

# PCAOB

Public Company Accounting Oversight Board

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# Small Business and Broker-Dealer Auditor Forum

*October 2-3, 2019*  
*Jersey City, NJ*

# **Welcome – October 2, 2019**

*Torrie Matous, Office of External Affairs*

# Disclaimer

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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 Objectives

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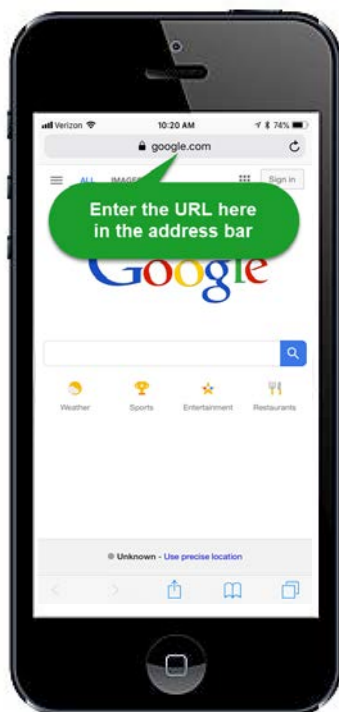
- To discuss important information concerning PCAOB activities with registered public accounting firms that audit the financial statements of public companies operating in the small business community or broker-dealers. The forum also provides an opportunity for Board members and PCAOB staff to hear comments, concerns and questions from auditors.
- On October 2, the morning session, intended for issuer auditors, features a panel discussion on auditor reporting, including critical audit matters. A case study, focusing on inventory, will be facilitated by PCAOB staff from the Division of Registration and Inspections (“DRI”). DRI staff will also discuss recent inspection findings.
- The afternoon session on October 2, intended for issuer and broker-dealer auditors, features updates from the PCAOB’s Standards and Enforcement groups. In addition, staff from the Securities and Exchange Commission’s Office of the Chief Accountant will join us to provide an update on SEC activities.
- On October 3, presentations for auditors of broker-dealers include a multi-topic panel discussion, an overview of inspection findings, and case studies facilitated by DRI staff covering auditing of revenue, audit sampling, and review procedures for broker-dealers with various lines of business. In addition, staff from FINRA will provide an update and cover various topics of current interest.

# Course Description

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The PCAOB Small Business and Broker-Dealer Forum is a 1.5 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.

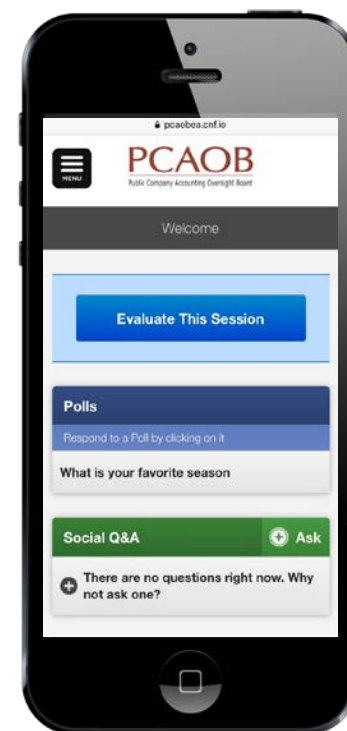
## Step 1: Enter website URL



## Step 2: Choose a Session

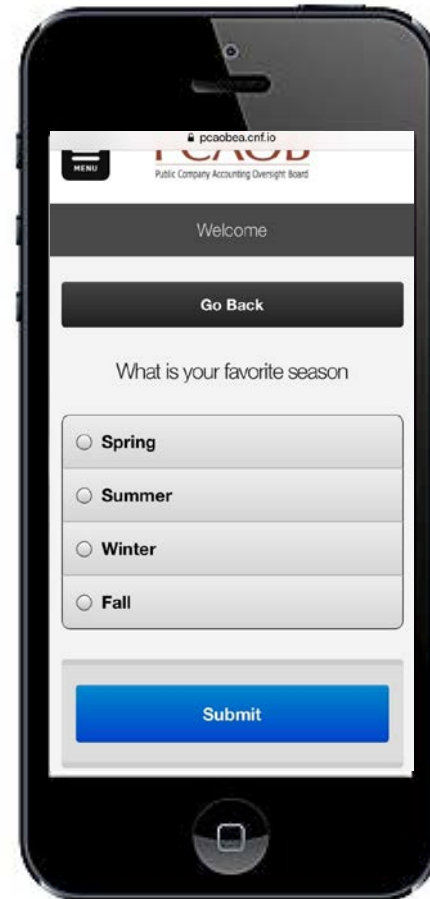


## Step 3: Participate



# Polling

- Polls will open automatically within the session
- Select answer and click “submit”



# Poll: What does CAM stand for?

1. Critical Accounting Matter
2. Critical Audit Matter
3. Certified Audit Magician
4. Current Audit Matter



# Poll: What does CAM stand for?

1. Critical Accounting Matter

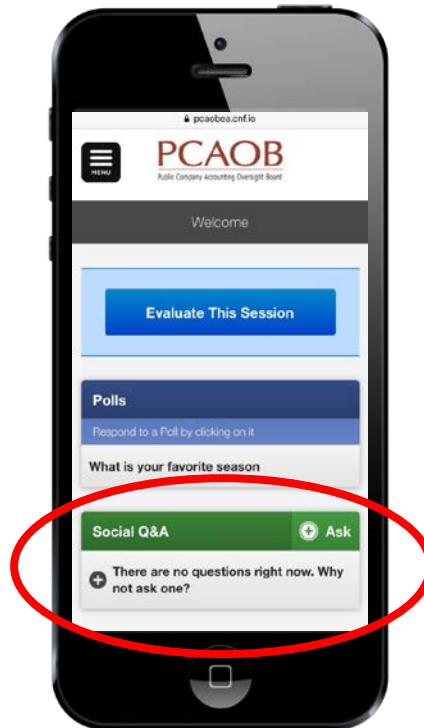
**2. Critical Audit Matter**

3. Certified Audit Magician

4. Current Audit Matter

# Q&A

- Utilize the “Social Q&A” option within each session

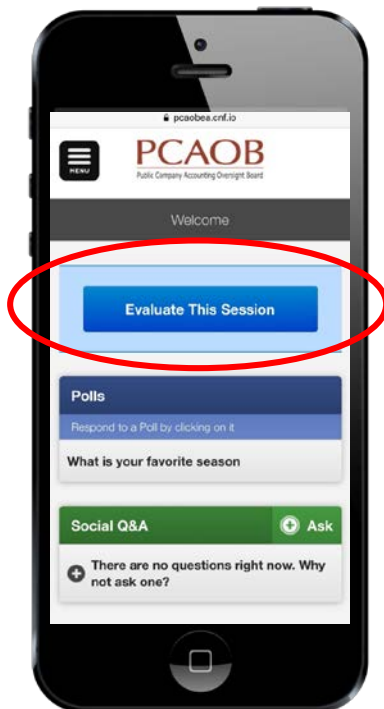


# Program Evaluation

<https://pcaobext.cnf.io>

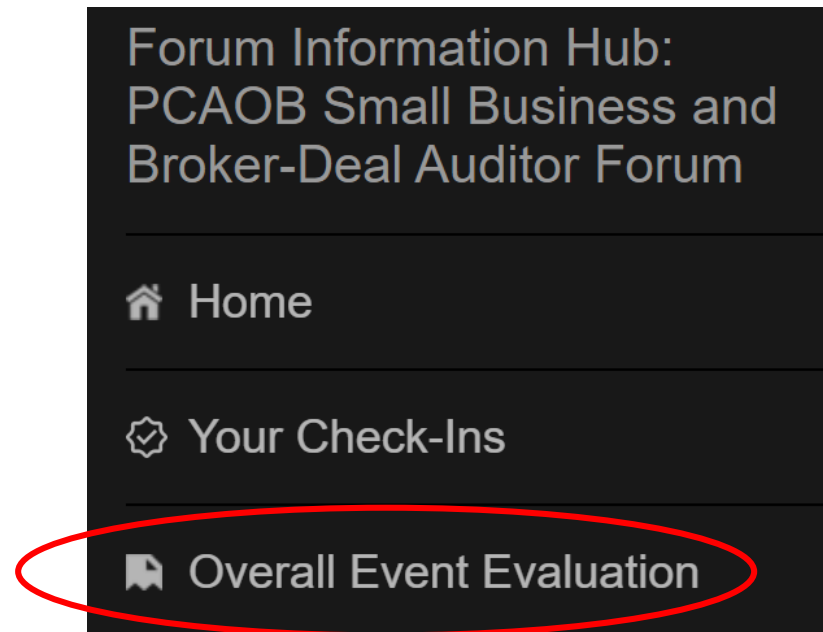
## Complete a session evaluation

Evaluation button will appear shortly before the session's scheduled conclusion



## Complete the overall evaluation

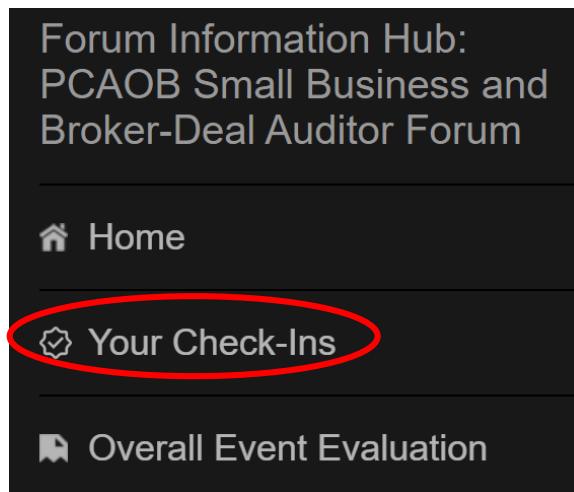
Select the link from the main menu



## 1. Note the session code

ARM19

## 2. Select “Your Check-Ins” from main menu



## 3. Follow instructions previously provided for entering codes

# Contact the PCAOB

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## ***Contact Link***

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

## ***General Information***

[info@pcaobus.org](mailto:info@pcaobus.org) **OR** [outreach@pcaobus.org](mailto:outreach@pcaobus.org)

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[https://twitter.com/PCAOB\\_News](https://twitter.com/PCAOB_News)

# **Panel: The New Auditor's Report: Critical Audit Matters and Other Current Topics**

*Torrie Matous, Moderator*

*Lisa Calandriello, Office of the Chief Auditor*

*Tim Sikes, Division of Registration and Inspections*

*Todd Tosti, Division of Registration and Inspections*

# Poll: What is your level of experience with CAMs?

1. Our firm has large accelerated filer audit clients, and we have reported, or will be reporting on CAMs within the next 12 months.
2. Our firm does not have large accelerated filer audit clients, but we have performed, or will be performing dry runs or pilot tests of CAMs on issuer audit engagements prior to the CAM effective date.
3. Our firm does not plan on doing dry runs or pilot tests of CAMs, but we plan on having discussions early with audit committees about how CAMs may impact the audit report, prior to the CAM effective date.
4. Our firm does not plan on preparatory activities prior to having audit engagements where CAMs will be in effect. Instead, we will deal with CAMs when the time comes to report on CAMs.
5. Our firm does not have any audit clients for which CAM reporting requirements apply.



# **Panel: The New Auditor's Report: Critical Audit Matters and Other Current Topics**

# **Poll: How many large accelerated filers were first impacted by the CAM requirements for June 30, 2019 fiscal year ends?**

1. 5
2. 50
3. More than 60

# Poll: How many large accelerated filers were first impacted by the CAM requirements for June 30, 2019 fiscal year ends?

