

# Forum for Auditors of Broker-Dealers

October 20, 2017

Las Vegas, NV

# Welcome

Greg Scates, Director  
Office of Outreach and Small  
Business Liaison

# Caveat

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 when we share our views they are those of the speaker alone, and do not necessarily reflect the views of the Board, its members or staff.

# Learning Objective and Course Description

## Learning Objective

The PCAOB Forum for Auditors of Broker-Dealers is intended to assist auditors in furthering their understanding of audit and attestation standards and rules relevant to audit and attestation engagements for broker-dealers.

## Course Description

The PCAOB Forum for Auditors of Broker-Dealers is a one-day session that will offer attendees the opportunity to learn about the audit and attestation standards and rules related to broker-dealer audit and attestation engagements and interact with staff from the PCAOB, SEC, and FINRA. The Forum features a panel discussion on exercising professional skepticism, a case study covering auditing revenue and tests of controls along with sessions on inspection observations and trends, auditor independence, PCAOB standard setting update, and an update from the PCAOB Division of Enforcement and Investigations. The Forum provides the opportunity for participants to ask questions of all the presenters.

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFORUMLV102017>

# Stay Connected

- ❑ Stay up-to-date on current PCAOB activities (including announcements about future forums!) by signing up for our email list.

<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>

# Polling and Messaging

- ❑ Use the following URL in your internet browser:

<https://web.meetoo.com/179814350>

**OR**

- ❑ Download the Meetoo app (iOS and Android) and enter meeting ID **179814350**

# How far did you travel to attend today's Forum?

- 1 Less than 1 hour
- 2 1-2 hours
- 3 More than 2 hours
- 4 I didn't have to travel



# PCAOB Highlights

Bob Maday, Deputy Director  
Broker-Dealer Audit Firm Inspection Program

# How many audits of broker dealers do you perform annually?

1 0-5

2 5-10

3 10-20

4 20+

POLL OPEN

# Do you perform audits of clearing broker dealers?

1 Yes

2 No

# How many years of experience do you have with the broker dealer industry?

- 1 0-5 years
- 2 5-10 years
- 3 10-15 years
- 4 15+ years

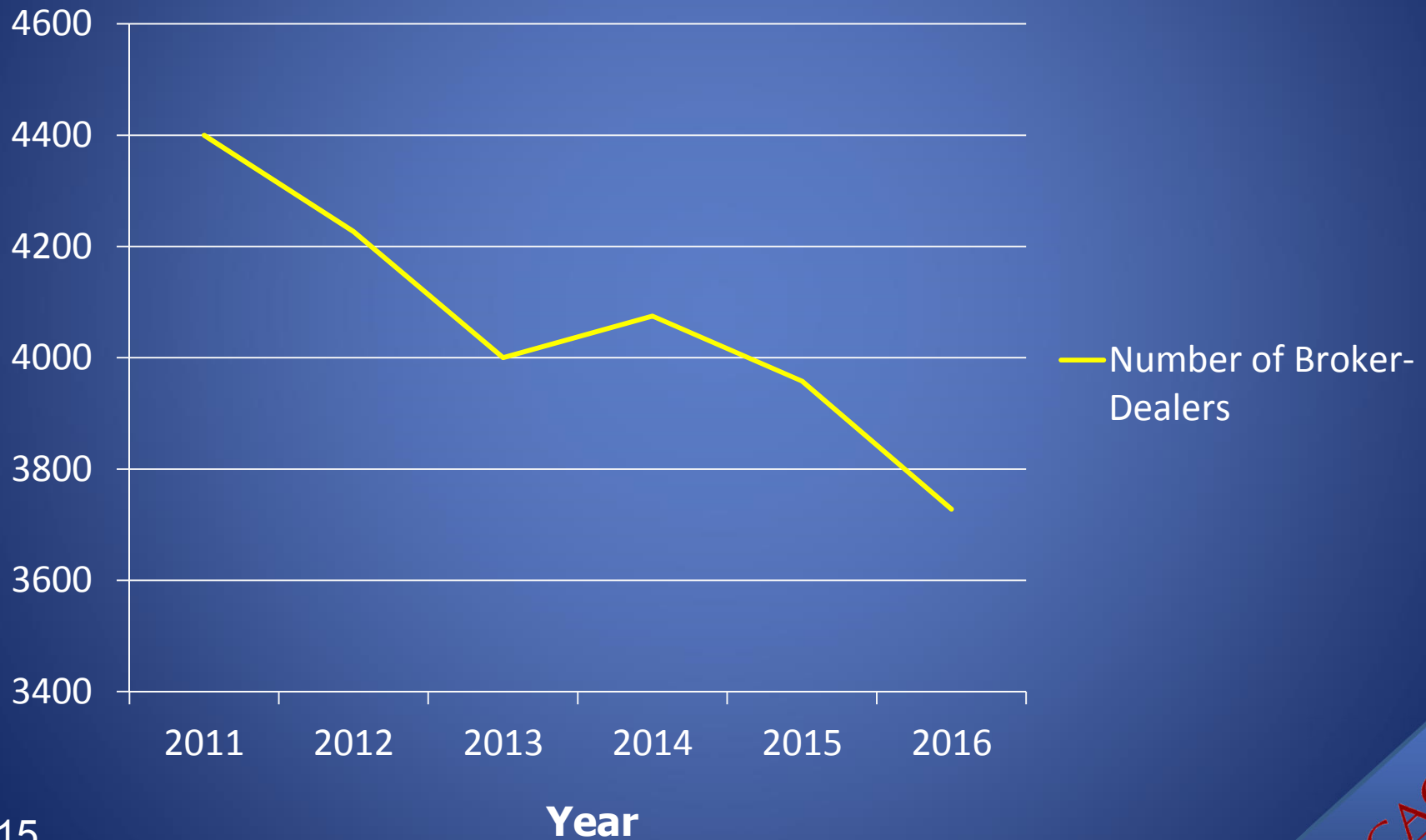
# What area are you most concerned about in your audits of broker dealers?

- 1 Fair Value Estimates
- 2 Fraud Risk
- 3 Revenue
- 4 Related Party Transactions
- 5 Other

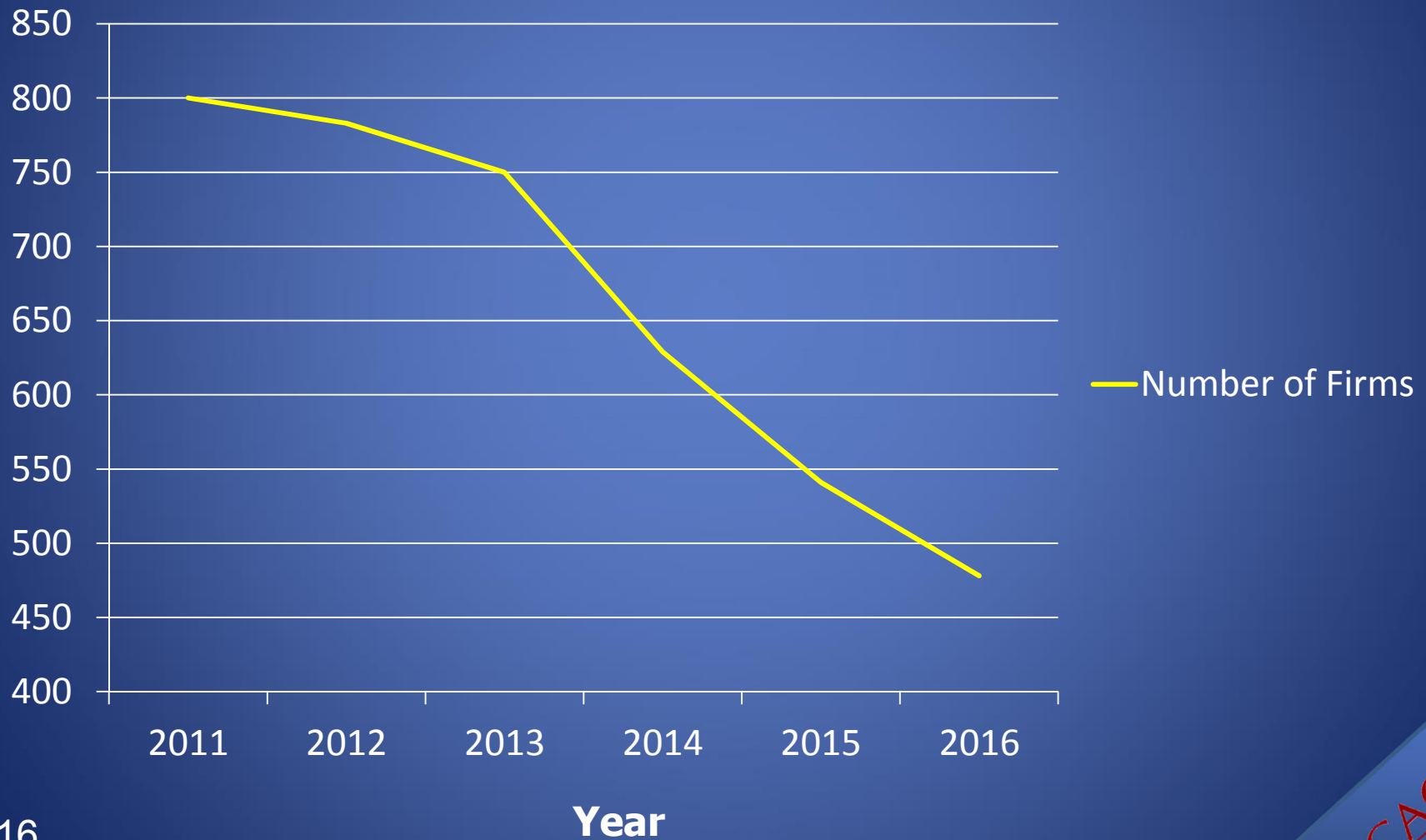
# Agenda Preview

- PCAOB Highlights
- Exercising Professional Skepticism
- (Break)
- Case Study
- SEC and FINRA Perspectives
- (Lunch)
- Case Study (continued)
- Auditor Independence
- Enforcement Update
- (Break)
- Standards Update
- Inspection Observations and Trends
- Q&A and Closing

