evaluating audit results	103	18	17%	21%	17%
Related party relationships and transactions	29	8	28%	33%	22%
Journal entries <sup>10</sup>	91	7	8%	22%	0%
Receivables and payables	14	5	36%	13%	14%
Expenses and related accruals	16	3	19%	29%	25%
Consideration of an entity's ability to continue as a going concern	6	2	33%	0%	27%
Securities owned and securities sold, not yet purchased	10	1	10%	50%	23%

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# REVENUE PRESENTATION AND DISCLOSURE SCENARIO

- A broker-dealer reported commissions revenue of \$6 million on its statement of income
- Commissions income comprised commissions from the sale of mutual funds \$2 million, mutual fund 12b-1 distribution fees of \$2 million, and merger and acquisition advisory fees of \$2 million
- The broker-dealer disclosed the following in its notes to its financial statements:
  - *Commissions - Commission revenues primarily include commissions from the initial sale of mutual fund products and are recognized at a point in time on the trade date*

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# JOURNAL ENTRY TESTING SCENARIO

- The auditor identified management override of controls to be a fraud risk
- As part of obtaining an understanding of the broker-dealer's financial reporting process and controls over journal entries and other adjustments, the auditor learned that journal entries are not required to have descriptions
- The auditor identified fraud risk factors in the journal entry population, including incomplete journal entry descriptions
- The auditor performed procedures to test the completeness of the population of journal entries and observed journal entries with and without descriptions

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# REVIEW ENGAGEMENTS

	2023			2022	2021
	Number of engagements reviewed	Number of engagements with deficiencies	Percentage	Percentage	Percentage
Review engagements	67	27	40%	40%	28%



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# AT NO. 2 REPORTING SCENARIO

- A broker-dealer files an exemption report that includes the following statements:
  - It is relying on Footnote 74 of the SEC Release No. 34-70073 adopting amendments to 17 C.F.R. § 240.17a-5
  - It limits its business activities exclusively to underwriting and merger and acquisition activity
  - Throughout the fiscal year, it did not:
    - Directly or indirectly receive, hold, or otherwise owe funds or securities for or to customers
    - Carry accounts of or for customers
    - Carry PAB accounts (as defined in Rule 15c3-3)

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# EXAMINATION ENGAGEMENTS

	2023			2022	2021
	Number of engagements reviewed	Number of engagements with deficiencies	Percentage	Percentage	Percentage
Examination engagements	29	19	66%	50%	64%

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# AT NO. 1 ICOC SCENARIO

- A broker-dealer provides all customers who consent to electronic delivery access to their account statements in electronic form
- The broker-dealer generates the customer account statements using information obtained from its internal systems and maintains the application used to store the account statements and make them available to customers (the “portal”)
- The auditor determines controls over electronic delivery of account statements to be important to the auditor’s conclusion about whether the broker-dealer maintained effective internal control over compliance (ICOC) with the Account Statement Rule

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# SUPPLEMENTAL INFORMATION AREAS

Area	2023			2022	2021
	Number of audits	Number of audits with deficiencies	Percentage	Percentage	Percentage
Net Capital Rule	28	9	32%	27%	18%
Customer Protection Rule	23	7	30%	24%	46%



# NONCOMPLIANCE WITH PCAOB STANDARDS

Area	2023			2022	2021
	Number of audits	Number of audits with deficiencies	Percentage	Percentage	Percentage
Auditor independence	87	11	13%	11%	15%
Identifying and assessing risks of material misstatement	103	1	1%	10%	5%
Consideration of fraud in a financial statement audit	91	2	2%	0%	0%
Audit findings	103	4	4%	0%	0%
Auditor communications	103	13	13%	1%	2%
Audit documentation	103	16	16%	15%	3%
Auditors' reports on the financial statements and supplemental information	103	13	13%	17%	1%

# AUDITOR INDEPENDENCE FINDINGS

Area	2023			2022	2021
	Number of audits	Number of audits with findings	Percentage	Percentage	Percentage
Auditor independence findings	87	1	1%	11%	0%

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# SPOTLIGHT – INSIGHTS INTO THE INTERIM INSPECTION PROGRAM

- Provides insights regarding potential factors contributing to high deficiency rates in broker-dealer engagements



# INSIGHT – INSUFFICIENT UNDERSTANDING OF THE BROKER-DEALER INDUSTRY

- Financial responsibility rules
- Broker-dealer operations and related revenue recognition policies