1. 5
2. 50

**3. More than 60**

# Poll: For what period are CAMs required to be communicated?

1. Current period only
2. Current and prior periods
3. All periods presented in the F/S

# Poll: For what period are CAMs required to be communicated?

1. **Current period only**
2. Current and prior periods
3. All periods presented in the F/S

# **Panel: The New Auditor's Report: Critical Audit Matters and Other Current Topics**

# **Poll: Can the auditor take into account factors other than those listed in the standard when determining if a matter is a CAM?**

1. Yes
2. No

**Poll: Can the auditor take into account factors other than those listed in the standard when determining if a matter is a CAM?**

**1. Yes**

2. No



# **Panel: The New Auditor's Report: Critical Audit Matters and Other Current Topics**

# Questions

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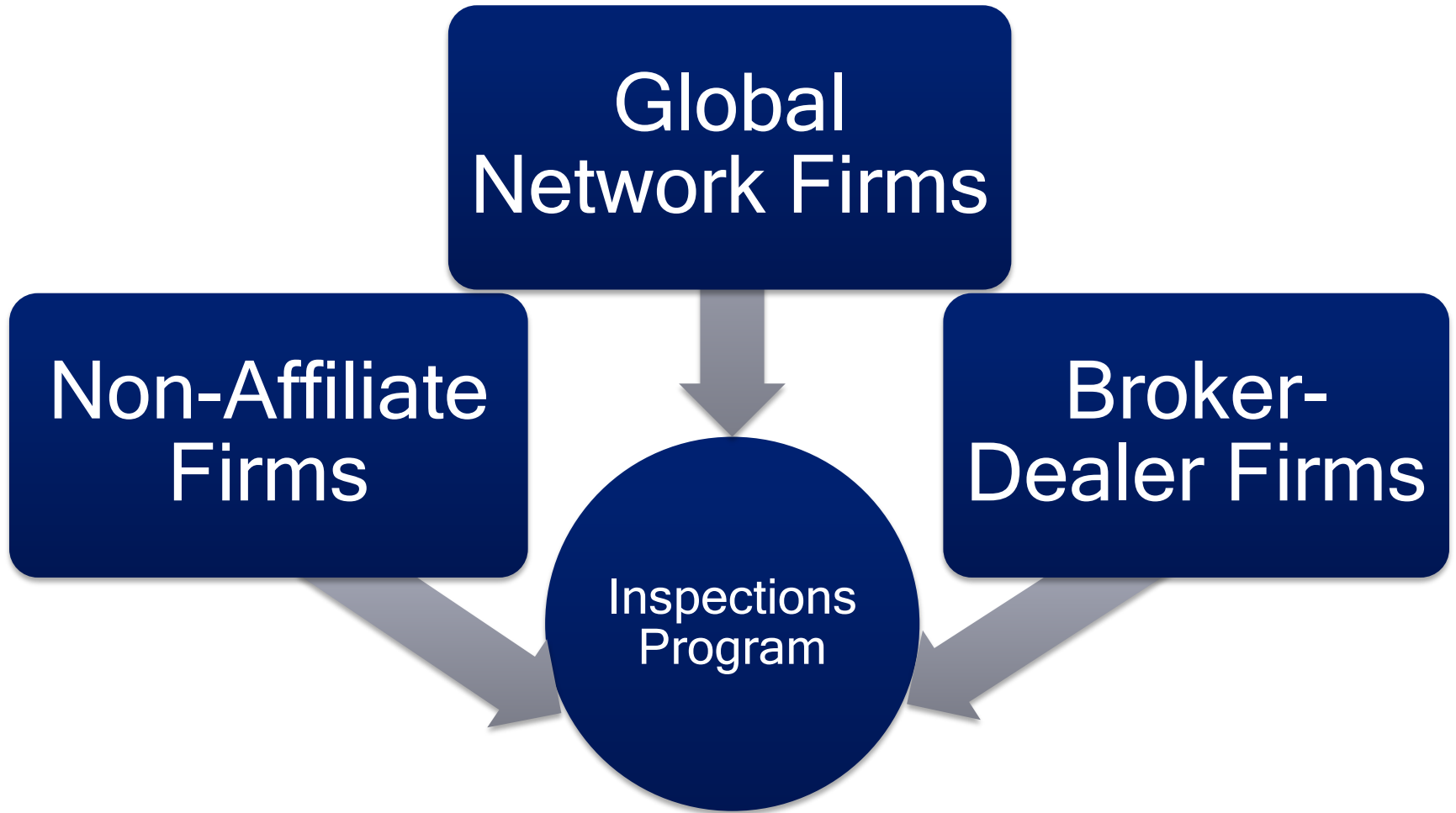
**BREAK (10 minutes)**

# Inspections Overview

*Tim Sikes, Division of Registration and Inspections*

# Inspection Programs Overview

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# Conducting Inspections

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- An Inspection consists of reviews of audit work and related quality control systems of registered accounting firms
  - Can be on-site
  - Can be “PCAOB-based”
    - Work papers shipped to PCAOB or accessed via internet portal
    - Interviews by telephone
- Inspector Skillsets/Background
  - Experienced auditors
  - Span major industry groups (e.g., financial services, technology, oil & gas)
  - Wide variety of language skills

# Risk-based Inspection

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## Factors Considered in Risk-Based Selections:

- Economic Trends
- Company or Industry Developments
- Issuer Market Capitalization
- Audit Firm and Audit Partner
- Inspection History

# PCAOB Inspection Focus

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- Auditor's risk assessment process
- Financial reporting and audit areas affected by economic trends and pressures
- Audit areas that present auditing challenges and significant audit risk, including areas of recurring deficiencies, and unpredictable selections
  - Estimating the allowance for loan losses
  - Valuation of acquired assets and financial instruments
  - Revenue recognition
  - Debt and equity related transactions
- Other areas of focus
  - Multinational audits
  - New accounting or auditing standards
  - Information technology systems and reports



# Quality Control Areas Reviewed

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- Varies based on nature of firm
- Includes:
  - Tone at the Top
  - Client Acceptance and Retention
  - Independence Policies and Procedures
  - Partner Matters
  - Policies, Guidance, and Tools
  - Training
  - Monitoring, such as Internal Inspection Program
  - Response to deficiencies in audit quality

# Inspection Process

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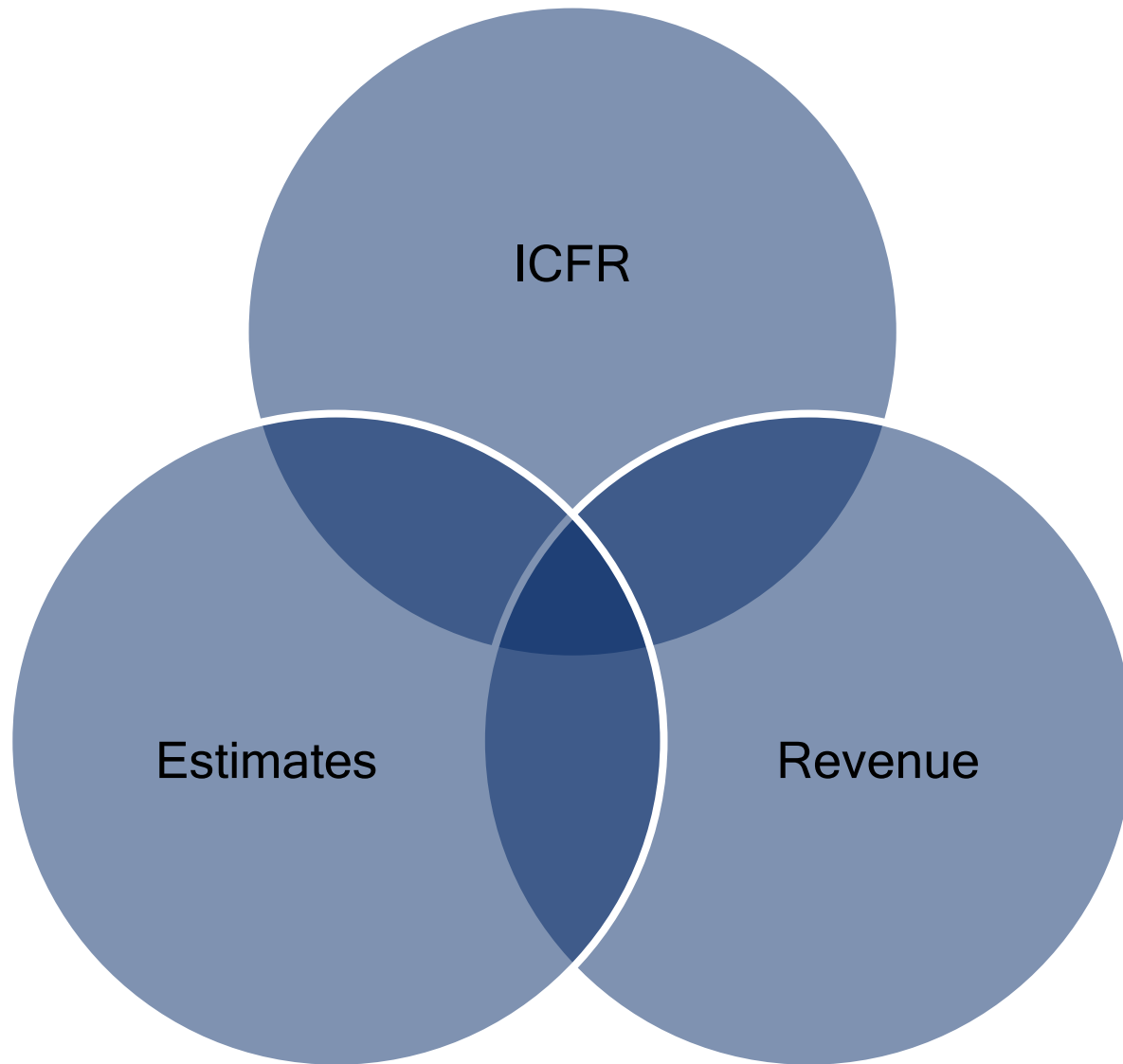
# Inspection Reports

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- Inspection reports
  - Do not identify an issuer by name
  - Contain public and may contain nonpublic portions
  - The public portions are posted on the PCAOB's website, including the public portion of firm responses
- Final inspection report triggers a 12-month remediation cycle for any quality control deficiency noted in inspection report
  - These criticisms or potential defects are made public only if they are not satisfactorily addressed by the firm before the 12-month period deadline

# Common Findings

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# Common Findings

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- Engagement Quality Review
  - Too much reliance on discussion
  - Limited review to summary memos
  - Experience and Independence

# Other Findings

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- Form AP filings
- Business Combinations
- Financial Instruments
- Information Provided by the Company

# System of Quality Control Findings

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- Independence
- Fraud Procedures
- Testing Appropriate to the Audit

# Outlook

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- System of Quality Control
- Independence
- New Auditing Standards
- Digital Assets
- Upcoming Changes to Inspection Reports



# Questions

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# Case Study: Auditing Inventory

*Tim Sikes, Division of Registration and Inspections*

*Todd Tosti, Division of Registration and Inspections*

# Auditing Inventory – Inspection Findings

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Issues identified in performing audit procedures related to:

- the use of audit sampling in connection with testing inventory costs
- testing labor and overhead costs capitalized in inventory
- testing the existence of inventory through physical inventory count procedures
- testing the valuation of inventory at the lower of cost or net realizable value
- controls testing related to inventory
- testing the existence of inventory held at third-party warehouses
- testing the company's estimate for its reserve for excess and obsolete inventory

# Case Study – Grillstars, Inc.

# Case Study – Background

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- The Company designs, manufactures, and sells gas and propane grills, pre-fabricated outdoor kitchens, and related accessories to both retailers and consumers.
- During the fiscal year ended June 30, 2019, the Company expanded its presence on the West Coast, along with planned sales incentives.
- This expansion, coupled with strong Q3 and Q4 sales, prompted a significant increase in inventories.
- The Company accounts for and reports its inventory on a first-in, first-out (FIFO) basis.
- The Company's enterprise resource planning ("ERP") system keeps a perpetual inventory record and carries items at standard cost.

## Case Study – Background (cont'd)

- Inventory represented approximately 40 percent of total assets as of June 30, 2019.
- The Company's inventory balances as of June 30, 2019 and 2018 consisted of the following:

----- \$ amounts in thousands -----

	June 30, 2019	June 30, 2018
Raw materials	\$11,000	\$ 4,000
Work-in-process ("WIP")	4,000	1,000
Finished goods	26,000	13,000
Reserve for obsolete inventory	<u>(700)</u>	<u>(500)</u>
Total	\$40,300	\$17,500

# Case Study – Background (cont'd)

- The Company's inventory is equally dispersed across its three locations: (1) its primary manufacturing center in the Midwest (the "Midwest facility"); (2) a Company-owned distribution facility on the East Coast (the "East Coast facility"); and (3) a new third-party distribution center on the West Coast (the "West Coast facility").