# Number of Broker-Dealers by Year



# Number of Firms Auditing Broker-Dealers by Year





# Number of Firms Auditing Broker-Dealers 2016 versus 2012

Number of Broker-Dealer Audits per Firm	Number of Firms in 2016	Percentage of Firms in 2016	Number of Firms in 2012	Percentage of Firms in 2012
1	155	32%	363	46%
2 to 20	286	60%	383	49%
21 to 50	23	5%	23	3%
51 to 100	9	2%	8	1%
More than 100	5	1%	6	1%
<b>Total</b>	<b>478</b>	<b>100%</b>	<b>783</b>	<b>100%</b>

# Questions?



# Panel Discussion: Exercising Professional Skepticism

Greg Scates, Moderator

Kate Ostasiewski, Inspections

Dima Andriyenko, Standards

John Abell, Enforcement

Ann Duguid, FINRA

# Exercising Professional Skepticism

## Topics for Discussion

- Professional skepticism – Why so important?
- What could undermine professional skepticism?
- Examples of where auditors went wrong
- Examples of positive steps auditors have taken
- Other ideas to drive appropriate application of professional skepticism

# Why is professional skepticism so important?

# What is professional skepticism?

What is an example of an impediment that could undermine an auditor's ability to have a questioning mind or to critically assess audit evidence?

- 1 Not being afraid to challenge your audit client
- 2 Taking a long time to evaluate audit evidence
- 3 Wanting to please your client to get high customer ratings
- 4 Effectively managing workload demands
- 5 All of the above

What is an example of an impediment that could undermine an auditor's ability to have a questioning mind or to critically assess audit evidence?

1. Not being afraid to challenge your audit client
2. Taking a long time to evaluate audit evidence
- 3. Wanting to please your client to get high customer ratings**
4. Effectively managing workload demands
5. All of the above



What are some of the impediments that could undermine professional skepticism?

# Impediments that Can Undermine Professional Skepticism

- ❑ Incentives to maintain a long-term audit engagement
  - ❑ Avoiding significant conflicts with management
  - ❑ Trying to please the client to achieve high satisfaction ratings
  - ❑ Keeping audit costs down
- ❑ Inappropriate level of trust or confidence in management
- ❑ Pressure to avoid negative interactions
- ❑ Workload demands

# Be Aware of Unconscious Human Biases

- ❑ These types of biases can be seen in the audit environment
  - ❑ Confirmation bias
  - ❑ Anchoring bias
  - ❑ Availability bias
  - ❑ Familiarity bias
  - ❑ Halo bias

Which one of these biases have you experienced or witnessed at some point in your audit career (select only one)?

- 1 Confirmation bias
- 2 Anchoring bias
- 3 Availability bias
- 4 Familiarity bias
- 5 Halo bias

# Discussion of Real-life Examples – Where Auditors Went Wrong

## Impediments

- **Incentives to maintain long-term client**
  - Avoiding conflicts with management
  - Pleasing the client
  - Keeping audit costs down
- **Pressure to avoid potential negative interactions**
- **Workload demands**

## Unconscious Biases

- **Confirmation bias**
- **Anchoring bias**
- **Availability bias**
- **Familiarity bias**
- **Halo bias**

# Discussion of Real-life Examples – Where Auditors Did the Right Thing

- Project management skills
- Appropriate supervision and level of expertise
- Level of involvement and communication by engagement partner
- Partner evaluation process

Which of the following areas in a firm's audit practice can auditors focus on in enhancing the application of professional skepticism?

- 1 Engagement team assignments
- 2 Documentation
- 3 Evaluating audit results
- 4 Partner and staff evaluation processes
- 5 Supervision
- 6 All of the above

Which of the following areas in a firm's audit practice can auditors focus on in enhancing the application of professional skepticism?

1. Engagement team assignments
2. Documentation
3. Evaluating audit results
4. Partner and staff evaluation processes
5. Supervision
- 6. All of the above**



What can auditors do to ensure appropriate application of professional skepticism?

# Considerations to Enhance Professional Skepticism

- ❑ Tone at the top
- ❑ Performance appraisal and promotion processes
- ❑ Professional competence and assignment of personnel to engagement teams
- ❑ Documentation
- ❑ Monitoring

# Considerations to Enhance Professional Skepticism (cont'd)

- ❑ Project management techniques
- ❑ Appropriate supervision
  - ❑ Maintaining a questioning mind throughout the audit
  - ❑ Exercising professional skepticism in gathering and evaluating audit evidence

# Considerations to Enhance Professional Skepticism (cont'd)

- ❑ It is ultimately the responsibility of each individual auditor to appropriately apply professional skepticism throughout the audit, including with specific focus into the following areas
  - ❑ Identifying and assessing risks of material misstatement
  - ❑ Performing tests of controls and substantive procedures
  - ❑ Evaluating audit results to form the opinion to be expressed in the auditor's report

# PCAOB Resources on Professional Skepticism

Most of the information we covered during this morning's panel discussion can be found in:

- ❑ PCAOB Staff Audit Practice Alert No. 10, *Maintaining and Applying Professional Skepticism in Audits*
- ❑ PCAOB Release No. 2017-002, June 1, 2017 – *Proposed Auditing Standard – Auditing Accounting Estimates, Including Fair Value Measurements and Proposed Amendments to PCAOB Auditing Standards*

# Questions



BREAK (15 minutes)

# Case Study: Revenue and Tests of Controls

Greg MacCune, Inspections

Mike Walters, Inspections

Kate Ostasiewski, Inspections

Dima Andriyenko, Standards



# PCAOB Standards

## 2100 Audit Planning and Risk Assessment

- ❑ AS 2101: *Audit Planning*
- ❑ AS 2105: *Consideration of Materiality in Planning and Performing an Audit*
- ❑ **AS 2110 : *Identifying and Assessing Risks of Material Misstatement***

## 2300 Audit Procedures in Response to Risks – Nature, Timing, and Extent

- ❑ **AS 2301: *The Auditor's Responses to the Risks of Material Misstatement***
- ❑ AS 2305: *Substantive Analytical Procedures*
- ❑ AS 2310: *The Confirmation Process*
- ❑ AS 2315: *Audit Sampling*

# Case Study: Treasured Securities, Inc.

# Part 1 – Risk Assessment

# Treasured Securities, Inc. (TSI) Overview

- ❑ Does not claim exemption from Rule 15c3-3.
- ❑ Provides execution and clearing services on a fully-disclosed basis.
- ❑ Primary business is executing orders from retail customers introduced through an affiliated, exempt BD.
- ❑ Operates essentially at breakeven given the competitive market for execution and clearing services.
- ❑ \$250,000 minimum dollar net capital requirement, but operates with a thin capital margin.
- ❑ No recent history of regulatory violations. FINRA is the designated examining authority.
- ❑ December 31 fiscal year-end.
- ❑ Key personnel include the Chief Financial Officer, Accounting  
44 Manager, Operations Manager, and Accounting Staff.

# TSI - Preliminary Information

## Revenues

- Through June 30, clearing revenue accounted for 70% of total revenues
- Generated from executing and clearing U.S. equity and fixed-income security transactions

## Receivable & Payable to Customers

- Related to customer cash and margin accounts

As the auditor, which of the facts presented so far may prompt you to identify one or more risks of material misstatement?

- 1 Clearing revenue accounted for 70% of revenue
- 2 TSI operates essentially at breakeven
- 3 No recent history of regulatory violations
- 4 \$250,000 minimum net capital
- 5 Customer receivables and payables are quantitatively material as of June 30

# TSI - Risk Assessment

- No new lines of business; revenues remained consistent with prior years.
- New control related to revenue recognition, specifically retail customer trade activity.
- No customer complaints and no regulatory issues.

# Understanding Internal Control Over Financial Reporting (ICFR)

- ❑ Sufficient understanding to:
  - ❑ Identify types of potential misstatements
  - ❑ Assess factors that affect the risks of material misstatement
  - ❑ Design further audit procedures
- ❑ Necessary procedures depend on various factors
- ❑ Includes evaluating design and implementation of controls



# TSI – Understanding ICFR

## Controls identified during walkthrough procedures performed by the auditor:

1. Daily, the Accounting Manager reviewed reconciliations prepared by the Accounting Staff of clearing revenue to trading activity.
2. Weekly, the Operations Manager reviewed customer accounts for evidence of under-margined, partially secured, or unsecured accounts.
3. Monthly, the Accounting Manager re-performed the Accounting Staff's tracing of customer receivable and payable balances to customer statements.
4. Any changes to the Clearing Agreement are approved by the CFO.
5. Monthly, the CFO verifies completion of a sample of the daily, weekly, and monthly controls.