# INSIGHT – LACK OF PROFESSIONAL SKEPTICISM

- Exercise due professional care in planning and performance of audit and attestation engagements
- Example areas where skepticism may be lacking:
  - Inquiries of management
  - Risk assessment
  - Testing significant accounts
  - Auditor's reports
  - GAAP departures



# INSIGHT – LACK OF RIGOR IN RISK ASSESSMENT

- Risk of material misstatement in financial statements assessed to be low without properly completing the required risk assessment procedures at the financial statement and assertion levels
- Citing of high degrees of automation and reliance on technology factors supporting lower-risk assessments
- “Default” control risk assessments at the maximum
- Insufficient assessment of external and broker-dealer-specific factors
- Lack of qualitative factors when identifying significant accounts

# INSIGHT – OVERRELIANCE ON STANDARDIZED AUDIT PROGRAMS

- Risks associated with use of standardized audit programs
  - May not be all encompassing
  - May not reflect all requirements in the standards
  - May be limited in the scope of procedures to be performed
- Need to tailor to reflect the nature of the broker-dealers' business operations, internal controls, financial reporting, and attestation risks
- Need to evaluate how well the firm's methodology and audit programs address the applicable PCAOB auditing standards



# INSIGHT – INEFFECTIVE EQR

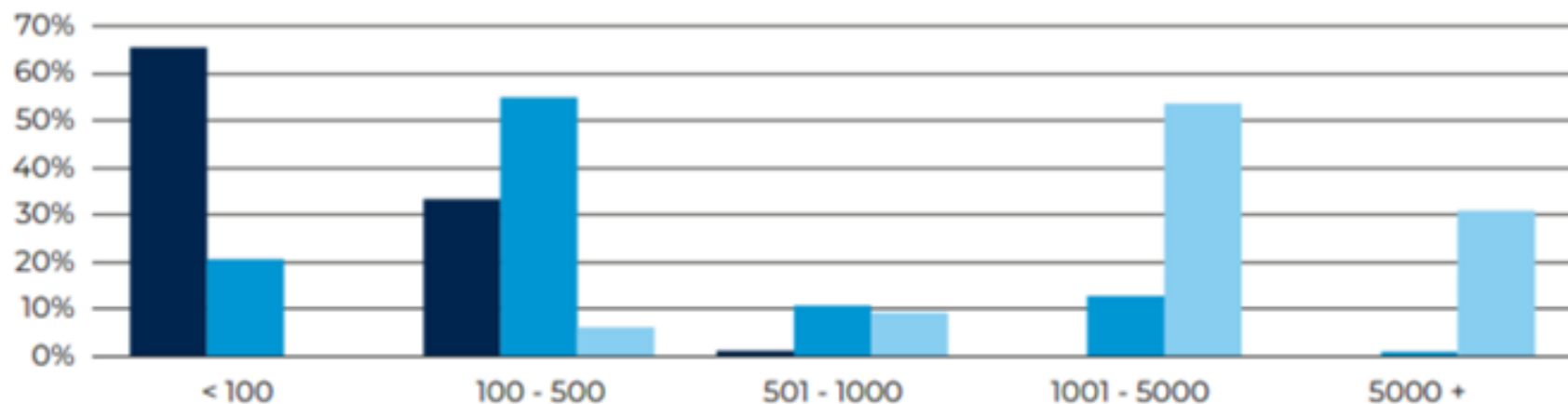
- Lack of EQR partners or individuals in equivalent positions with the knowledge and experience in the broker-dealer industry
- Deficiencies associated with EQRs include:
  - Insufficient evaluation of responses to significant risks areas
  - Errors or inconsistencies in the financial statements
  - Errors or inconsistencies in auditor reports
- Consider developing capabilities through more technical firm training, vendor sessions, conferences, and self-study