## Case Study – Background (cont'd)

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- To periodically test its physical inventory quantities, the Company:
  - uses a monthly cycle count approach at its Midwest facility;
  - performs a year-end wall-to-wall count at its East Coast facility; and
  - utilizes and relies upon periodic reports provided by the West Coast facility (a third-party).
- Significant variances (in excess of \$1,000) between perpetual records and physical counts (or third-party records) are required to be investigated by inventory managers.



# Case Study – Risk Assessment

- You are the audit engagement partner. Your audit team has made the following risk assessments for the existence and valuation of inventory:

	Inherent Risk	Control Risk	Risk of Material Misstatement	Significant / Fraud Risk?
Existence	Moderate	Low	Low	No
Valuation	High	High	High	Yes

- The low control risk assessment for existence corresponds to the engagement team's plan to test controls relative to the Midwest facility cycle counts, which will reduce the extent of substantive procedures required over existence at that location. Other locations will be tested on a purely substantive basis.
- Because of the significant increase in gross inventory, coupled with the disproportionately smaller increase in the inventory reserve and the Company's planned sales incentives that could reduce selling prices to below cost to promote its West Coast expansion, the engagement team determined that there is a significant risk that inventory might not be carried at the lower of cost or net realizable value (valuation).

# Case Study Part 1 – Existence Testing

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- You are currently reviewing the internal control and substantive testing procedures performed by your engagement team related to the existence of inventory.
- With respect to inventory held at the Midwest facility, the engagement team has identified and tested certain controls covering the performance of monthly cycle counts in order to support the “low” control risk assessment for the existence assertion.
- The engagement team determined a sample size of three cycle counts (including the June 2019 cycle count) to test the design and operating effectiveness of the inventory cycle count controls.
- In addition to inquiries of the Company’s Controller and Inventory Managers, the engagement team has performed the following procedures to test controls for each of the three monthly cycle counts selected for testing (see next slide):

# Case Study Part 1 – Existence Testing (cont'd)

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The engagement team's control testing procedures for the Midwest facility:

- Obtained and evaluated the Company's cycle count sheets, which indicated the inventory items counted by the Company and any variances that were identified;
- Verified that the inventory variances from the cycle counts were included in the ERP-generated transaction posting journal ("variance summary report");
- Evaluated the variance summary report to determine that any inventory variances over \$1,000 were investigated by the inventory managers;
- Determined that the count sheets and variance summary report were reviewed and approved by the inventory managers; and
- Obtained the cycle count rolling excel file from the Company, which tracks inventory items counted throughout the year and any variances identified during each cycle count.

# Case Study Part 1 – Existence Testing (cont'd)

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Substantive procedures performed by the engagement team relative to the existence of inventory included the following:

- Midwest facility – Relied upon the cycle count procedures (i.e. dual-purpose testing approach).
- East Coast facility – Observed the Company's wall-to-wall count procedures, and selected a sample of 40 inventory items (20 floor-to-sheet, and 20 sheet-to-floor) to test count at year end. The sample size was determined assuming no control reliance. No errors were noted in the engagement team's test counts.
- West Coast facility (third-party owned) – Obtained a confirmation letter from the third party to confirm the existence of inventories at year end.
- All locations – Performed shipping and receiving cutoff procedures at year end.

**Poll: In general, a well-designed cycle-count program would be expected to result in each item in inventory being counted at least once per year?**

1. True
2. False
3. It depends

**Poll: In general, a well-designed cycle-count program would be expected to result in each item in inventory being counted at least once per year?**

1. True

2. False

**3. It depends**

# Case Study Part 1 – Existence Testing (cont'd)

## *Question #2 – Discussion Question*

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- What are your thoughts on the engagement team's procedures over the cycle counts? Do you believe they are sufficient? If not, what other procedures would be necessary to satisfy you?

# Case Study Part 1 – Existence Testing (cont'd)

## Question #3 – Discussion Question

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- Suppose that after testing its cycle count selections, the engagement team concluded that the Company's controls over its Midwest facility cycle count procedures are ineffective, due to the engagement team having identified instances where variances in excess of \$1,000 were not investigated or resolved. What alternative procedures could the engagement team perform in that case?



**Poll: Inventory held at the West Coast facility (the third-party facility) accounts for approximately 33 percent of the Company's total inventory and approximately 13 percent of the Company's total assets. Which of the following procedures would you say the auditor should perform in order to obtain reasonable assurance with respect to the existence of the Company's inventory at that facility?**

1. Obtain direct confirmation of the Company's inventory quantities held at the third-party warehouse.
2. Obtain an independent accountant's report on the third-party warehouse's control procedures relevant to the custody of the Company's goods, and/or observe physical inventory counts of the Company's goods.
3. None, as long as the auditor obtains significant testing coverage from all other inventory locations tested.
4. 1 and 2

**Poll: Inventory held at the West Coast facility (the third-party facility) accounts for approximately 33 percent of the Company's total inventory and approximately 13 percent of the Company's total assets. Which of the following procedures would you say the auditor should perform in order to obtain reasonable assurance with respect to the existence of the Company's inventory at that facility?**

1. Obtain direct confirmation of the Company's inventory quantities held at the third-party warehouse.
2. Obtain an independent accountant's report on the third-party warehouse's control procedures relevant to the custody of the Company's goods, and/or observe physical inventory counts of the Company's goods.
3. None, as long as the auditor obtains significant testing coverage from all other inventory locations tested.
- 4. 1 and 2**

# Case Study Part 2 – Valuation Testing

The following procedures have been proposed by the audit manager as it relates to valuation:

## Proposed Audit Approach

### Substantive Testing:

- (1) Using the year-end inventory listing, select a sample of inventory items (allocated to raw materials, WIP, and finished goods) and perform FIFO price testing.
  - a. For raw materials selections, obtain and inspect the latest vendor invoices that aggregate to the total quantity on hand at year end, and compare the standard cost per the year-end inventory listing to the actual purchase prices per the invoices.
  - b. For manufactured items included in the sample
    - i. Select the most significant raw materials component and perform the procedure noted in “a.” above.
    - ii. For labor and overhead components, trace standard rates to production data/reports available and assess for reasonableness.
- (2) Select a sample of finished goods items and obtain evidence supporting the latest selling price for that item, and determine whether inventory is stated at the lower of cost or market.
- (3) Perform high-level analytical procedures, such as comparing inventory turnover ratios against previous years.

# Case Study Part 2 – Valuation Testing (cont'd)

## *Question #1 – Discussion Question*

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- What are your thoughts on the proposed procedures? Are there other procedures you believe should be performed?

# Case Study Part 2 – Valuation Testing (cont'd)

## Question #2 – Discussion Question

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- The audit is now well under way. You are currently reviewing your engagement team's price testing work for the valuation of inventory. Your first step is to review the sample planning form to determine whether your engagement team selected a sufficient number of items to test. In reviewing the sample size calculation in the sample planning form, you notice a significant reduction in the calculated sample size based on an input indicating that extensive other substantive procedures were being performed.
- Based on your review, you have asked the engagement team to explain why such weight was given to other substantive procedures, thereby reducing the required sample size. Your engagement team explains their view that the other substantive procedures, including the analytical procedures and NRV testing, collectively address the valuation assertion; therefore, the engagement team believes it should take credit for those procedures in determining the sample size for price testing.

# Case Study Part 2 – Valuation Testing (cont'd)

## *Question #2 – Discussion Question (cont'd)*

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- What are your thoughts on the engagement team's response?

# **Poll: In general, when planning a sample for a substantive test of details, AS 2315, Audit Sampling, indicates that an auditor should consider which of the following:**

1. The relationship of the sample to the relevant audit objective
2. Tolerable misstatement
3. The auditor's allowable risk of incorrect acceptance
4. Characteristics of the population
5. The timing of when the audit procedures will be performed
6. All of the above.
7. 1, 2, 3, and 4 above

# **Poll: In general, when planning a sample for a substantive test of details, AS 2315, Audit Sampling, indicates that an auditor should consider which of the following:**

1. The relationship of the sample to the relevant audit objective
2. Tolerable misstatement
3. The auditor's allowable risk of incorrect acceptance
4. Characteristics of the population
5. The timing of when the audit procedures will be performed
6. All of the above.
- 7. 1, 2, 3, and 4 above**



# Case Study Part 2 – Valuation Testing (cont'd)

## Question #4 – Discussion Question

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As you continue to review the results of the price testing procedures, you observe that for each WIP and finished good selection, the engagement team has obtained the bill of materials (“BOM”) and performed the following procedures:

- Selected the most significant raw material component of the BOM and performed similar FIFO price test procedures as described in the “Proposed Audit Approach” presented earlier.
- Agreed the labor and overhead rates to a report provided by the Company that summarizes the standard direct labor rates and overhead rates per manufacturing workstation.

What procedures would you recommend your engagement team perform to test the accuracy and completeness of that report?

# **Poll: In general, as it relates to inventory cost buildup, which of the following costs would you say should be included in inventory?**

1. Repairs and maintenance of production equipment
2. Research and development costs
3. Costs of quality control and inspection
4. 1 and 3 above
5. 2 and 3 above

# Poll: In general, as it relates to inventory cost buildup, which of the following costs would you say should be included in inventory?

1. Repairs and maintenance of production equipment
2. Research and development costs
3. Costs of quality control and inspection
- 4. 1 and 3 above**
5. 2 and 3 above

# Poll: In general, as it relates to fixed overhead production costs, which of the following scenarios is true?

1. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased.
2. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is increased.
3. In periods of abnormally low production, the amount of fixed overhead allocated to each unit of production is increased.
4. 1 and 3 above

# Poll: In general, as it relates to fixed overhead production costs, which of the following scenarios is true?

1. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased.
2. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is increased.
3. In periods of abnormally low production, the amount of fixed overhead allocated to each unit of production is increased.
4. 1 and 3 above

# Case Study Part 3 – Results of Evaluating Capitalized Variances

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Additional information:

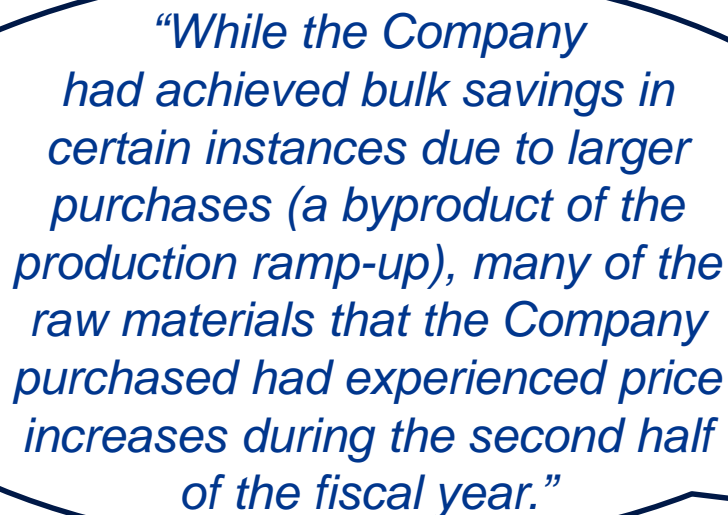
- The Company initially records all variances between standard and actual costs to cost of sales.
- On a quarterly basis, the Company performs an analysis of total inventory variance costs for the period to determine what portion of the variance amount, if any, needs to be capitalized.
- As of June 30, 2019, you observe that the Company has capitalized approximately \$3 million in unfavorable variances, based on the results of its analysis.
- Assume your engagement team determined that tolerable misstatement was \$2 million for this balance.

## Case Study Part 3 – Results of Evaluating Capitalized Variances (cont'd)

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To evaluate the amount of inventory standard costing variances that were capitalized into inventory, the engagement team's procedures consisted of comparing the amount capitalized at June 30, 2019 to amount capitalized at June 30, 2018 and investigating fluctuations in excess of a certain threshold.

Because the threshold for investigation was triggered, the engagement team inquired with the Controller, and documented the following response from the Controller:



*“While the Company had achieved bulk savings in certain instances due to larger purchases (a byproduct of the production ramp-up), many of the raw materials that the Company purchased had experienced price increases during the second half of the fiscal year.”*

## **Poll: Based on the fact pattern provided, what are your thoughts on this procedure?**

1. It's fine as is, since the capitalized variances are not significantly higher than tolerable misstatement.
2. The engagement team should evaluate whether the prior year amount is a relevant and appropriate amount to compare to, given the changes in the Company.
3. The engagement team should perform procedures to corroborate the explanation provided by the Controller.
4. 2 and 3 above
5. There may be a better way to analytically test this account.