# What did the auditor fail to consider when evaluating the design effectiveness of the identified controls?

- 1 Whether discrepancies identified during the customer receivables & payables review are investigated, explained or resolved
- 2 Controls over the accuracy and completeness of information used in the performance of controls
- 3 The frequency, nature and extent of the CFO's review of the approved daily revenue reconciliations

# What did the auditor fail to consider when evaluating the design effectiveness of the identified controls?

1. Whether discrepancies identified during the customer receivables & payables review are investigated, explained or resolved
2. **Controls over the accuracy and completeness of information used in the performance of controls**
3. The frequency, nature and extent of the CFO's review of the approved daily revenue reconciliations

# How would you assess inherent risk for Clearing Revenue and Customer Receivables and Payables?

- 1 High for both
- 2 High for Clearing Revenue only
- 3 High for Customer Receivables and Payables only
- 4 Low for both

# How would you assess control risk for Clearing Revenue and Customer Receivables and Payables?

- 1 High for both
- 2 High for Clearing Revenue only
- 3 High for Customer Receivables and Payables only
- 4 Low for both

# Would you identify any significant risks, including fraud risks?

- 1 Yes, for Clearing Revenue and Customer Receivables and Payables
- 2 Yes, for Clearing Revenue only
- 3 Yes, for Customer Receivables and Payables only
- 4 No

# Planned Risk Assessment

<b>Account &amp; Assertions</b>	<b>Inherent Risk</b>	<b>Significant/ Fraud Risk?</b>	<b>Planned Control Risk</b>	<b>Planned Overall RoMM</b>
Clearing Revenue (E/O, V/A, P&D, C)	High	Yes	Low	Moderate
Customer Receivable & Payable (E/O, V/A, C, R&O, P&D)	Low	Yes	Low	Moderate

# Audit Responses to the Risks of Material Misstatement



# Questions





# ***PCAOB Forum for Auditors of Broker-Dealers***

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***Godfrey Murangi***  
***Associate Chief Accountant***

***Office of the Chief Accountant***  
***U.S. Securities and Exchange Commission***

***October 20, 2017***



# *Disclaimer*

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***The Securities and Exchange Commission disclaims responsibility for any private publication or statement of any SEC employee or Commissioner. This presentation and my remarks express my views and do not necessarily reflect those of the Commission, the Commissioners, or other members of the staff.***

# *Agenda*

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- **ASC 606: The New Revenue Standard**
  - **Implementation considerations**
  
- **Office of Compliance Inspections and Examinations**
  - **Broker-Dealer Examinations**
  
- **SEC Enforcement Update**
  
- **Broker-Dealer Related Discussions**



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## **ASC 606: The New Revenue Standard**

- Implementation considerations**

# *Objective of New Revenue Standard (ASC 606)*

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- **Provide a comprehensive framework for addressing revenue recognition issues**
- **Increase comparability among entities, industries, jurisdictions, and capital markets**
- **Simplify preparation by reducing complexity and volume of guidance**
- **Enhance disclosures regarding revenue-generating activities**

# *Effective Date of the New Revenue Standard*

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- **Public business entities – annual reporting periods beginning after December 15, 2017, and interim periods therein**
- **All other entities – annual reporting periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019**
- **Early adoption is permitted for annual reporting periods beginning after December 15, 2016**

# *New Revenue Standard - Implementation*

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- **Impact to Broker-Dealers**
- **Bottoms- up Approach**
- **Consistent Approach**
- **Implementation efforts to Address Diversity in Practice**



## *New Revenue Standard – Implementation (cont'd)*

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- **FASB/Transition Resource Group (“TRG”) efforts**
- **SEC OCA Efforts**
- **AICPA Broker-Dealer Task Force (Financial Reporting Center for Revenue Recognition)**



## *New Revenue Standard – Implementation (cont'd)*

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- **Internal Control over Financial Reporting**
  - **Importance to broker-dealers**
  - **New Revenue Process Considerations**



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***Office of Compliance Inspections  
and Examinations (“OCIE”):***

***Broker-Dealer Examinations***

# ***OCIE Broker-Dealer Inspections***

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- **Scoping involves, among other considerations:**
  - **Review of Annual Reports, Form Custody and e-Focus filings**
  - **Compliance with the annual reporting requirements**
- **Inspections – Recurring/Common Themes**
  - **Expense Sharing Agreements**
  - **Capital contributions and withdrawals**
  - **Haircut computations**
  - **Compliance with Rule 15c3-3 exemption**



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***SEC Enforcement Update***

# *SEC Enforcement Update*

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- **SEC vs Edward Richardson: Settlement (approx. \$35,000) in June 2017**
  - Violation of SEC auditor independence requirements set forth in Rule 2-01 (b) and (c) of Regulation S-X
  - Non compliance with numerous PCAOB auditing standards
  
- **SEC Customer Protection rule non- compliance**
  - SEC vs Merrill Lynch: Settlement (approx. \$415 million) in June 2016
  
  - PCAOB vs PricewaterhouseCoopers LLP: Settlement (approx. \$1 million) in August 2017 (Related to Merrill Lynch matter)
  
  - SEC Chief Accountant (Wesley Bricker) speech at September 11, 2017 AICPA National Banking & Saving Institutions conference



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***Broker-Dealer Related  
Discussions with OCA***



## *Broker-Dealer Related Discussions with OCA*

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- **SEC Trading and Markets**
- **Broker - Dealers**
- **FINRA**
- **PCAOB**



# *Contact Information*

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## ❖ **Division of Trading and Markets**

- <https://www.sec.gov/divisions/marketreg/bdnotices.htm>
- Phone: (202) 551-5777
  - E-mail : [tradingandmarkets@sec.gov](mailto:tradingandmarkets@sec.gov)

## ❖ **Office of the Chief Accountant**

- **Professional Practice Group (including Independence)**
- **Accounting Group**
- **International Group**
- Phone: (202) 551-5300
- E-mail : [OCA@sec.gov](mailto:OCA@sec.gov)

# FINRA Perspectives

## PCAOB Forum for Auditors of Broker-Dealers

October 20, 2017

Ann Duguid, Director  
Risk Oversight and Operational Regulation  
Financial Operations Policy Group



# FINRA Perspectives

1. The Nature and Scope of FINRA's Financial Surveillance, and Risk-Based Examinations, and Programs
2. Update on Relevant FINRA notices
3. FINRA rule 4210 – Margin Requirements on Covered Agency Transactions
4. Exam Observations



# 1

## The Nature and Scope of FINRA's Financial Surveillance and Risk-Based Examination Program



# FINRA's Financial Surveillance Program

- **Ongoing reviews of firm's financial reporting including submission of FOCUS Reports, Supplemental Schedules, Annual Audits, Form Custody**
- **Broker Dealer Notification Provisions: SEA Rule 17a-11**
  - Certain conditions warrant accelerated reporting (FINRA's Notice to members 10-44)
- **Supplemental Schedules: Rule 4524**
  - Supplemental Schedule to the Statement of Income
  - Supplemental Inventory Schedule
    - FINRA Notice to Members 14-43
  - Supplemental Schedule for Derivatives and Off-Balance Sheet Items
    - FINRA Notice to Members 16-11
    - FAQ published and available on FINRA website

# FINRA's Risk-Based Examination Program

- **Scope, content, frequency and nature of a firm's examination depends on the characteristics of the firm**
  - Characteristics include, but are not limited to, firm size & complexity, business lines, and nature of operations.
- **FINRA's routine examinations are conducted on a one to four year cycle**
  - Nonetheless, examination frequency can be modified for various regulatory reasons.
- **Certain events may result in accelerated or special examinations**
- **What to expect: Preparing for a FINRA Cycle Examination**
  - Located on FINRA.org website.

# Sources of Information

## Located on the FINRA.ORG website

- **Interpretations of Financial and Operational Rules**

- Current Interpretations of Net Capital, Customer Protection, OTC derivatives Dealers, Records to be made and preserved and Notification provisions

- **FINRA Rules**

- **FINRA Notices to Members**

- **Guidance**

# 2017 FINRA Regulatory and Exam Priorities

- FINRA's Annual Regulatory and examination priorities letter

Investor Protection

Market Integrity

Financial and Operational Risks

- Liquidity Risk
- Financial Risk Management
- Cybersecurity
- Supervisory Controls Testing
- Customer Protection/Segregation of Client Assets



# 2

## Regulatory and Information Notices

## Other Relevant FINRA Regulatory Notices

### ■ Liquidity

- Regulatory Notice 15-33: Guidance on Liquidity Risk Management Practice

### ■ Definition of “Ready Market” for Certain Foreign Equity Securities

- Reg Notice 16-13

### ■ Margin Requirements for Covered Agency Transactions

Reg Notice 16-31

### ■ Reg T and SEA Rule 15c3-3 Extension of Time Requests under a T+2 Settlement Cycle

- Reg Notice 17-12

## Other Relevant FINRA Information Notices

- **2017 Holiday Information Notice**
  - 12/14/16: 2017 Holiday Trade Date, Settlement Date and Margin Extensions Schedule
- **2017 and 1Q 2018 report due date**
  - 12/5/2016: 2016 and First Quarter of 2017 Report Filing Due Dates
- **Electronic Filing: Annual Reporting to the SEC**
  - Reg Notice 16-05 and 17-07: SEC No-Action Guidance on Electronic Filing of Broker-Dealer Annual Reports

# 3 Margin Requirements for Covered Agency Transactions

## FINRA Rule 4210



## FINRA Rule 4210

- SEC approved FINRA's rule change amending FINRA rule 4210 in June 2016.
- Rule 4210 establishes margin requirements for Covered Agency Transactions.
- Covered Agency transactions include :
  1. To Be Announced (TBA) transactions, inclusive of adjustable rate mortgage (ARM) transactions
  2. Specified Pool Transactions
  3. Transactions in Collateralized Mortgage Obligations (CMOs), issued in conformity with a program of an agency or Government-Sponsored Enterprise (GSE), with forward settlement dates
- Effective date
  - Risk limit determination requirements: December 15, 2016
  - All other requirements: June 25, 2018

# FINRA Rule 4210

- Helpful sources of information:
  - Rule 4210
    - FINRA.ORG (Rules & Guidance – FINRA Manual) has the version of the rules that are applicable for specific time periods. For example: December 15, 2016 through June 24, 2018
  - FINRA Notice to Members 16-31
    - Covered Agency Transactions: Overview of rule 4210
  - FINRA Notice to Members 17-28
    - FINRA publishes FAQs and guidance and extends effective date of margin requirements for covered agency transactions.