# INSIGHT – INEXPERIENCE WITH PCAOB STANDARDS

## 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

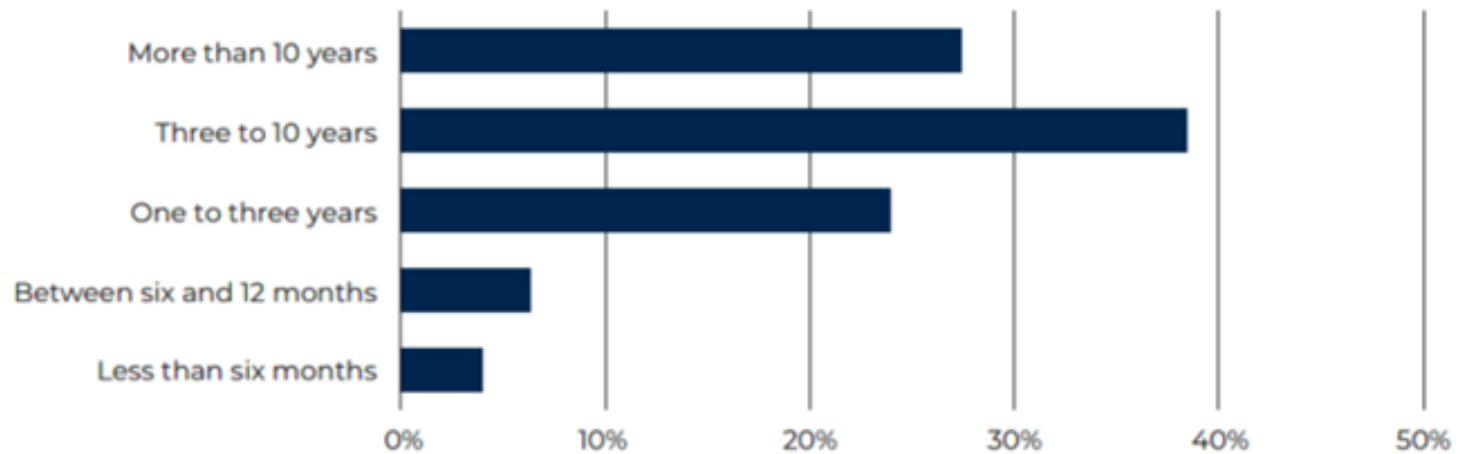


# INSIGHT – PACE OF AUDITOR CHANGES

## Auditor Tenure Reported by Inspected Firms

(2022 inspection year)

■ Percentage of all broker-dealer clients

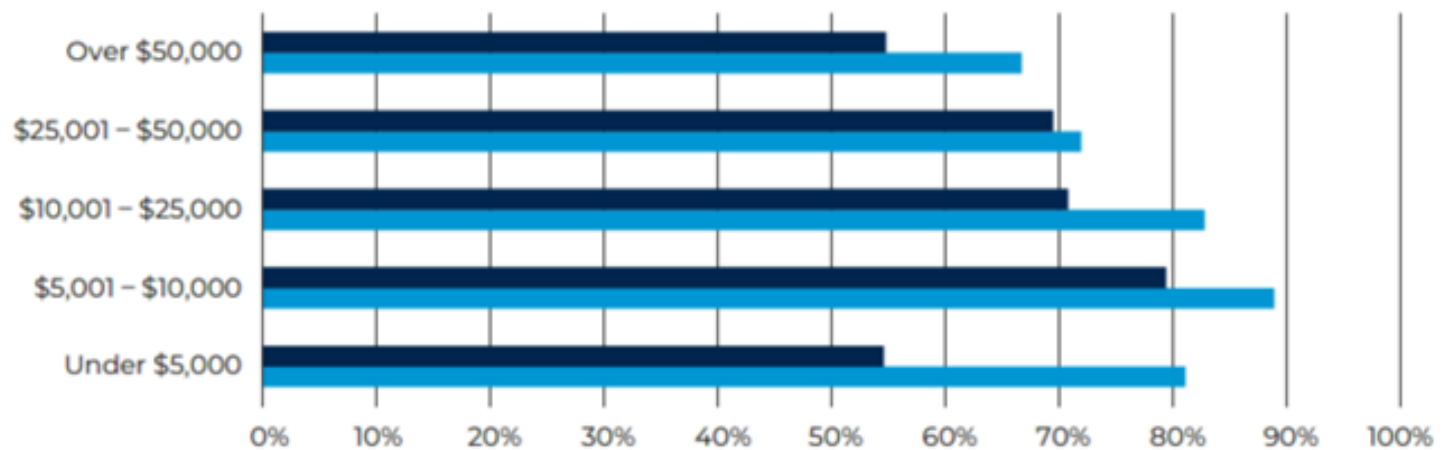


# INSIGHT – AUDIT FEES AND DEFICIENCY RATES

## Audit Engagement Deficiency Rates by Fee Range

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

■ 2020 – 2022 inspection period    ■ All inspection periods since PCAOB standards became effective



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# 2024 INSPECTIONS UPDATE

	<b>2024 Inspections</b>
Selections – Status	Completed
Selections – Extent	Comparable to 2023 (60 Firms and 103 Audits)
Fieldwork – Status	Continuing Through December
Fieldwork – Location	Mixture of In-Person, Remote, and Hybrid, but More Frequently In-Person
Reporting – Status	No Later than July 2025

# QUESTIONS