## **Poll: Based on the fact pattern provided, what are your thoughts on this procedure?**

1. It's fine as is, since the capitalized variances are not significantly higher than tolerable misstatement.
2. The engagement team should evaluate whether the prior year amount is a relevant and appropriate amount to compare to, given the changes in the Company.
3. The engagement team should perform procedures to corroborate the explanation provided by the Controller.
- 4. 2 and 3 above**
- 5. There may be a better way to analytically test this account.**

# Case Study Part 4 – Results of Net Realizable Value (“NRV”) Testing

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Additional information:

- The engagement team’s approach to test NRV is to utilize the finished good items selected in the price-testing sample discussed earlier.
- Using these selections, as well as a report provided by the Company that indicates sales data by inventory item for the period July 1, 2019 to August 31, 2019, the engagement team:
  - obtained the latest sales invoice for each selection; and
  - compared the selling price per the invoice to the standard cost listed in the year-end inventory listing.
- The engagement team noted no instances where cost was greater than the selling price.

# **Poll: What are your thoughts on the sample used and the testing approach employed by the engagement team?**

1. It's fine as is.
2. The engagement team should test the accuracy and completeness of the sales data report provided by the Company.
3. The engagement team should incorporate selling costs and costs to complete into the selling prices in order to establish NRV.
4. 2 and 3

# Poll: What are your thoughts on the sample used and the testing approach employed by the engagement team?

1. It's fine as is.
2. The engagement team should test the accuracy and completeness of the sales data report provided by the Company.
3. The engagement team should incorporate selling costs and costs to complete into the selling prices in order to establish NRV.

**4. 2 and 3**

# Questions

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**LUNCH (70 minutes)**

# Board Member Perspective

*Jim Kaiser, Board Member*

# Fall 2019 Standard-Setting Update

*Lisa Calandriello, Office of the Chief Auditor*

*Dominika Taraszewicz, Office of the Chief Auditor*



# Agenda

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- Recent activities
  - Recently approved standards and amendments
  - Guidance issued in 2019
- Updates on other standard-setting and research projects
- Staying current on standard-setting activities
- Contact OCA

# Recently Approved Standards and Amendments

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- On July 1, 2019, the SEC approved the projects:
  - Auditing Accounting Estimates, including Fair Value Measurements
  - Auditor's Use of the Work of Specialist
- The new standards and amendments will be effective for audits of financial statements for fiscal years ending on or after December 15, 2020.

# **Auditing Accounting Estimates, including Fair Value Measurements**

# Introduction

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- The requirements are reflected in revised and retitled AS 2501, *Auditing Accounting Estimates, Including Fair Value Measurements* and related amendments to other PCAOB auditing standards.
  - The revised standard replaces three existing standards,
    - AS 2501, *Auditing Accounting Estimates*;
    - AS 2502, *Auditing Fair Value Measurements and Disclosures*;
    - AS 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*;
- with a single standard that sets forth a uniform, risk-based approach.

# Key Aspects of AS 2501 (Revised)

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- Focuses auditors on estimates with greater risk of material misstatement.
- Emphasizes application of professional skepticism, including addressing potential management bias.
- Enhances the requirements under the three existing approaches to auditing estimates.
- Provides direction on auditing fair value of financial instruments, particularly when pricing information is obtained from third parties.

# Approach to Auditing Estimates

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The revised standard and related amendments:

- Address how the auditor's responsibilities for identifying and responding to risk under the risk assessment standards apply to accounting estimates.
- Clarify the audit procedures under each of the three approaches auditors use to substantively test estimates.
  - Testing the company's process
  - Developing an independent expectation
  - Evaluating evidence from events or transactions after measurement date

# Auditing Estimates – Substantive Testing

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## Testing the Company's Process

Testing the company's process used to develop accounting estimates involves performing procedures to test and evaluate the methods, data, and significant assumptions used by the company in developing the estimate.

The revised standard:

- Sets forth requirements for evaluating the company's method.
- Clarifies requirements for testing internal company data and data from external sources.
- Explicitly requires the auditor to identify significant assumptions used by the company.
- Enhances requirements for evaluating the reasonableness of significant assumptions.

# Auditing Estimates – Substantive Testing (cont'd)

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## Developing an Independent Expectation

The requirements are tailored to the particular sources of the methods, data, and assumptions used by the auditor.

For example, when the auditor's independent expectation is developed using:

- Assumptions and methods of the auditor.
- Data and assumptions obtained from a third party.
- Company data, significant assumptions, or methods.

## Evaluating Evidence From Events or Transactions After the Measurement Date

The revised standard focuses the auditor's evaluation of the subsequent event on whether its reliable and relevant to the estimate.



# Auditing Fair Value of Financial Instruments

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Appendix A of the revised standard provides specific direction when auditing the fair value of financial instruments, primarily when pricing information is obtained from third parties, such as pricing services and brokers and dealers.

The approach consists of:

- identifying and assessing risks of material misstatement associated with the valuation of financial instruments, and
- performing procedures to determine whether the pricing information provides sufficient appropriate evidence to respond to those risks.

# Using Pricing Information from Third Parties

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## Pricing Services

The revised standard:

- Establishes factors that affect the reliability and relevance of pricing information obtained from a pricing services.
- Requires auditors to perform additional procedures 1) when fair values are based on transactions of similar financial instruments, or 2) when no recent transactions have occurred for either the financial instrument being valued or similar financial instruments.
- Provides additional direction when pricing information is obtained from multiple pricing services.

## Brokers or Dealers

The revised standard:

- Sets forth factors that affect the relevance and reliability of quotes from brokers or dealers.

# **Auditor's Use of the Work of Specialists**

# **Poll: Before we start talking about the changes to specialists, I'd like to know how you use the work of specialists in your audits**

1. Use the work of a company's specialist
2. Use the work of an auditor-employed specialist
3. Use the work of an auditor-engaged specialist
4. Use the work of both company's and auditor's specialists
5. We don't use the work of specialists in our audits

# Introduction

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## What is a specialist?

- A person (or firm) possessing special skill or knowledge in a particular field other than accounting or auditing.

## Company's specialist –

- A specialist, employed or engaged by the company, whose work auditors often use as audit evidence.

## Auditor's specialist –

- A specialist, employed (“auditor-employed”) or engaged (“auditor-engaged”) by the auditor, that may assist auditors in, among other things, obtaining or evaluating audit evidence with respect to a relevant assertion of a significant account or disclosure.

# Before and After the Amendments

Specialist Type	Nature of Specialist's Involvement	<b><u>Before</u></b> Effective Date of Final Amendments	<b><u>After</u></b> Effective Date of Final Amendments
Company's	Specialist employed or engaged by the company	Auditor performs the procedures required by existing AS 1210	Auditor performs the procedures required by AS 1105 (including Appendix A), as amended
Auditor's	Auditor-engaged specialist		Auditor applies the supervisory procedures required by AS 1210, as amended
	Auditor-employed specialist	Auditor supervises the specialist under AS 1201	Auditor supervises the specialist under AS 1201 (including Appendix C), as amended

## Before and After the Amendments (cont'd)

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- Requirements for company's specialist and auditor-engaged specialist are no longer the same.
  - Company's specialist – Appendix A to AS 1105
  - Auditor-engaged specialist – AS 1210, as amended
- Requirements for auditor-employed and auditor-engaged specialists are parallel, except for assessment of qualifications and relationships to the company
  - Auditor-employed – must be independent, a member of the engagement team; the engagement partner assigns tasks commensurate with qualifications of the engagement team member
  - Auditor-engaged – auditor assesses knowledge, skill, and ability, and degree of objectivity

# Overview of Requirements – Company's Specialist

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- The amendments retain the requirements for **assessing the knowledge, skill, and ability** of the company's specialist and the company's specialist's **relationship to the company**.
- Auditor **evaluates** the work of the company's specialist instead of merely **obtaining an understanding**.
- Auditor has requirements to:
  - **Test** data provided by the company and used by the company's specialist, and
  - **Evaluate** methods and assumptions used by the company's specialist.



# Overview of Requirements – Company's Specialist (cont'd)

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- The four factors for the auditor to consider in **determining the extent of the auditor's evaluation** –
  - Risk of material misstatement of the relevant assertion
  - Significance of the specialist's work to the financial statement assertion
  - Knowledge, skill, and ability of the specialist
  - Relationship of the specialist to the company

# Overview of Requirements – Auditor’s Specialist

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- The auditor **assesses** the qualifications and **independence** of the auditor-employed specialists and qualifications and **objectivity** of the auditor-engaged specialist.
- The auditor **establishes** and **documents an understanding with the auditor's specialist** of the specialist's roles and responsibilities in the audit.

# Overview of Requirements – Auditor’s Specialist (cont’d)

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- The auditor reviews the work of the auditor's specialist and evaluates that –
  - The report, or equivalent documentation, are in accordance with the established understanding
  - The findings or conclusions are consistent with the work performed
- The amendments lay out factors for determining the necessary extent of supervision and review of the work of the auditor’s specialist –
  - Risk of material misstatement of the relevant assertion
  - Significance of the specialist's work to the financial statement assertion
  - Knowledge, skill, and ability of the specialist

# Planning considerations

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- When a company uses the work of a company's specialist, an auditor should **obtain an understanding** of the work and report(s), or equivalent communication, of the company's specialist(s) and related company processes and controls, including:
  - The nature and purpose of the specialist's work;
  - The sources of the data used by the specialist; and
  - The company's processes and controls for using the work of the specialist.
- The auditor **determines** if the auditor needs to get individuals with specialized skill or knowledge to assist in any phase of the audit to:
  - Perform appropriate risk assessments,
  - Plan or perform audit procedures, or
  - Evaluate audit results.

## Planning considerations (cont'd)

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- If a person with specialized skill or knowledge employed or engaged by the auditor participates in the audit, the auditor should have sufficient knowledge of the subject matter to be addressed by such a person to enable the auditor to:
  - Communicate the objectives of that person's work;
  - Determine whether that person's procedures meet the auditor's objectives; and
  - Evaluate the results of that person's procedures as they relate to the nature, timing, and extent of other planned audit procedures and the effects on the auditor's report.
- If the person with specialized skill or knowledge is in a field outside of accounting or auditing, the requirements of Appendix C to AS 1201 or AS 1210 will apply.

# Implementation Reminders

# Poll: What do you expect your firm will do to implement the amendments?

1. Read the adopting release
2. Develop/attend training
3. Update your firm methodology
4. Start early
5. A combination of methods

# Guidance Issued in 2019



# Accounting Estimates and Fair Value Measurements

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- Staff Guidance: Auditing Accounting Estimates (Aug. 22, 2019)
- Staff Guidance: Auditing the Fair Value of Financial Instruments (Aug. 22, 2019)

# Auditor's Use of the Work of Specialists

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- Staff Guidance: Using the Work of a Company's Specialist (Aug. 22, 2019)
- Staff Guidance: Supervising or Using the Work of an Auditor's Specialist (Aug. 22, 2019)

# Implementation of Critical Audit Matters

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- The Basics (March 18, 2019)
- Staff Observations from Review of Audit Methodologies (March 18, 2019)
- A Deeper Dive on the Determination of CAMs (March 18, 2019)
- A Deeper Dive on the Communication of CAMs (May 22, 2019)

# Communications with Audit Committees about Independence

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- Rule 3526(b) Communications with Audit Committees Concerning Independence (May 31, 2019)

# Updates on Other Projects

# Updates on Other Standard-Setting Projects

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- Quality Control
  - The staff is developing a concept release for the Board's consideration in the fourth quarter of 2019. The concept release would seek public comment to inform the direction of the standard-setting project.
- Other Auditors
  - The staff is analyzing comments received in response to the 2017 supplemental request for comment, and determining next steps.
- Going Concern
  - The staff is monitoring the effect on audits of the changes to the relevant accounting standards. In the meantime, AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, and Staff Audit Practice Alert No. 13 continue to provide the applicable requirements and guidance.