# 4

## Exam Observations

# FinOp Regulatory exam observations

- **US GAAP Financial Statement Accuracy**
  - Revenue and Expense recognition
  - Accruals and disclosures for loss contingencies
  - Capital transactions versus operating activity
  - Monthly FOCUS reporting vs. Annual Financial Statement
  - ASU 2014-15 : Going Concern
  
- **Accuracy of Net Capital Calculation and Customer Protection**
  - GAAP Netting: circumstances with capital implications
  - Allowable vs. non-allowable assets
  
- **Exemption and Compliance Reports**
  
- **17a-4 requirements**



LUNCH (75 minutes)

# Case Study Part II – Audit Responses to the Risks of Material Misstatement

# Clearing Revenue – Tests of Controls

- ❑ Selected sample of daily reconciliations performed by Accounting Staff
- ❑ Re-performed work of Accounting Staff
- ❑ Observed Accounting Manager's signature on each reconciliation indicating that a review was performed of the reconciliation

Has the engagement team obtained sufficient audit evidence with respect to the Accounting Manager's review to conclude that this control is operating effectively?

1 Yes

2 No

During its tests of detail of the clearing fee rates, the auditor detected that rates applied to trades from May through the end of the year for most security types did not agree with the executed clearing agreement. Which statement is true?

- 1 There is risk of a material error in Clearing Revenues.
- 2 The auditor should re-assess control risk.
- 3 Both 1 and 2.

During its tests of detail of the clearing fee rates, the auditor detected that rates applied to trades from May through the end of the year for most security types did not agree with the executed clearing agreement. Which statement is true?

1. There is risk of a material error in Clearing Revenues.
2. The auditor should re-assess control risk.
- 3. Both 1 and 2.**

# Customer Balances – Tests of Details

For a sample of customer accounts, sent requests to positively confirm the customer payable or receivable balance per the customer trial balance as of September 30:

- Prior to sending the confirmation the customer name and address was verified to the account opening agreement;
- For those confirmations returned, the auditor did not identify any exceptions. Certain replies were signed by someone other than the account holder.
- For replies, customers noted no exceptions. Certain replies were signed by someone different than the name on the account.
- For non-replies, traced balances to the customer sub-ledger.

Certain replies were signed by someone different than the name on the account. The auditor concluded these confirmations were returned without exception. Do you agree with the auditor's conclusion?

1 Yes

2 No



# Customer Balances – Year-End Procedures

- ❑ Reconciled the December 31 customer sub-ledger to the general ledger.
- ❑ Inquired regarding a significant increase in customer payables balances between September 30 to December 31
- ❑ For customer accounts confirmed at September 30, compared September 30 balances per the customer sub-ledger to December 31 and investigated differences exceeding a judgmental threshold.
- ❑ For a sample of accounts opened since September 30, sent positive confirmation requests.

Do the year-end procedures provide a reasonable basis for extending the conclusions regarding Customer Receivables and Payables from the interim date to the period end?

- 1 Yes – The procedures collectively provide sufficient evidence to extend the audit conclusions.
- 2 Yes – The procedure to extend the conclusion for the sampled accounts was sufficient.
- 3 No – A three-month rollforward period is too long.
- 4 It depends on the nature of the rollforward procedures for the sampled accounts.

Do the year-end procedures provide a reasonable basis for extending the conclusions regarding Customer Receivables and Payables from the interim date to the period end?

1. Yes – The procedures collectively provide sufficient evidence to extend the audit conclusions.
2. Yes – The procedure to extend the conclusion for the sampled accounts was sufficient.
3. No – A three-month rollforward period is too long.
- 4. It depends on the nature of the rollforward procedures for the sampled accounts.**

# Case Study Part III - Attestation Engagements

# AT 1 Examination Engagements

Obtain appropriate audit evidence sufficient to obtain reasonable assurance whether:

- One or more material weaknesses existed during the fiscal year specified in the broker's or dealer's assertion ("fiscal year")
- One or more material weaknesses existed at the end of the fiscal year
- One or more instances of non-compliance with the net capital rule or the reserve requirements existed as of the end of the fiscal year

Which of the following audit procedures performed may provide evidence relevant to the auditor's objectives related to ICOC under AT 1?

- 1 Accounting Manager's review of balances, positions, and transactions per customer statements
- 2 Test of sub-ledger to Security Master File reconciliations
- 3 Customer confirmations
- 4 Both 1 & 2
- 5 All of the above

# Which of the following audit procedures performed may provide evidence relevant to the auditor's objectives related to ICOC under AT 1?

1. Accounting Manager's review of balances, positions, and transactions per customer statements
2. Test of sub-ledger to Security Master File reconciliations
3. Customer confirmations
4. **Both 1 & 2**
5. All of the above

# ICOC –The Account Statement Rule

FINRA Rule 2340 establishes customer statement requirements for Broker-Dealer's for whom FINRA is the Designated Examining Authority. The rule requires that:

- Statements should be sent to the customer no less frequent than once per calendar quarter
- Statements should include a description of positions, money balances, or account activity
- Statements should include guidance for how to report discrepancies



Based on the information presented in the case, controls over which of the following have been tested by the engagement team?

- 1 Controls over the production and delivery of customer statements
- 2 Controls over the completeness and accuracy of required guidance for how to report discrepancies
- 3 Controls over the completeness and accuracy of position, balance, and activity information
- 4 All of the above.

Based on the information presented in the case, controls over which of the following have been tested by the engagement team?

1. Controls over the production and delivery of customer statements
2. Controls over the completeness and accuracy of required guidance for how to report discrepancies
- 3. Controls over the completeness and accuracy of position, balance, and activity information**
4. All of the above.

# Relevant PCAOB Standards

- ❑ AS 2101: Audit Planning

<https://pcaobus.org/Standards/Auditing/Pages/AS2101.aspx>

- ❑ AS 2105: Consideration of Materiality in Planning and Performing an Audit

<https://pcaobus.org/Standards/Auditing/Pages/AS2105.aspx>

- ❑ AS 2110: Identifying and Assessing Risks of Material Misstatement

<https://pcaobus.org/Standards/Auditing/Pages/AS2110.aspx>

- ❑ AS 2301: The Auditor's Responses to the Risks of Material Misstatement

<https://pcaobus.org/Standards/Auditing/Pages/AS2301.aspx>

# Relevant PCAOB Standards (continued)

- ❑ AS 2305: Substantive Analytical Procedures  
<https://pcaobus.org/Standards/Auditing/Pages/AS2305.aspx>
- ❑ AT No. 1: Examination Engagements Regarding Compliance Reports of Brokers and Dealers  
<https://pcaobus.org/Standards/Attestation/Pages/AT1.aspx>
- ❑ AT No. 2: Review Engagements Regarding Exemption Reports of Brokers and Dealers  
<https://pcaobus.org/Standards/Attestation/Pages/AT2.aspx>

# Questions



# Auditor Independence

Greg Scates, Director  
Office of Outreach

# Agenda

- ❑ Overview of Independence Rules and Guidance
  - ❑ SEC Independence Rules and Interpretive Guidance
  - ❑ PCAOB Independence Rules
- ❑ Prohibited Non-Audit Services
- ❑ Audit Client and Affiliate of an Audit Client

# SEC Independence Rules and Guidance

- ❑ Title II of the Sarbanes-Oxley Act, as Codified in Section 10A(g) through (l) of the Securities Exchange Act of 1934
- ❑ SEC Exchange Act Rule 10A-2
- ❑ SEC Rule 2-01 of Regulation S-X (17 C.F.R. § 210.2-01)
  - Adopting Release No. 33-8183 – *Strengthening the Commission's Requirements Regarding Auditor Independence* [2003]
  - Adopting Release No. 33-7919 - *Revision of the Commission's Auditor Independence Requirements* [2000]
- ❑ Frequently Asked Questions – *SEC Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence*

Note: Auditors of brokers and dealers are not subject to the requirements for partner rotation; compensation; audit committee pre-approval; or cooling-off period for employment. These requirements only reference issuers.



# PCAOB Independence Rules and Guidance

<b>Overall Framework and Definitions</b>	Rules 3500T, 3501, and 3520
<b>Contingent Fees</b>	Rule 3521
<b>Tax Transactions</b>	Rule 3522
<b>Tax Services for Persons in Financial Reporting Oversight Roles</b>	Rule 3523*
<b>Audit Committee Pre-approval of Certain Tax Services</b>	Rule 3524*
<b>Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting</b>	Rule 3525*
<b>Communications with Audit Committees Concerning Independence</b>	Rule 3526

\* Rule applies only to audits of issuers.

# PCAOB Independence Rules and Guidance (cont'd.)

<b>Rule 3500T - Interim Ethics and Independence Standards</b>	
<b>Independence</b>	ET 101
<b>Integrity and Objectivity</b>	ET 102
<b>Ethics Rulings on Independence, Integrity and Objectivity</b>	ET 191
<b>Certain Independence Implications of Audits of Mutual Funds and Related Entities</b>	ISB No. 2
<b>Employment with Audit Clients</b>	ISB No. 3
<b>Impact on Auditor Independence of Assisting Clients in Implementation of FAS 133 (Derivatives)</b>	ISB Interpretation 99-1
<b>Interim Quality Control Standards Related to Independence (from Rule 3400T)</b>	
<b>System of Quality Control for a CPA Firm's Accounting and Auditing Practice – Independence, Integrity and Objectivity</b>	QC Section 20.9 & 20.10
<b>Independence Quality Controls – SEC Practice Section Member Firms</b>	SEC Practice Section – Section 1000.08(O) .46 Appendix L

# Prohibited Non-Audit Services

## Rule 2-01(c)(4)

“An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides the following non-audit services to an audit client.”

