

# Illustrative Examples for Auditors of Broker-Dealers

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# AGENDA

- Review of Exemption Reports (AT No. 2)
- Revenue Procedures

# Review of Exemption Reports (AT No. 2)

# REVIEW OF EXEMPTION REPORTS (AT NO. 2)

## Conditions that Would Cause One or More of the Broker-Dealer's Assertions Not to be Fairly Stated, in all Material Respects

- Assertion that identifies the provisions in paragraph (k) of SEC Rule 15c3-3 under which the broker-dealer claimed an exemption for SEC Rule 15c3-3 is inaccurate
- Assertion that the broker-dealer met the identified exemption provision(s) in paragraph (k) of SEC Rule 15c3-3 without exception when there were one or more exceptions during the most recent fiscal year
- Assertion that identifies and describes each exception to the identified exemption provision(s) in paragraph (k) to SEC Rule 15c3-3 during the most recent fiscal year is inaccurate or incomplete

# REVIEW OF EXEMPTION REPORTS (AT NO. 2)

## About the Broker-Dealer

- Earns revenues from one line of business
  - Clears equity transactions with and for customers on a fully disclosed basis with its clearing broker pursuant to a clearing agreement (introducing business)

## Exemption Report

- Claimed exemption - (k)(2)(ii)

**Any concern regarding accuracy of the exemption claimed?**

# REVIEW OF EXEMPTION REPORTS (AT NO. 2)

## About the Broker-Dealer

- In addition to the introducing business, earns revenue from effecting securities transactions for the sale of mutual funds:
  - Via subscription-way basis where the customer funds are payable to the issuer or its agent and not to the broker-dealer (onshore mutual funds products)
  - Via a special account for the exclusive benefit of customers used for the receipt and disbursement of customer checks to the issuer or agent (offshore mutual funds products)

## Exemption Report

- Claimed exemptions - (k)(2)(i) and (k)(2)(ii)

**Any concern regarding accuracy of the exemptions claimed?**

# REVIEW OF EXEMPTION REPORTS (AT NO. 2)

## About the Broker-Dealer

- The broker-dealer also earns revenue from effecting securities transactions for the sale of mutual funds via:
  - Effecting securities transactions for the sale of mutual funds via subscription-way basis where the customer funds are payable to the issuer or its agent and not to the broker-dealer (onshore mutual funds products)
  - No offshore mutual fund business

## Exemption Report

- Claimed exemptions - (k)(1) and (k)(2)(ii)

**Any concern regarding accuracy of the exemptions claimed?**



# REVIEW OF EXEMPTION REPORTS (AT NO. 2)

## General Requirements

- Auditors must obtain an understanding of the exemption conditions and other rules and regulations that are relevant to the broker-dealer's assertions

## Engagement Coordination

- The review engagement should be coordinated with the audit
- Auditors should take into account relevant evidence from the audit. Potential examples:
  - Understanding the broker-dealer's business
  - Results of audit procedures in areas involving customer transactions (e.g., revenue)
  - Review of the financial statements and footnotes

# Revenue Procedures



# REVENUE PROCEDURES

## About the Broker-Dealer

- Revenue (management fees) from managing investments in affiliated mutual funds
- Fees are calculated quarterly by the funds' administrator based upon fee rates per an investment advisory agreement and the customers' daily net assets

## Risk Assessment

- Improper revenue recognition was a fraud risk

## Audit Procedures – Valuation Assertion

- Obtained each trial balance from the funds' administrator, compiled the management fees, compared the total to the general ledger, and vouched payments received

# REVENUE PROCEDURES

## **About the Broker-Dealer**

- Revenue (fees) from investment banking services
- Fees calculated based on gross proceeds from the transactions and commission percentages per the investment banking agreements

## **Risk Assessment**

- Improper revenue recognition was a fraud risk

## **Audit Procedures – Valuation and Occurrence Assertions**

- For a sample of revenue transactions, compared revenue recorded to the broker-dealer prepared invoice and vouched payments received

# REVENUE PROCEDURES

## About the Broker-Dealer

- Revenues include commissions from introducing customer trades to a clearing broker and gains/losses from proprietary trading activities

## Financial Statement Presentation and Disclosure

- The statement of income includes a single line item for “revenues”
- The accounting policy disclosure for commissions states “*Commissions are earned in accordance with agreement terms.*”

# QUESTIONS

Please submit any questions or feedback you might have on this presentation to [forum@pcaobus.org](mailto:forum@pcaobus.org).