# Updates on Research Projects

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- Data & Technology
  - The staff continues to obtain and analyze information that is important for determining whether there is a need for guidance, changes to PCAOB standards, or other regulatory actions in light of the increased use of new and emerging technology-based tools by both auditors and preparers. The staff's activities to date have not indicated that PCAOB standards are currently impeding auditors' use of technology-based tools.
- Noncompliance with Laws and Regulations
  - The staff is summarizing its research findings and developing recommendations for next steps for Board consideration.
- Other Information
  - The staff is summarizing its research findings and developing recommendations for next steps for Board consideration.

# **Keeping Current with Standard-Setting Activities & Contacting OCA**



# **Poll: Have you contacted the Standards Inquiry Line in the past?**

1. Yes
2. No

# Keeping Current with Standard-Setting Activities & Contacting OCA

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- PCAOB Standards website –  
<http://www.pcaobus.org/Standards/Pages/default.aspx>
  - PCAOB standards and rules
  - Guidance
  - Standard-related activities
- 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>
- Contact the Standards Inquiry Line via the web form or at (202) 591-4395

# Questions

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OCA19



# **Division of Enforcement and Investigations Update**

*Michelle Jaconski, Division of Enforcement and Investigations*

# Division of Enforcement & Investigations

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What do we do.....



# Agenda

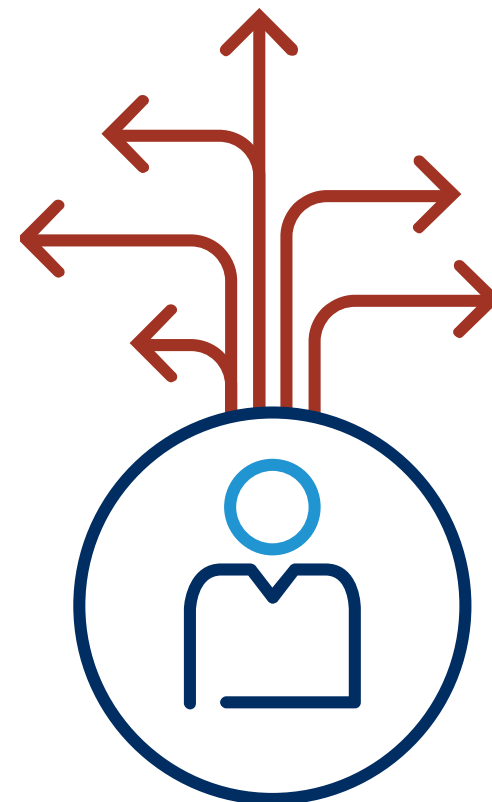
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- Today we would like to discuss:
  - Range of possible sanctions and effects of bars/suspensions
  - Meaning of association with a registered firm
  - Enforcement Program statistics and outlook
    - 2018 Settled enforcement actions and adjudicated actions made public
    - Certain types of enforcement actions and their consequences
    - Recent matters involving auditing standards violations
  - Extraordinary cooperation credit
  - Termination of bars

# Range of Possible Sanctions

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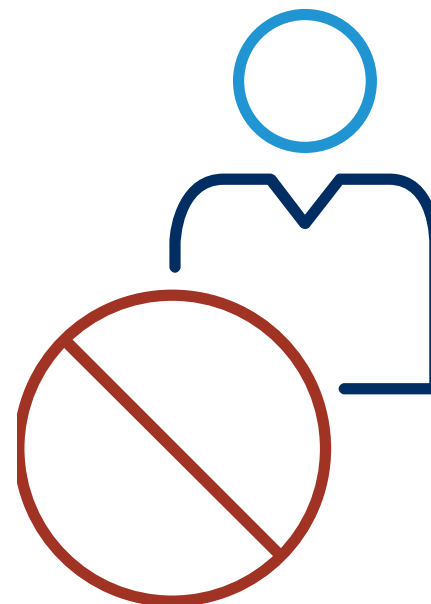
- In a disciplinary proceeding, the Board may:
  - suspend or permanently bar an individual from association with a registered public accounting firm
  - temporarily or permanently revoke a firm's registration
  - appoint an independent monitor or consultant
  - impose a civil monetary penalty
  - temporarily 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
  - impose a censure, and/or any other sanction per Board rules



# Effect of Suspensions and Bars

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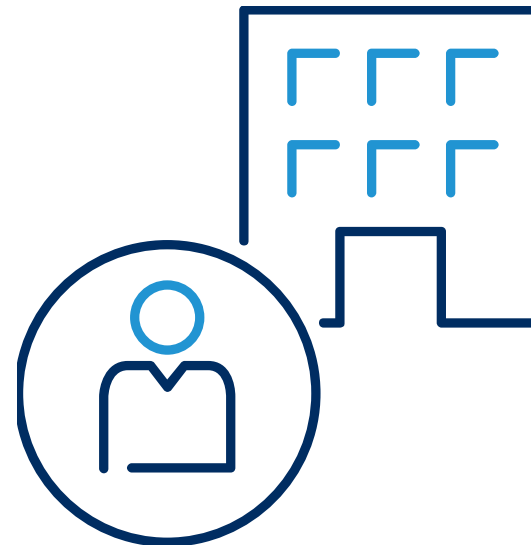
- It is unlawful for any person that is suspended or barred to become or remain associated with any registered firm or with any issuer, broker, or dealer in an accountancy or a financial management capacity
  - See Section 105(c)(7) of the Sarbanes-Oxley Act of 2002, as amended; PCAOB Rule 5301
- It 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*



## ***In the Matter of Leigh J Kremer CPA and Leigh J. Kremer, CPA – July 24, 2018***

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- The firm, and its sole partner, Kremer, improperly permitted a barred individual to associate with the firm
  - The firm and Kremer entered into a “buy-out” agreement such that the barred individual would receive a percentage of fees collected in issuer and broker-dealer audits referred by that individual to the firm
    - This made the barred individual an associated person of the firm, as he was now sharing in the profits, or receiving compensation from the firm, from audits
  - Firm and Kremer were censured
  - Firm’s registration was revoked and Kremer was barred, both with the right to reapply after three years
  - \$10,000 civil monetary penalty imposed on the firm

# **Poll: How often do you read settled or adjudicated enforcement orders from the PCAOB website?**

1. I routinely read all the enforcement orders
2. I periodically go to the enforcement webpage to look for and read recent enforcement orders of interest
3. I read certain enforcement orders that come to my attention
4. I have not read any enforcement orders

# Program Statistics for 2018

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- In 2018 the Board imposed sanctions on auditors ranging from censures to monetary penalties and bars on association with registered firms in settled or public adjudicated disciplinary orders
- The Board issued **20** settled disciplinary orders
  - Sanctioning **13** registered firms and **19** associated persons in those proceedings, imposing a total of about **\$1.2 million** in monetary penalties

# Program Statistics for 2018

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- **Two** adjudicated orders were made public during 2018
  - One action of the Securities and Exchange Commission sustaining the Board's Final Decision on appeal of an initial decision of the hearing officer, that had resulted in a censure, bar and a \$50,000 monetary penalty for non-cooperation of an associated person
  - Another action of the Commission vacating its previous action sustaining the Board's findings of violations and imposition of sanctions
    - Resulted from a ruling by the D.C. Circuit Court that an associated person was unlawfully barred from bringing an accounting expert to assist counsel during an investigative interview

# Program Statistics for 2018

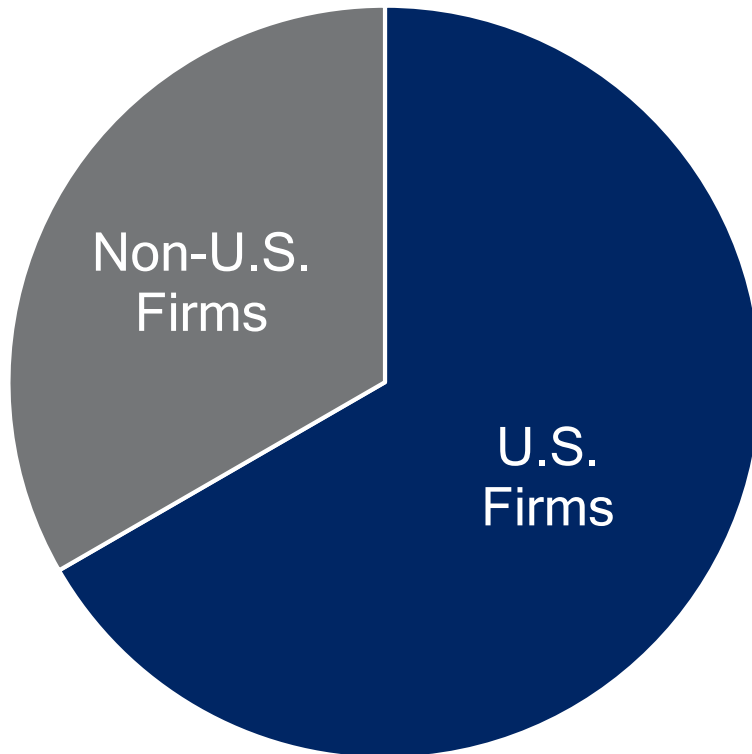
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- Following its initial 2017 settled matters involving violations of Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, the Board settled another matter in 2018:
  - *Tarvaran Askelson & Company, LLP, et al.*
- The Board also imposed sanctions in a matter involving violations of Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*:
  - *Richard J. Girasole, CPA PC, et al.*

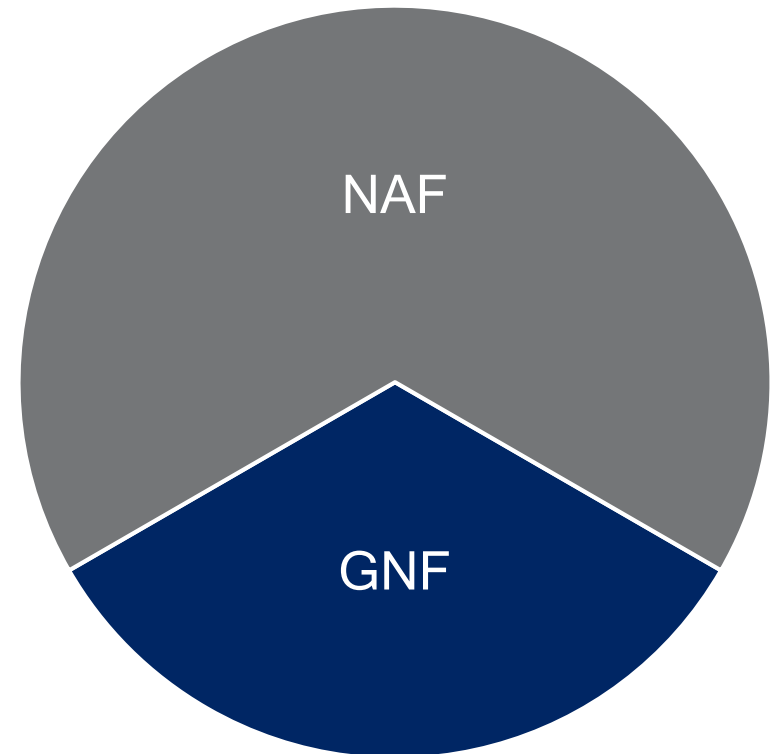
# 2018 Settled Enforcement Actions

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Firm Locality



Firm Type



Highest civil monetary penalty = \$500,000

# Program Outlook

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- 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:
  - Matters relating to deficiencies in firm quality control policies and procedures
  - Audit matters relating to new and evolving issues (e.g., cryptocurrency or cannabis)