Prohibited Non-Audit Services	
Bookkeeping or other services related to the accounting records or financial statements of the audit client	Management functions
Financial information systems design and implementation	Human resources
Appraisal or valuation services, fairness opinions, or contribution-in-kind reports	Broker-dealer, investment adviser, or investment banking services
Actuarial services	Legal services
Internal audit outsourcing services	Expert services unrelated to the audit

# Prohibited Non-Audit Services

With respect to the following 5 prohibited non-audit services, the rules state that the service may not be provided "unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements."

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Financial information systems design and implementation
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing services

In considering potential independence violations when performing non-audit services, materiality should be considered as a basis for determining potential impairments.

- 1 True
- 2 False

In considering potential independence violations when performing non-audit services, materiality should be considered as a basis for determining potential impairments.

1. True
2. False

# SEC FAQ – Non-Audit Services

## Question 4 (issued August 13, 2003)

**Q:** For five of the prohibited services (bookkeeping, internal audit outsourcing, valuation services, actuarial services, information system design and implementation), the rules contain the modifier that allows the audit firm to provide these services to an audit client when "it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements." The release text discussion indicates that there is a presumption that the services will be subject to audit procedures. Is materiality a basis for determining that it is reasonable to conclude that the services will not be subject to audit procedures (e.g., could the audit firm provide bookkeeping services for a subsidiary that is immaterial to the consolidated financial statements)?

**A:** No. There is a rebuttable presumption that the prohibited services will be subject to audit procedures. Determining whether a subsidiary, division, or other unit of the consolidated entity is material is a matter of audit judgment. Thus, the determination of whether to apply detailed audit procedures to a unit of the consolidated entity is, in and of itself, an audit procedure. Therefore, materiality is not an appropriate basis upon which to overcome the presumption in making a determination that it is reasonable to conclude that the results of the services will not be subject to audit procedures.

# What Does 'Audit Client' Mean?

Rule 2-01(f)(6) defines 'audit client' as follows:

*Audit client* means the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client, other than, for purposes of paragraph (c)(1)(i) of this Rule 2-01, entities that are affiliates of the audit client only by virtue of paragraph (f)(4)(ii) or (f)(4)(iii) of this Rule 2-01.



# What is an 'Affiliate of the Audit Client?'

Rule 2-01(f)(4) defines 'affiliate of the audit client' as follows:

*Affiliate of the audit client* means:

- (i) An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;
- (ii) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
- (iii) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and
- (iv) Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

# Questions



# Division of Enforcement and Investigations Update

John Abell  
Associate Director

# Division of Enforcement & Investigations

What do we do.....



**MISSION**

**Investor Protection**

# Agenda

- ❑ Today we would like to discuss:
  - ❑ Program Statistics for 2016 & YTD 2017
  - ❑ Matters involving Interference in Board Processes
  - ❑ Independence Matters
  - ❑ Matters involving Audit Standards Violations
  - ❑ Engagement Quality Review Matters
  - ❑ Admissions in Settlements
  - ❑ Coordination with the SEC
  - ❑ Rules Regarding Association and Termination of Bars

Unless otherwise noted, in settled disciplinary proceedings, the firms and the associated persons neither admitted nor denied the Board's findings, except as to the Board's jurisdiction over them and the subject matter of the proceedings.

# Program Statistics for 2016 & 2017

- ❑ The Board has imposed sanctions on auditors ranging from censures to monetary penalties and bars on association with registered firms in settled or public adjudicated disciplinary orders
  - ❑ For 2016:
    - ❑ The Board issued 54 settled disciplinary orders
    - ❑ Sanctioned 30 registered firms and 44 associated persons in those proceedings, imposing a total of \$9.3 million in monetary penalties
  - ❑ In 2017 (to September 30):
    - ❑ The Board issued 39 settled disciplinary orders
    - ❑ Sanctioned 31 registered firms and 32 associated persons in those proceedings, imposing more than \$2.4 million in monetary penalties
  - ❑ Six adjudicated orders were made public during 2016 and 2017

# Program Statistics for 2016 & 2017

- ❑ The DEI continues to prioritize:
  - ❑ Large firm cases involving significant potential audit failures and risk to investors
  - ❑ Investigations involving a lack of professional skepticism
  - ❑ Audit matters related to the independence and integrity of the audit
  - ❑ Matters threatening or eroding the integrity of the Board's regulatory oversight processes
  - ❑ Investigations focusing on risks associated with cross border audits

# Broker-Dealer Audit Matters 2017

- ❑ The Board settled 9 matters involving auditors of registered broker-dealers in 2017, including:
  - ❑ First settled order involving violations of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers* (AT No. 1)([Fulvio & Associates, LLP, et al.](#))
  - ❑ First settled order involving violations of AT No. 1 and AS No. 17 by a global national firm ([PricewaterhouseCoopers LLP](#))
  - ❑ Violations of the independence rules related to the preparation of client financial statements
  - ❑ Violations of Auditing Standard No. 7 *Engagement Quality Review* with respect to audit work associated with registered broker-dealer clients



# Broker-Dealer Audit Matters 2017

- ❑ PwC – Merrill Lynch:
  - ❑ PwC violated Board’s broker-dealer auditing standards in its evaluation of Merrill’s compliance with the “no lien” provision of the Customer Protection Rule
  - ❑ Firm was censured and settled to a \$1 million civil money penalty
- ❑ Fulvio & Associates, LLP., et al
  - ❑ The Board imposed sanctions in its first settled order involving violations of Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers
  - ❑ Non-cooperation with inspection process regarding engagement partner and senior manager
  - ❑ Inadequate EQR

# Matters involving Interference in Board Processes

- ❑ Violations of PCAOB Rules 4006 and 5110, which govern registered firms and associated person's conduct with respect to a Board inspection or investigation
  - ❑ ZERO tolerance for failing to provide information or interference with these processes
- ❑ Failures to timely file PCAOB Form 3

# Staff Practice Alert No. 14, *Improper Alteration of Audit Documentation*

- ❑ Improper alteration of audit documentation in connection with an inspection or investigation can result in disciplinary actions with severe consequences (violation of duty to cooperate)
- ❑ Issues in recent oversight activities have heightened concerns about this at a range of firms including global network affiliates
- ❑ Consequences of improper alteration, in many cases, is more severe than from the underlying perceived audit deficiency

# Deloitte Touche Tohmatsu Auditores Independentes – December 5, 2016

- ❑ *Firm is a Brazilian affiliate firm of Deloitte Touche Tohmatsu Limited*
- ❑ First admissions in a settled order obtained from a global network firm
- ❑ Matter involved:
  - ❑ 14 now former partners and other audit personnel
  - ❑ Violations of AS 3, Rule 4006 and 5110, SEC Rule 10(b)(5)
  - ❑ Failure to obtain sufficient evidence prior to issuance of the Firm's audit opinion or issuance of false audit report
- ❑ Sanctions imposed
  - ❑ Firm: censure, limitation of activities, independence monitor, adoption of certain QC policies and procedures, \$8 million monetary penalty
  - ❑ Associated Persons: censures, range of \$20,000 monetary penalties, bar with right to reapply after 5 years, permanent bars

# Galaz, Yamazaki, Ruiz Urquiza, S.C. – December 5, 2016

- ❑ *Galaz, Yamazaki, Ruiz Urquiza is a Mexican affiliate firm of Deloitte Touche Tohmatsu Limited*
- ❑ In December 2016, three individuals were sanctioned for
  - ❑ Participating in the deletion and improper alteration of archived audit documentation in advance of an internal practice review
  - ❑ Providing improperly altered work papers to Board staff during an inspection (Rule 4006)
- ❑ The firm was sanctioned for quality control violations associated with timely archiving working papers
- ❑ There were also significant audit violations by the individuals

# Galaz, Yamazaki, Ruiz Urquiza, S.C. – December 5, 2016

- ❑ Sanctions included:
  - ❑ Firm: censure and a \$750,000 monetary penalty
  - ❑ Associated Persons:
    - ❑ All received a censure
    - ❑ Two of the three received a bar with a right to reapply (after 2 or 5 years) and a monetary penalty (either \$50,000 or \$25,000)

# Paul L. Ford, Jr. CPA – March 29, 2017

- ❑ Matter involves both Issuer and B/D audits:
  - ❑ Multiple AS 3 violations
    - ❑ Made, or directed, additions and alterations to work papers in 15 broker-dealer audits and one issuer audit after document completion date, and after learning of upcoming PCAOB inspection
  - ❑ Failure to cooperate with inspectors (Rule 4006)
    - ❑ Alterations were not disclosed to inspectors
- ❑ As a result:
  - ❑ Engagement partner
    - ❑ Censured and bar, with right to reapply after five years
    - ❑ Monetary penalty of \$30,000

# Kabani & Co. – Released March 10, 2017

- ❑ Significant efforts were made over a several week period to alter documents in the audit files of three issuers with the intent to deceive the PCAOB about the deficiencies in the Firm's audit work papers in a noticed inspection
- ❑ The SEC noted that respondents engaged in an egregious attempt to deceive PCAOB
- ❑ Violations included PCAOB Rule 4006 and AS No. 3



# Kabani & Co. – Released March 10, 2017

- ❑ Sanctions included:
  - ❑ Firm – permanent revocation
  - ❑ Kabani – permanent bar and \$100,000 monetary penalty
  - ❑ Deutchman – bar, with a right to reapply after 2 years, and \$35,000 monetary penalty
  - ❑ Khan – bar, with right to reapply after 18 months, and \$20,000 monetary penalty
- ❑ Litigation was non-public as required by SOX for approximately 4 years and 8 months – firm allowed to continue auditing

# Failures to Timely File PCAOB Form 3

- ❑ PCAOB Rules require firms to complete and file a special report on Form 3 to report any event specified in that form within 30 days of an event's occurrence
- ❑ Information on violations or disciplinary proceeding helps the PCAOB staff identify possible audit quality issues
- ❑ Event examples include:
  - ❑ The institution of certain criminal or disciplinary proceedings against the firm or its partners
  - ❑ The conclusions of such criminal or disciplinary proceedings
- ❑ Seven firms have been sanctioned
  - ❑ All firms received a censure, and monetary penalty of either \$10,000 or \$15,000
  - ❑ Three firms were required to undertake remedial measures

# Independence Matters

- ❑ Since December 2014, the Board has entered into settled orders with **32 firms** and certain associated persons for violations associated with maintaining the financial records or preparing financial statements of a **broker-dealer** audit client of the firm
- ❑ The Board has also entered into settled orders with **three firms** and certain associated persons for violations associated with maintaining the financial records or preparing financial statements of an **issuer** audit client of the firm
- ❑ Sanctions included:
  - ❑ **Firms**: censures, monetary penalties of \$2,500 - \$20,000, remedial measures, one year prohibitions on new clients
  - ❑ **Associated Persons**: censures, monetary penalties of \$5,000-\$10,000, bars with a right to reapply after one year

# Independence Matters – Sanctionable Conduct

- For one or more of its audit clients, members of the audit firm
  - Prepared and filed Focus reports
  - Prepared all or a portion of the financial statements, including notes
  - Prepared draft statements with placeholders for dollar amounts
  - Obtained drafts, but made extensive changes
  - Directed or supervised professionals from another firm to prepare all or a portion of the financial statements that were the subject of the firm's audit opinion
  - Maintained and prepared accounting records, including journal entries
  - Prepared tax provision
  - Provided valuation services

# Independence Matters – Factors in Severity of Sanctions

- ❑ Range of Conduct
  - ❑ Audits of multiple issuers or broker-dealers over multiple years resulted in more severe sanctions
- ❑ Context of Conduct
  - ❑ More severe sanctions resulted from:
    - ❑ Specific awareness of independence rules
    - ❑ Continued conduct after specific notice of previous violations
  - ❑ Less severe sanctions when firms or associated person made changes with the intent to comply, but efforts fell short

# Extraordinary Cooperation Credit

- ❑ Extraordinary cooperation is voluntary and timely action – beyond compliance with legal or regulatory obligations – that contributes to the mission of the Board
- ❑ Three types:
  - ❑ self-reporting
  - ❑ remedial or corrective action
  - ❑ substantial assistance to the Board’s investigative processes or to other law enforcement authorities
- ❑ Examples
  - ❑ Certain non-sanctioned auditors with independence violations
  - ❑ Matter of Schild & Co. Inc. and David Schild, CPA
  - ❑ Matter of KAP Purwantono, Sungkoro & Surja

# Extraordinary Cooperation Credit

- ❑ The Board has announced that two unnamed broker-dealer audit firms had prepared financial statements, but would not be sanctioned
  - ❑ The Board awarded credit for extraordinary cooperation based on the firms':
    - ❑ Timely and voluntary self-reporting to the PCAOB Tip Line
    - ❑ Timely, voluntary, and meaningful remedial actions, including, in one case, communicating the violation to the client and discussing the conduct and violation at an annual firm training session

# Extraordinary Cooperation Credit

- ❑ In Schild, et al., sanctions credit was given for the substantial assistance it provided the Division through timely and voluntarily providing information on independence and EQR violations
  - ❑ Disclosure that financial statements for an issuer had been prepared by Respondents
  - ❑ Disclosure that the Firm did not obtain concurring approval of issuance of an audit report before granting permission to use it



# Matters involving Audit Standards Violations

- ❑ Wander Rodrigues Teles – March 20, 2017
- ❑ KAP Purwantono, Sungkoro & Surja – February 9, 2017
- ❑ Scrudato & Co. – December 20, 2016

# Wander Rodrigues Teles – March 20, 2017

- ❑ *Teles was a partner of the Brazilian affiliate firm of PricewaterhouseCoopers International Ltd.*
- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence prior to issuance of an interoffice opinion for referred audit work on a U.S. -based issuer's Brazilian subsidiaries
  - ❑ On two successive audits, the lead partner in Brazil:
    - ❑ failed to adequately follow-up on evidence that a subsidiary was re-aging its receivables; and
    - ❑ treated trade promotions as a normal risk area, despite substantial customer disputes over trade promotions
- ❑ As a result:
  - ❑ Lead partner on referred work received censure, \$10,000 penalty, and a bar with right to reapply after 2 years

# KAP Purwantono, Sungkoro & Surja – February 9, 2017

- ❑ *KAP Purwantono, Sungkoro & Surja is an Indonesian affiliate firm of Ernst & Young Global Limited*
- ❑ Matter involves:
  - ❑ Failure to obtain sufficient evidence prior to issuance of the Firm's audit opinion
  - ❑ Also violations of AS 3, PCAOB Rules 4006 and 5110
- ❑ As a result
  - ❑ Firm received censure and \$1 million penalty
  - ❑ Engagement Partner received censure, \$20,000 penalty, bar with right to reapply after 5 years
  - ❑ Asia-Pacific Area Prof. Practice Director (a U.S. seconded partner) received censure, \$10,000 monetary penalty, 1 year limitation on activities

# Scrudato & Co. – December 20, 2016

- ❑ Matter involves
  - ❑ Seven audits on five issuers
  - ❑ Significant audit violations
    - ❑ Failed to obtain sufficient appropriate audit evidence on significant accounts (e.g., revenue, fixed assets, oil and gas properties)
    - ❑ Inappropriate reliance on specialist (e.g., failed to understand methods/ assumptions used by specialist)
    - ❑ Failed to perform a re-audit of prior year financial statements on certain issuers
- ❑ Firm sanctions: censure, 2 year revocation, \$15,000 monetary penalty
- ❑ Engagement partner sanctions: censure, bar with right to reapply after 2 years

# Engagement Quality Review Matters – June 14, 2016 Settlements

- ❑ In June 2016, the Board settled disciplinary orders against eight firms and eight associated persons for conduct substantially relating to violations of EQR requirements (AS No. 7)
  - ❑ EQRs are required for issuer audits and interim reviews, broker-dealer audits, and examinations/reviews of broker-dealer compliance/exemption reports
- ❑ Each of the firms violated one of two requirements
  - ❑ 3 firms – No concurring approval of an EQR was obtained prior to granting permission to the client to use the firm’s audit report
  - ❑ 1 firm – Engagement quality reviewer had not satisfied the experience requirement

# Engagement Quality Review Matters – June 14, 2016 Settlements

- ❑ With respect to sanctions, the firms fell into one of two groups
  - ❑ **Multiple violations** resulted in censure, revocation, \$5,000 – \$10,000 monetary penalty
  - ❑ **Attempting to comply** resulted in censure, \$2,500 monetary penalty, remedial actions
- ❑ Each associated person was sanctioned with censure
  - ❑ Where misconduct was more severe, a bar with right to reapply after one or two years
- ❑ Three of the four cases also included other audit standard or regulation violations

# Engagement Quality Review Matters – *David Lee Hillary, Jr., et al.*

- ❑ On December 13, 2016, Board sanctioned a firm and its managing partner for failing to obtain an EQR prior to issuing the audit opinion for 24 audits
  - ❑ For three of these audits, the Firm failed to obtain an EQR despite being on notice of the requirement from PCAOB inspectors
- ❑ Firm was censured and its registration was revoked
- ❑ Managing Partner was censured and was permanently barred
- ❑ One of the audits also included significant audit standard violations

# Admissions in Settlements

- ❑ In its settlement recommendations to the Board, DEI considers requiring admissions in certain circumstances
- ❑ In considering whether to require admissions, DEI reflects on whether a matter involves
  - ❑ Egregious and intentional conduct
  - ❑ Obstruction of Board processes
  - ❑ Significant harm to investors or securities markets
  - ❑ Situations where an admission can send a particularly important message to audit firms, auditors, or the public
  - ❑ Situations where a wrongdoer poses a particular future threat to investors
- ❑ Most settlement recommendations will continue to include language stating that respondent(s) “neither admit nor deny” the Board’s findings



# Settled Cases with Admissions

- ❑ Through September 2017, the Division has 21 settled disciplinary orders that include admissions
  - ❑ Fourteen of the settled orders included admissions by associated persons
  - ❑ Eleven of the settled orders included admissions by the involved firms
- ❑ The 21 matters involved some combination of
  - ❑ Significant audit violations, on multiple audits
  - ❑ Audits of issuers and broker-dealers
  - ❑ Instances of noncooperation
  - ❑ Failures to perform an EQR

# Coordination with the SEC

- ❑ PCAOB may share information with the SEC, DOJ, and other agencies enumerated in the Act
- ❑ Coordination with SEC Enforcement is standard practice
  - ❑ Parallel investigations: PCAOB investigates auditor conduct; SEC investigates public company, its management, and others
- ❑ PCAOB may defer its investigation of auditor to the SEC
- ❑ PCAOB seeks to avoid duplication of effort

# Effect of Suspensions and Bars From Being An Associated Person

- ❑ 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
  - ❑ *See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301*
- ❑ 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
  - ❑ *See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301*

# Association with a Registered Firm

- ❑ An individual associates with a registered firm if he or she, in connection with the preparation or issuance of any audit report:
  - ❑ Shares in the profits of, or receives compensation in any other form from, that firm; or
  - ❑ Participates as agent or otherwise on behalf of such accounting firm in any activity of that firm.
- ❑ See Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301; Rules on Investigations and Adjudications, PCAOB Release No. 2003-015 (Sept. 29 2003), at A2-80-81.