# Coordination with the SEC

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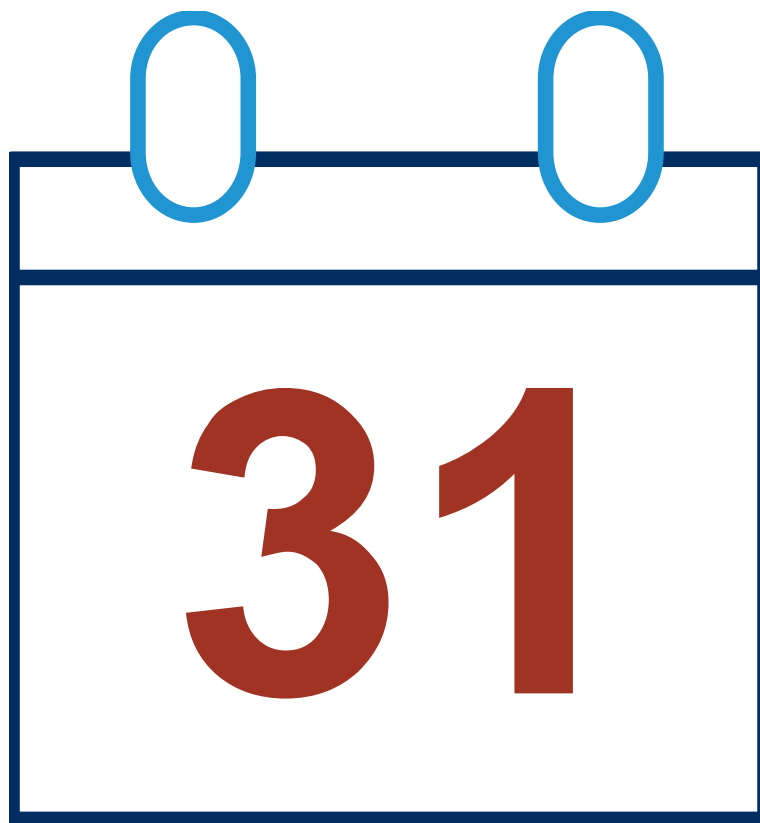


- PCAOB may share information with the SEC, DOJ, and other agencies enumerated in the Act
- Coordination with SEC Enforcement is standard practice
  - Parallel investigations: PCAOB investigates auditor conduct; SEC investigates public company, its management, and others
- PCAOB may defer its investigation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

# Information about Enforcement Matters in Certain Areas

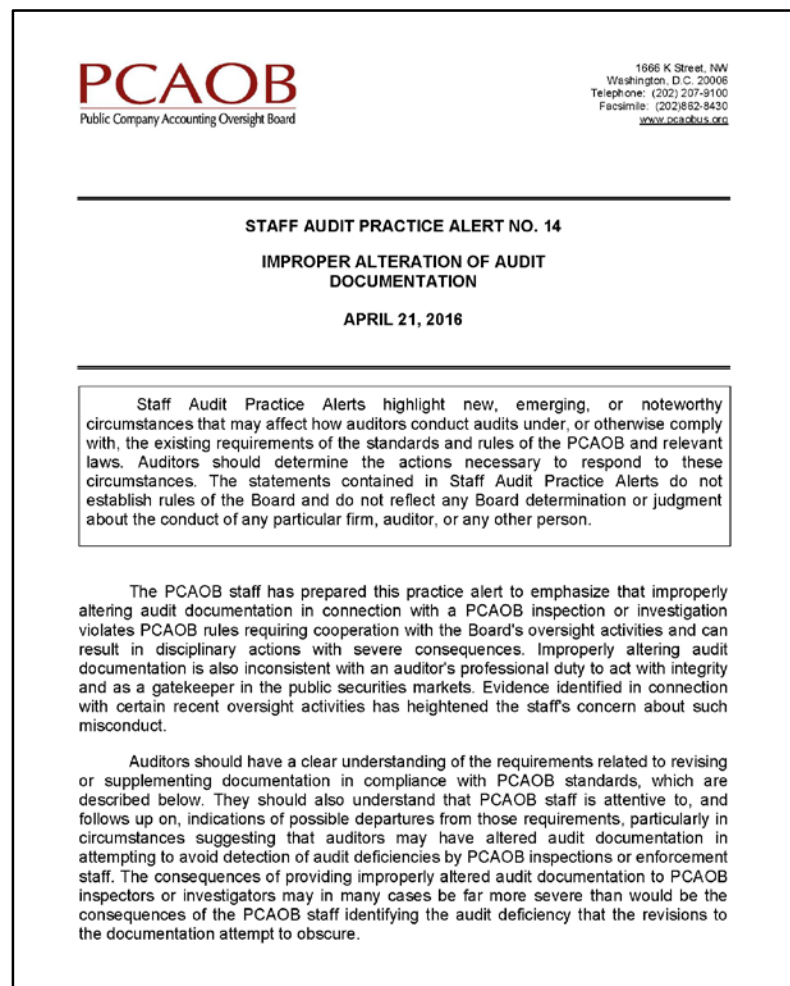
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*Data inception to Dec. 31, 2018, unless otherwise indicated*



# Improper Alteration of Audit Documentation

- Staff Practice Alert No. 14, *Improper Alteration of Audit Documentation*, issued in April, 2016
- 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 relatively recent oversight activities have heightened concerns about this at a range of firms, including global network affiliates
- Consequences of improper alteration, in many cases, are more severe than from the underlying perceived audit deficiency



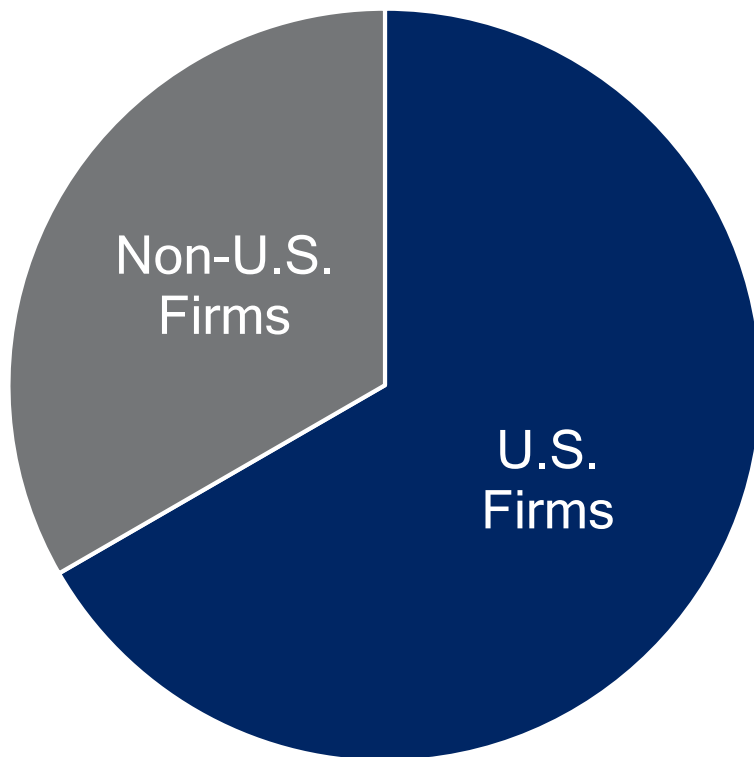
# Interference in Board Processes

- 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
- These matters primarily involve providing improperly altered audit documentation to the Board in its inspections, or enforcement, processes
- These matters can be pursued in isolation, or in conjunction with other auditing standards violations
- The Board has settled or finalized adjudication in **more than 65** non-cooperation matters, involving **more than 90** firms and associated persons

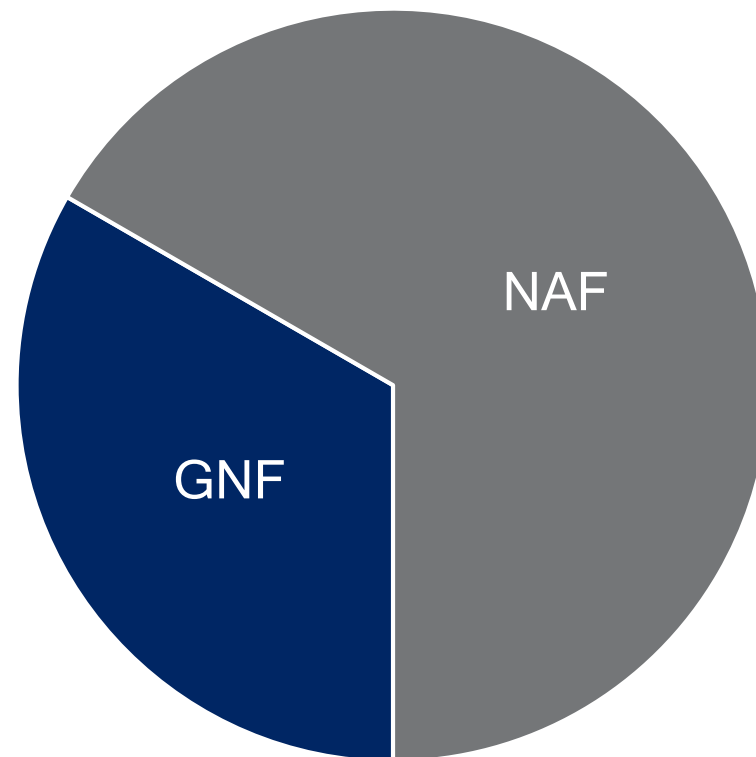


# Interference in Board Processes

Firm Locality



Firm Type



- **Nearly one-half** of the respondents received a **five year** or **permanent** bar or revocation
- **About one-third** also involved other violations of auditing standards in the associated audits

## ***In the Matter of Zhang Hongling CPA, P.C. and Hongling Zhang, CPA – Oct. 2, 2018***

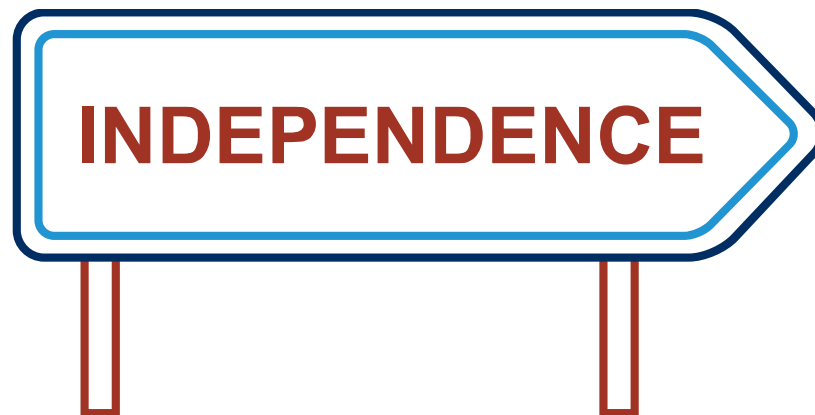
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- During a Board inspection, the inspectors inquired of Zhang whether certain debt cancellation agreements had been executed in connection with a share issuance in the year under audit
- Zhang indicated they existed, but she had not obtained them
- Subsequent to this conversation with the inspectors, and with Zhang's knowledge, the issuer created thirteen debt cancellation agreements, which Zhang then shared with the Board inspectors without disclosing when created
  
- For this, and other audit failures
  - The firm and Zhang were censured
  - Firm's registration was revoked and Zhang was barred, both with the right to reapply after five years
  - \$15,000 civil monetary penalty imposed on the firm

# Independence Matters

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- A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period
  - To be recognized independent, an auditor must be free from any obligation to or interest in the audit client, its management or its owners
- The Board has found independence violations in several areas—*one significant area is violations associated with maintaining the financial records or preparing financial statements for issuers and broker/dealers*



# Independence Matters

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- Since December 2014, the Board has entered into settled orders with certain associated persons for violations associated with maintaining the financial records or preparing financial statements of:
  - Broker-dealer audit clients – **more than 25 orders**
  - Issuer audit clients – **about 10 orders**
- Sanctions included:
  - Firms: censures, civil monetary penalties of \$2,500 – \$20,000, remedial measures, one year prohibitions on new clients
  - Associated Persons: censures, civil monetary penalties of \$2,500 – \$15,000, bars with a right to reapply of typically one or two years
- In 2018, only **one** matter involving independence failures due to preparation of financial statements



# Independence Matters – Sanctionable Conduct

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- 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 the tax provision
  - Provided valuation services

# Independence Matters – Factors in Severity of Sanctions

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- 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

# Other Recent Independence Matters

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- ***In the Matter of Marcum LLP and A.G. Giugliano*** – Sept. 10, 2019
  - The firm was sanctioned for
    - Impairing its independence with respect to 62 issuer audit clients over four years by publicly advocating those clients as high-quality investment opportunities at firm hosted investor conferences
      - This created a mutual interest between the firm and its clients in whether their subsequent performance lived up to the touting
    - Failing to comply with quality control standards to provide reasonable assurance it would maintain independence in all required circumstances
  - Giugliano, *the firm's head of independence*, was sanctioned for substantially contributing to these violations by approving the conferences without considering the independence implications of touting its audit clients presenting at the conferences

## Other Recent Independence Matters (cont'd)

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- ***In the Matter of Marcum LLP and A.G. Giugliano*** – Sept. 10, 2019
  - The firm was censured, received a civil monetary penalty of \$450,000 and is required to engage an independent consultant to review and make recommendations concerning the firm's policies, procedures, staffing and training with respect to auditor independence
  - Giugliano was censured and received a civil monetary penalty of \$25,000
- A parallel settlement, ***In the Matter of Marcum Bernstein and Pinchuk LLP*** – Sept. 10, 2019, was simultaneously entered into with respect to similar independence violations by Marcum LLP's affiliated firm, which resulted in a censure of that firm, a civil monetary penalty of \$50,000 and requirement that the firm review and revise its policies and procedures with respect to auditor independence

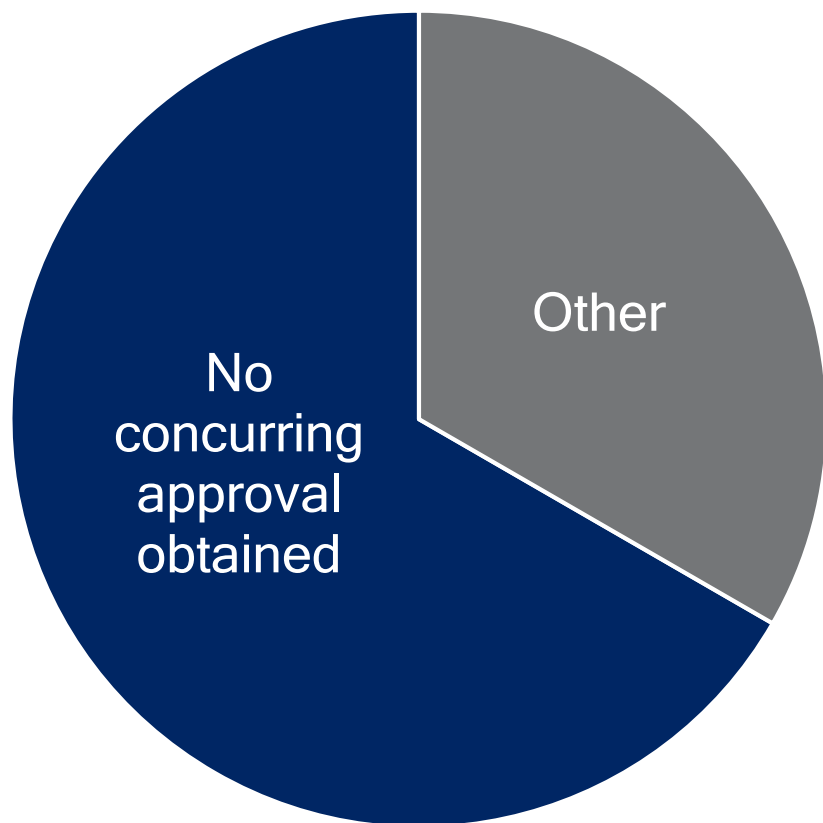
# Engagement Quality Review Matters

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- Engagement quality reviews are required for issuer audits and interim reviews, broker-dealer audits, and examinations/ reviews of broker-dealer compliance/exemption reports
- In 2018 settlements, EQR violations were present where other auditing standard or regulation violations were also present, in some cases
- The Board settled disciplinary orders in 2018 against **18** firms and associated persons for conduct relating to violations of EQR requirements

# Engagement Quality Review Matters – 2018 Settlements

Nature of EQR Violation



- Of the 2018 settlements with EQR violations –
  - **Two-thirds** related to conduct where no concurring approval of an EQR was obtained prior to granting permission to the client to use the firm’s report
  - The **remainder** related to conduct where the Engagement Quality Reviewer violated the mandatory two year “cooling off” period, was unqualified, or failed to exercise appropriate due care

# Certain 2018 EQR Matters

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- **Two** matters in 2018 concerned failures to obtain an EQR for numerous audits in multiple years, which resulted in lengthy bars/revocations and significant civil monetary penalties:
  - ***Shedjama Inc. and Edward Opperman, CPA*** – March 13, 2018
    - Failure to obtain an EQR in 23 broker-dealer audit and attestation engagements in one year, and 30 broker-dealers in another
    - Firm and Opperman were censured
    - Firm's registration was revoked and Opperman was barred, both with the right to reapply after two years
    - \$10,000 civil monetary penalty imposed on the firm

# Certain 2018 EQR Matters

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- **Two** matters in 2018 concerned failures to obtain an EQR for numerous audits in multiple years, which resulted in lengthy bars/revocations and significant civil monetary penalties:
  - ***Breard & Associates, Inc. Certified Public Accountants and Kevin G. Breard, CPA*** – Aug. 9, 2018
    - Failure to obtain an EQR in 135 broker-dealer audit and attestation engagements over a three-year period
    - Firm and Breard were censured
    - Firm's registration was revoked and Breard was barred, both with the right to reapply after five years
    - \$75,000 civil monetary penalty imposed on the firm



# Certain Recent Matters involving Auditing Standards Violations

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- *In the Matter of Deloitte & Touche LLP* – May 23, 2018
- *In the Matter of David S. Friedkin, CPA, and David Scott Friedkin, CPA* – July 12, 2018
- *In the Matter of Crowe MacKay LLP* – Dec. 20, 2018

## *In the Matter of Deloitte & Touche LLP*

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- The firm was sanctioned for missing material accounting errors in three consecutive audits of Jack Henry & Associates
  - Deloitte was primarily responsible for the violations because none of the engagement personnel it assigned to the audits had sufficient software industry experience and knowledge to properly evaluate and audit the accounting for software license revenue
- Jack Henry's accounting errors and audit failures concerning software license sales first came to light during preparations started after notification by the PCAOB that the 2014 Jack Henry audit was to be inspected
  - Ultimately as a result of the errors found, Jack Henry restated its financial statements for 2012, 2013 and 2014, acknowledging that revenue had been prematurely recognized
- Firm was censured, received a civil monetary penalty of \$500,000 and required to undertake certification that it had enhanced its use of industry expertise as part of its quality control processes

## *In the Matter of David S. Friedkin, CPA, et al.*

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- The firm and associated person were sanctioned for failing to obtain sufficient appropriate audit evidence and exercise due professional care and professional skepticism, among other things, including failures:
  - to follow engagement acceptance procedures, as no response to its inquiry of predecessor auditor was received prior to issuance of the audit report
  - to evaluate whether related party transactions had been properly accounted for and disclosed
    - Issuer had terminated a marijuana dispensaries service contract with a related party and entered into a settlement agreement that provided substantial benefits to the related party
  - to obtain written representations from management
- Firm and Friedkin were censured; the firm's registration was revoked and Friedkin was barred, both with the right to reapply after two years

## *In the Matter of Crowe MacKay LLP*

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- The Canadian firm was sanctioned for failing to have appropriate quality control policies and procedures to provide reasonable assurance:
  - that the firm undertakes only those engagement it can reasonably expect to be completed with professional competence
  - that the work performed by the firm met applicable PCAOB and regulatory requirements
- Even though the firm had evidence that one of its audit clients was a U.S. issuer filing its financial statements in a Form 20-F, it failed to recognize that it needed to perform its audit under PCAOB auditing standards
  - For one year, its audit report included in the issuer's filing indicated that it had been prepared in accordance with both Canadian GAAS and PCAOB standards, even though the firm had used ISA standards in its audits
  - In another year, its audit report included in the issuer's filing only indicated that it had been prepared in accordance with Canadian GAAS

## ***In the Matter of Crowe MacKay LLP***

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- Firm was censured, received a civil monetary penalty of \$25,000 and required to undertake to establish, or review and supplement existing, policies and procedures to address its quality control deficiencies

# Certain Recent Matters involving Attestation Standards Violations

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- *Matter of Richard J. Girasole, CPA PC and Richard J. Girasole, CPA – Jun. 13, 2018*
- *Matter of Tarvaran Askelson & Company, LLP, Eric Askelson, and Patrick Tarvaran – Feb. 27, 2018*

# ***In the Matter of Richard J. Girasole, CPA PC, et al.***

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- On June 13, 2018, Board sanctioned the firm and Girasole for violations of auditor independence, AT 2, and AS 1220, among other violations
  - Respondents changed line item amounts and updated footnote disclosures in a broker-dealer audit client's financial statements; and prepared the net capital calculation and exemption report
  - Respondents failed to perform any procedures to identify exceptions to exemption provisions, as required by AT 2
  - Engagement quality reviewer was senior accountant at the firm – not a partner or an equivalent position
- Firm was censured, had its registration revoked with a right to reapply after two years and received \$10,000 civil monetary penalty
- Girasole was censured, and barred with a right to reapply after two years

# ***In the Matter of Tarvaran Askelson & Company, LLP, et al.***

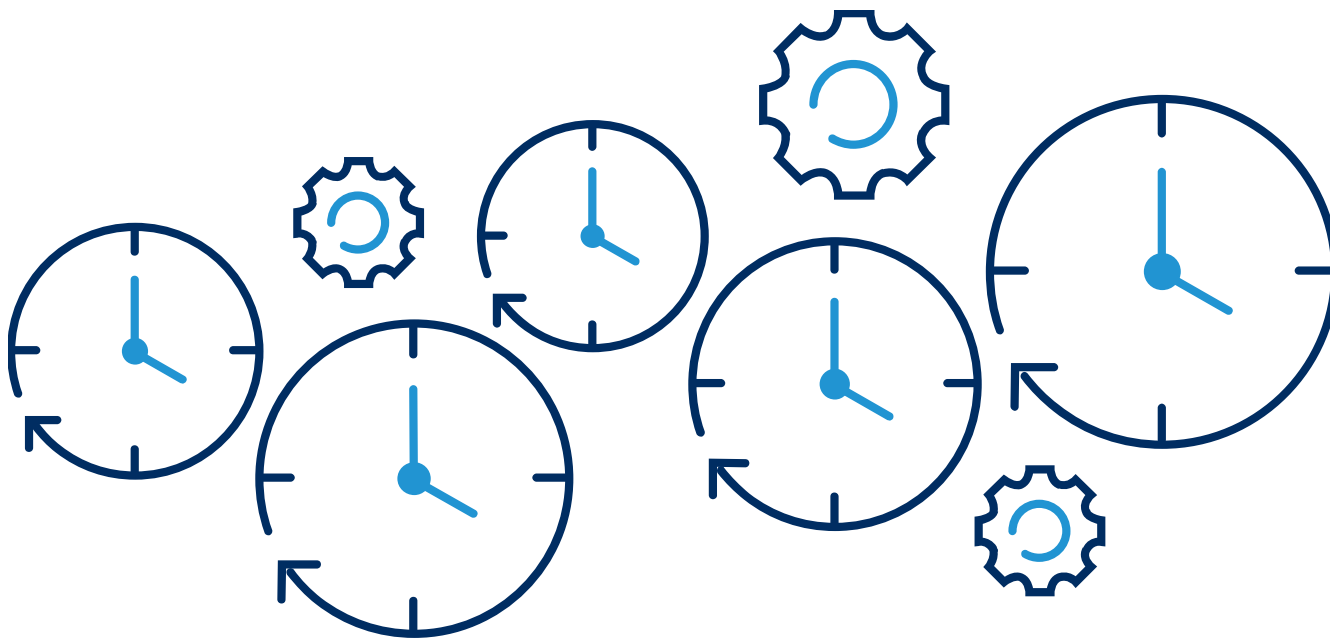
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- On February 27, 2018, Board sanctioned Respondents for violations of AS 2701 and AT 1, among other violations, in connection with an audit of carrying broker-dealer's financial statements and examination of compliance report
  - With respect to customer reserve / net capital, Respondents failed to test information produced by broker-dealer for completeness and accuracy
  - Respondents failed to perform any procedures to test broker-dealer's Internal Control Over Compliance (ICOC)
- Firm was censured, had its registration revoked with a right to reapply after two years and received \$15,000 monetary penalty
- The engagement partner, Askelson, was censured, barred with a right to reapply after two years, and received \$5,000 monetary penalty
- The EQR, Tarvaran, was censured, barred with a right to reapply after one year, and received \$5,000 monetary penalty



# Form AP – Timely Filings

- PCAOB Rule 3211 requires timely filing of Forms AP with the Board:
  - **Within 10 days** after first filing of an audit report in a registration statement with the Securities and Exchange Commission
  - **Within 35 days** after first filing of an audit report in other documents filed with the Commission
- Through Jun 30, 2019, the Board has entered into **two** settlements involving failure to timely file Forms AP