# Terminations of Bars

- ❑ PCAOB Rule 5302(b) governs petitions to terminate a bar
  - ❑ Specific items outlined in the PCAOB Rules 5302(b)(2), 5302(b)(3), and 5302(b)(4) must be addressed for the Board to consider a petitioners request
- ❑ In 2016, the Board granted one petition to terminate a bar

# PCAOB Center for Enforcement Tips, Complaints and Other Information

Website:

<http://pcaobus.org/Enforcement/Tips/Pages/default.aspx>

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

Post: PCAOB Complaint Center  
1666 K Street, NW  
Washington, DC 20006

Fax: 202-862-0757

Telephone: 800-741-3158

# Questions



BREAK (15 minutes)



# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFORUMLV102017>

# Standard-Setting Update

Dima Andriyenko  
Associate Chief Auditor

# Agenda

- ❑ Office of the Chief Auditor's recent activities:
  - ❑ New standard on auditor's reporting model
  - ❑ Ongoing standard-setting projects
  - ❑ Research projects & monitoring activities
- ❑ Form AP (for public company audit reports)
- ❑ Keeping current with PCAOB standards

# New Standard: Auditor's Reporting Model (Slide 1 of 5)

## ❑ Status:

- ❑ On June 1, 2017, the Board adopted a new auditor reporting standard, which the SEC is now considering for approval.

## ❑ Effective date (if the standard is approved by SEC as adopted):

- ❑ Changes relating to the basic elements and form of report would affect auditor reporting beginning with audits of fiscal years ending on or after December 15, 2017;

- ❑ Changes relating to critical audit matters would become effective at a later date.

# New Standard: Auditor's Reporting Model (Slide 2 of 5)

## Basic Elements & Form of Report

Effective date – For fiscal years ending on or after December 15, 2017.

- Standardized form of the auditor's report
- Addressee
- Independence
- Enhancements to basic elements
- Auditor tenure

# New Standard: Auditor's Reporting Model (Slide 3 of 5)

- ❑ **Critical Audit Matters** – details on next slides

*Effective date:* For audits of large accelerated filers – for fiscal years ending on or after June 30, 2019; for audits of all other companies to which the requirements apply – for fiscal years ending on or after December 15, 2020.

- ❑ Requirements do not apply to audits of:
  - ❑ Brokers and dealers;
  - ❑ Investment companies, other than business development companies;
  - ❑ Employee benefit plans; and
  - ❑ “Emerging growth companies” (public companies that meet certain criteria).

# New Standard: Auditor's Reporting Model (Slide 4 of 5)

## ❑ Critical Audit Matters (cont'd)

Definition: A critical audit matter is any matter arising from the audit of the financial statements that was communicated or required to be communicated to the audit committee and that:

- (1) Relates to accounts or disclosures that are material to the financial statements, and
- (2) Involved especially challenging, subjective, or complex auditor judgment.

# New Standard: Auditor's Reporting Model (Slide 5 of 5)

## **Critical Audit Matters** (cont'd)

Communication requirements: The communication of each critical audit matter in the auditor's report includes:

- Identification of the critical audit matter;
- Description of the principal considerations that led the auditor to determine that the matter was a critical audit matter;
- Description of how the critical audit matter was addressed in the audit; and
- Reference to the relevant financial statement accounts or disclosures.



# Ongoing standard-setting projects

- Auditing accounting estimates, including fair value measurements  
(Proposal issued on June 1, 2017; comment period closed.)
- Auditor's use of the work of specialists  
(Proposal issued on June 1, 2017; comment period closed.)
- Auditor's use of other auditors  
(Proposal issued on April 12, 2016. Subsequently, supplemental request for comment ("SRC") was issued on September 26, 2017; comment period on SRC ends on November 15, 2017.)
- Going concern  
(Outreach, monitoring, and research)

# Proposal: Auditing Accounting Estimates, Including Fair Value Measurements

- ❑ The proposal would:
  - ❑ Build on the three existing approaches to auditing estimates (testing management’s process, developing an independent estimate, and reviewing subsequent events or transactions);
  - ❑ Replace three existing, overlapping standards – AS 2501 (estimates), AS 2502 (fair value), and AS 2503 (derivatives) – with a single standard that streamlines and strengthens the direction to auditors, including an emphasis on applying professional skepticism;
  - ❑ Further integrate the risk assessment standards to focus auditors on estimates with greater risk of material misstatement, e.g., by amending AS 2110 (risk assessment), and 2301 (response to risk); and
  - ❑ Update certain other standards in light of developments in practice for auditing the fair value of financial instruments.

# Proposal: Auditor's Use of the Work of Specialists

- ❑ The proposal would:
  - ❑ Establish a uniform risk-based approach to testing and evaluating the work of company specialists, by amending AS 1105 (audit evidence); and
  - ❑ Establish a common supervisory approach for auditor specialists, whether employed or engaged, by:
    - ❑ Amending AS 1201 (supervision) with supplemental requirements for auditor-employed specialists, and
    - ❑ Replacing AS 1210 (work of a specialist) with new requirements for using the work of auditor-engaged specialists.

# Proposal: Auditor's Use of Other Auditors

- ❑ The proposal would:
  - ❑ Strengthen requirements for lead auditors, and provide a more uniform approach to the lead auditor's supervision of other auditors, principally by:
    - ❑ Superseding AS 1205 (use of other auditors);
    - ❑ Amending AS 1201 (supervision), AS 2101 (planning), AS 1220 (engagement quality review); and certain other standards; and
    - ❑ Providing a new standard, AS 1206, for situations in which the lead auditor divides responsibility for the audit with another firm.
- ❑ On September 26, 2017, PCAOB issued a supplemental request for comment ("SRC"):
  - ❑ SRC includes incremental targeted revisions (clarifications and modifications) to certain proposed requirements.
  - ❑ Comment period on SRC ends on November 15, 2017.

# Research Projects and Monitoring Activities

- ❑ Research Projects: The following projects are on the September 30, 2017 research agenda:
  - ❑ Quality Control Standards, Including Assignment and Documentation of Firm Supervisory Responsibilities
  - ❑ Changes in the Use of Data and Technology in the Conduct of Audits
  - ❑ The Auditor's Role Regarding Other Information and Company Performance Measures, Including Non-GAAP Measures
  - ❑ Auditor's Consideration of Noncompliance with Laws and Regulations
- ❑ Monitoring Activities: Also, monitoring activities are conducted in other areas that could affect audits or PCAOB standards (e.g., financial reporting fraud, auditor independence, and new accounting standards).

# Form AP (Slide 1 of 2)

## Overview

- ❑ Firms are required to file Form AP with the PCAOB for issuer audit reports.
- ❑ Form AP requires disclosure of:
  - ❑ Engagement partner's name and Partner ID (assigned by the partner's firm) – for auditor's reports issued on or after January 31, 2017;
  - ❑ Information about other accounting firms – for auditor's reports issued on or after June 30, 2017.
- ❑ Form APs filed with the PCAOB are publicly available and searchable through *AuditorSearch* (search feature on PCAOB website).

# Form AP (Slide 2 of 2)

## Guidance and Resources

- ❑ Staff guidance for Form AP Implementation: *Auditor Reporting of Certain Audit Participants and Related Voluntary Audit Report Disclosure* (February 16, 2017)
- ❑ The Form AP Resource Page includes a number of additional resources, including a sample form, XML instructions and related materials (e.g., video tutorials), contact information for Form AP related queries, and more at:

<https://pcaobus.org/Pages/form-ap-reporting-certain-audit-participants.aspx>

# Keeping Current with PCAOB Standards

- ❑ PCAOB Standards website –  
<http://www.pcaobus.org/Standards/Pages/default.aspx>
  - ❑ PCAOB standards and rules
  - ❑ Guidance
  - ❑ Standard-related activities
  - ❑ Standing Advisory Group
- ❑ Contact the Standards Inquiry Line via the web form or at (202) 591-4395
- ❑ Sign up for the PCAOB Updates service to receive a notification via e-mail that briefly describes significant new postings to our website at:  
<https://pcaobus.org/About/Pages/PCAOBUpdates.aspx>



# Questions



# Inspections: Observations and Trends

Bob Maday and Kate Ostasiewski  
Division of Registration and Inspections

# Agenda

- ❑ Summary of Inspection Program
- ❑ 2017 Inspection Plan
- ❑ Inspection Observations
- ❑ Actions for Auditors
- ❑ Questions

The 2017 inspection year is the \_\_\_\_\_ year we performing inspections of audits of brokers and dealers performed under PCAOB standards and also the \_\_\_\_ year we are performing inspections of attestation engagements under PCAOB attestation standards.

- 1 third, second
- 2 sixth, sixth
- 3 second, second
- 4 third, third

The 2017 inspection year is the \_\_\_\_\_ year we are performing inspections of audits of brokers and dealers performed under PCAOB standards and also the \_\_\_\_\_ year we are performing inspections of attestation engagements under PCAOB attestation standards.

1. third, second
2. sixth, sixth
3. second, second
4. **third, third**

# Inspection Program – Objectives

- ❑ Assess compliance with applicable Board and Commission rules and PCAOB standards
- ❑ Help inform the Board's eventual determinations about the scope and elements of a permanent inspection program
- ❑ Assist in the development of the approach to inspections under a permanent inspection program

# 2017 Inspection Plan

- ❑ 75 firms and portions of 115 audits and the related attestation engagements
- ❑ Audits of the financial statements and supporting schedules of brokers and dealers, required to be performed in accordance with PCAOB standards
- ❑ Examination and review engagements, required to be performed in accordance with PCAOB standards

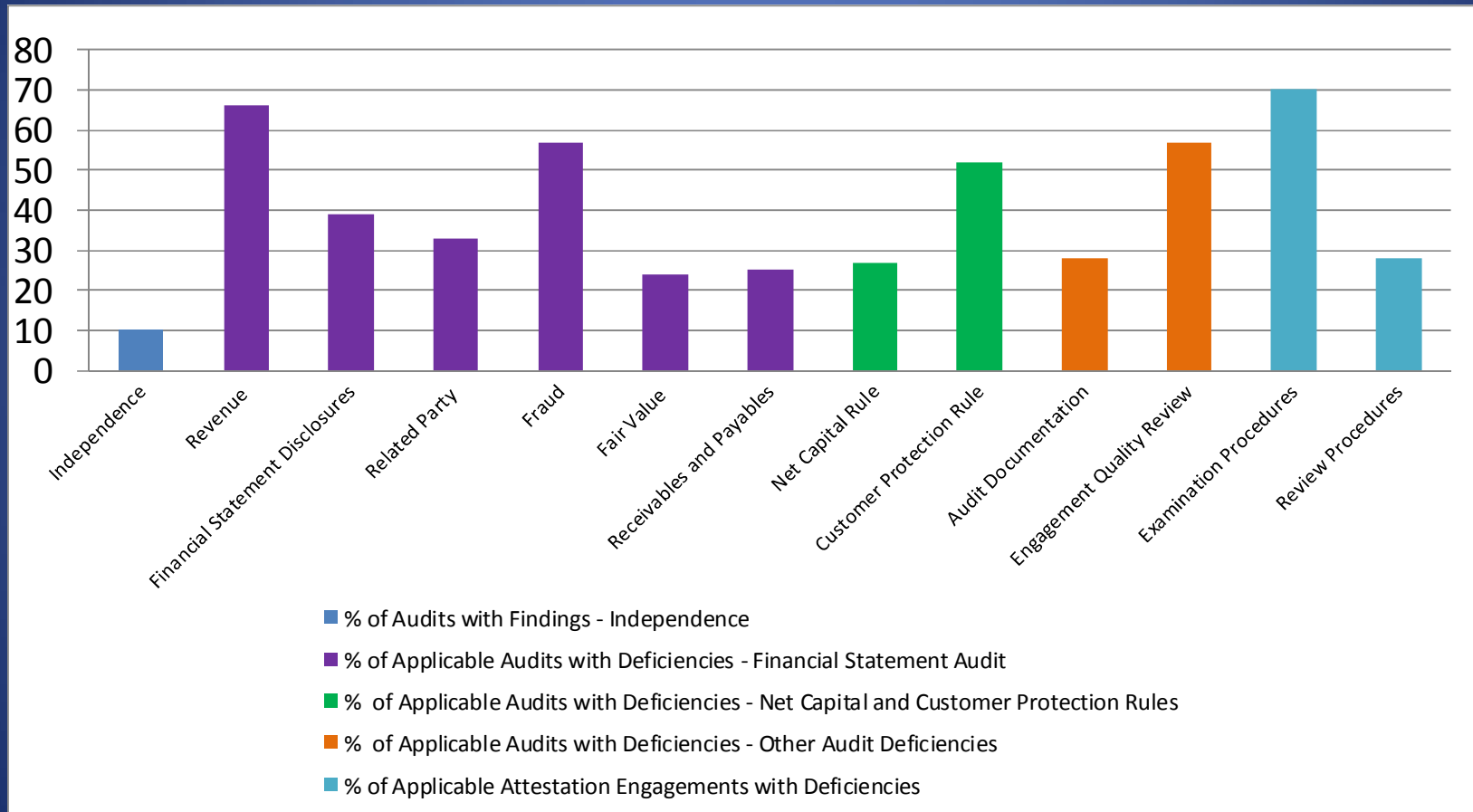
# Inspection Observations

The information presented in the following slides is not necessarily indicative of the full population of firms, or of all audit and attestation engagements of brokers and dealers, because the selection of firms for inspection and the audit and attestation engagements for brokers and dealers covered by the inspections is not necessarily representative of these populations.



# Inspection Results by Area - 2016

*Percentage of Applicable Engagements with Deficiencies*



How did the percentage of independence findings of the audits covered by the inspections in 2016 compare to the percentage of the audits covered by the inspections in 2015?

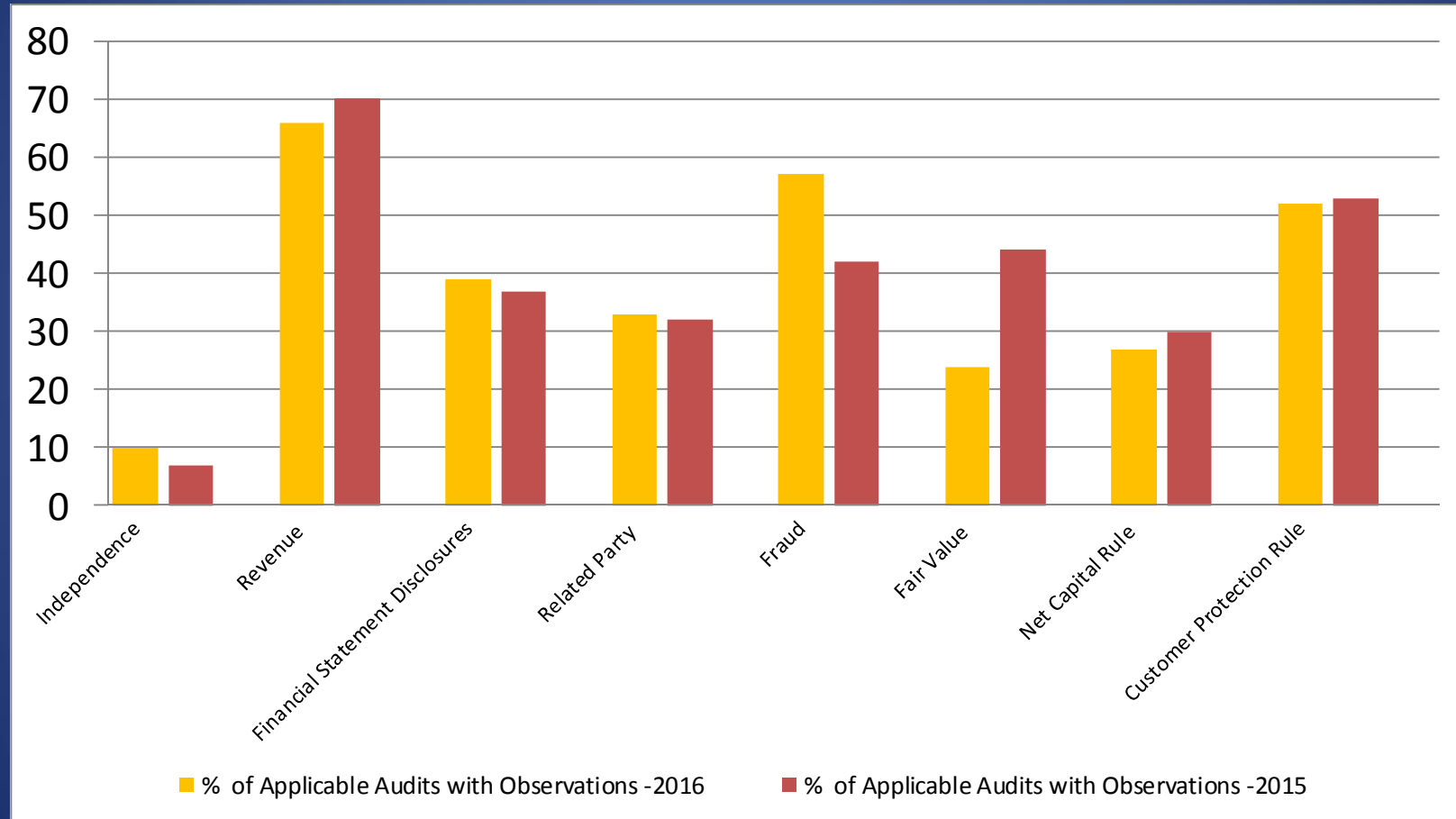
- 1 Increased
- 2 Decreased
- 3 No change

How did the percentage of independence findings of the audits covered by the inspections in 2016 compare to the percentage of the audits covered by the inspections in 2015?

1. **Increased**
2. Decreased
3. No change

# Inspections Observations by Audit Area 2016 Compared to 2015

*Percentage of Applicable Audits with Observations*



## In your opinion, what most often is a difficult aspect of performing tests of controls?

- 1 Obtaining an understanding of the broker-dealer's processes including relevant controls;
- 2 Evaluating the design effectiveness of a control in relation to assessed risk;
- 3 Obtaining necessary evidence to support the operating effectiveness of the control; or
- 4 Evaluating deficiencies.

# Perspective on Certain Audit Matters

- Risk Assessment
- Internal Controls
  - Controls Reliance Approach
  - Tests of Controls
  - Common Process
  - Use of Service Organization
  - Evaluation of Deficiencies
- Going Concern

# Perspective on Certain Attestation Matters

- ❑ Examination Procedures
  - ❑ Internal controls over compliance
  - ❑ Net Capital
  - ❑ Reserves – customer and PAB
- ❑ Review Procedures
  - ❑ Exemption claimed
  - ❑ Extent of procedures

# Actions for Auditors

- ❑ Ensure compliance with independence requirements for audit and attestation engagements
- ❑ Ensure the firm has the resources and expertise to support broker-dealer audit and attestation engagements
- ❑ Consider whether deficiencies described in the Annual Report might be present in current audit and attestation engagements
- ❑ Maintain policies and procedures that provide reasonable assurance that the work performed by engagement personnel meets applicable PCAOB standards and regulatory requirements



# Actions for Auditors

- ❑ Ensure that all audits and the related attestation engagements have an engagement quality review performed: 1) by a qualified individual and 2) in accordance with AS 1220
- ❑ Give attention to the importance of effective practice monitoring, including performing effective root causes of quality control related deficiencies; and
- ❑ Provide appropriate guidance and training to firm personnel and evaluate the appropriateness of the firm's policies on supervision and review
- ❑ Standards Inquiry: 202-591-4395

# Questions?



# Q&A and Closing Remarks

# Program Evaluation

Your feedback is very important to us. Please take a few minutes and complete the program evaluation via the link below.

<https://www.surveymonkey.com/r/BDFORUMLV102017>