# Form AP – Timely Filings

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- In one matter, the failures to timely file Forms AP were in addition to audit failures involving the performance of the firm's audits
- In the other matter, **WDM Chartered Professional Accountants**, sanctions were imposed on March 19, 2019, solely for untimely filing of Forms AP
  - WDM failed to file an overdue Form AP for an issuer, even after it had been brought to the firm's attention during a Board Inspection, and then failed to file a subsequent Form AP for the following year's audit
  - The firm was censured, received a \$2,500 civil monetary penalty, and agreed to undertake training and review and/or supplement its policies and procedures

# 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



# Extraordinary Cooperation Credit

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- The Board has previously 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 matter, communicating the violation to the client and discussing the conduct and violation at an annual firm training session
- On February 27, 2018, ***In the Matter of Baum & Company, P.A., et al.***, sanctions credit was given for providing substantial assistance by
  - Self-reporting, at the start of the inspection, the improper adding and backdating of audit documentation in anticipation of the inspection
  - Providing a list identifying remembered added or altered documents and describing such changes in general terms

# Terminations of Bars

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- 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 petitioner's request
- Through June 30, 2019, eight individuals have successfully terminated their bars
  - One each in 2009, 2010, 2016 and 2017
  - Three in 2018
  - One through June 30, 2019

# PCAOB Center for Enforcement Tips, Complaints and Other Information

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

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

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

Fax: 202-862-0757

Telephone: 800-741-3158

# Questions

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ENF19



# Poll: How many scholarships did the PCAOB award in 2019?

1. 74
2. 154
3. 207
4. 284



# Poll: How many scholarships did the PCAOB award in 2019?

1. 74

2. 154

**3. 207**

4. 284

**BREAK (15 minutes)**

**SEC19**

# SEC Update

**PCAOB 2019 Forums on  
Auditing in the Small  
Business Environment and on  
Auditing Broker-Dealers**

Jersey City, NJ

October 2, 2019

**Thomas Collens  
Vassilios Karapanos  
Ryan Milne**

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



# Disclaimer

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# Agenda

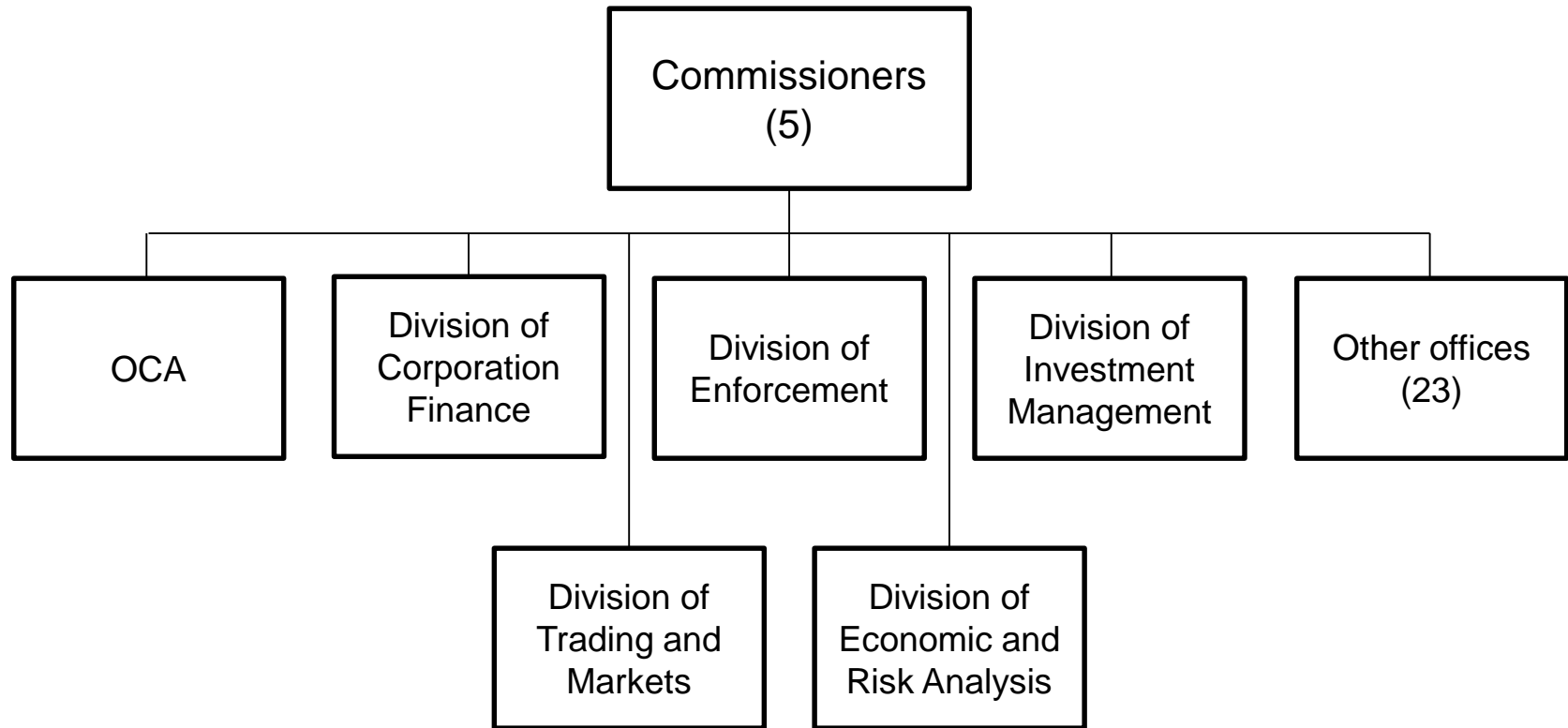
- Commission Overview
- Office of the Chief Accountant (OCA) Overview
- Division of Corporation Finance Overview
- Commission Rulemaking Update
- OCA – Accounting Update
- OCA – Professional Practice Update
  - Audit
  - Auditor Independence

# Commission Overview

# Commission Overview: SEC Commissioners

- Jay Clayton (Chairman) – May 2017
- Robert J. Jackson Jr. – January 2018
- Hester M. Peirce – January 2018
- Elad L. Roisman – September 2018
- Allison Herren Lee – July 2019

# Commission Overview: SEC Structure



Note: Divisions of Corporation Finance, Enforcement, and Investment Management have Chief Accountants



# Office of the Chief Accountant (OCA) - Overview

# OCA Overview: Responsibilities

- Principal adviser to the Commission on accounting and auditing matters
- Rulemaking and interpretive guidance
- Oversight and monitoring of standard setting
- Consultations

# OCA Overview: Main Groups

- Accounting
- Professional Practice
  - Audit
  - Independence
- International
- Office of Chief Counsel and Enforcement Liaison

# Division of Corporation Finance - Overview

# Division of Corporation Finance Overview

- 11 Industry Groups

<https://www.sec.gov/corpfina/Article/contact-us.html>

- Compliance with the Sarbanes-Oxley Act of 2002
- Reviews are focused on compliance with GAAP or IFRS and SEC rules and regulations
- Reviews consider information obtained outside of the filing itself

# Division of Corporation Finance Overview

## Non-GAAP Measures

- Continue to be a staff focus
- Compliance & Disclosure Interpretations revised in May 2016  
<https://www.sec.gov/divisions/corpfin/guidance/nongaaapiinterp.htm>
- Areas of focus:
  - Prominence (Question 102.10)
  - Misleading (Question 100.01)
  - Tailored accounting principles (100.04)
  - Liquidity per share (102.05)

# Commission Rulemaking Update

# Commission Rulemaking Update

- Selected “Reg-Flex Agenda” Items
  - Disclosures of selected financial data, MD&A, and supplementary financial information
- Request for comment on earnings releases and quarterly reports.



# Commission Rulemaking Update

- Proposal stage
  - Accelerated filer definitions
  - Disclosures for registered debt guarantors and issuers of guaranteed securities (Rules 3-10 and 3-16 of Regulation S-X)
  - Financial disclosures about acquired businesses (S-X Rule 3-05)
  - Disclosures of business, legal proceedings, and risk factors (S-K Items 101, 103, and 105)

# Commission Rulemaking Update

- Recently completed
  - Disclosure update and simplification
  - Amendments to implement FAST Act report

# OCA – Accounting Update

# OCA Accounting Update

## New Accounting Standards

- Revenue recognition (2018)
- Leases (2019)
- Credit losses (2020)
- Other new accounting standards

# OCA Accounting Update

## New Accounting Standards

- Cross-functional exercise
- Internal control over financial reporting (ICFR)
- Comparability across industries
- Evaluate specific facts and applicable literature
- Consistency in application of accounting
- Importance of disclosures (including SAB 74)
- Tone at the top/audit committee role

# OCA Accounting Update

## New Accounting Standards – Revenue

- Adopted by a majority of registrants
- Implementation required collaboration by many stakeholders
- Enhanced disclosure requirements are a key element of the new standard
- OCA actively monitoring implementation work and consulted on many revenue topics
- Division of Corporation Finance filing reviews

# OCA Accounting Update

## New Accounting Standards – Revenue

- Recent consultation themes:
  - Identification of performance obligations
  - Principal – agent considerations (i.e., gross vs. net presentation)
- OCA continues to welcome consultations

# OCA Accounting Update

## New Accounting Standards – Leases

- FASB Topic 842 objectives:
  - Transparency – Most lessees will recognize leases on balance sheet
  - Comparability – Enhanced qualitative and quantitative disclosures by lessees and lessors
- Addresses a primary objective of the 2005 SEC staff report on off-balance sheet arrangements\*

\*See: Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers (June 15, 2005)



# OCA Accounting Update

## New Accounting Standards – Leases

- OCA staff has been actively monitoring implementation activities
  - FASB activities supporting transition
  - Engaging in stakeholder dialogue
  - Speeches and consultations on Topic 842 implementation and application questions
- Recent consultation themes
  - Scope
  - Transition
  - Lessee/Lessor costs

# OCA Accounting Update

## New Accounting Standards – Credit losses

- Affects financial and non-financial institutions, including certain lessor receivables
- OCA staff has been actively monitoring implementation activities:
  - FASB/TRG activities supporting transition
    - Proposal to defer effective date for some entities
  - Dialogue with various constituents
  - OCA welcomes consultation

# OCA Accounting Update

## New Accounting Standards – Credit losses

- Many FRR 28 and SAB 102 concepts will remain relevant
  - Procedural discipline
  - Development, documentation, and application of a controlled systematic methodology
  - Data reliability

# OCA Accounting Update

## New Accounting Standards – Other

- Hedging
- Statement of Cash Flows
- Insurance
- Share-based payments (non-employee)

# OCA Accounting Update

## Consultations

Top consultation topics:\*

1. Revenue
2. Financial assets and derivatives
3. Business combinations
4. Consolidations
5. Income taxes and contingencies

\*Fiscal year ended September 30, 2018

# OCA Accounting Update

## Consultations

- LIBOR
- Business combinations
  - Accounting acquirer
  - Common control
  - New definition of a business

# OCA – Professional Practice Update Audit

# OCA Professional Practice Update – Audit Responsibilities

- Assist in Commission oversight of the PCAOB
- ICFR
- Auditing matters
- Other activities
  - Enforcement assistance
  - Rulemaking support



# OCA Professional Practice Update – Audit ICFR

- Importance of ICFR to:
  - Investors
  - Management
  - Audit committees
- Working together – audit committees, auditors, and management
- 404(b) proposal
- New GAAP standards
- Evaluation of control deficiencies

# OCA Professional Practice Update – Audit New Auditing Standards – Critical Audit Matters

- Implementation best practices
  - Importance of planning and communication
  - Engagement-specific and auditor-driven
  - “Dry runs” including discussions with audit committees
- PCAOB and SEC actively supporting implementation efforts
- PCAOB has published six different guidance documents
- Feedback from “dry runs” and filings for which the requirements were effective

# OCA Professional Practice Update – Audit New Auditing Standards – Estimates & Specialists

- Commission approved both standards on July 1, 2019
- PCAOB standard-setting process
- SEC 19b-4 process

# OCA Professional Practice Update – Audit

## New Auditing Standards – Estimates

- Auditing accounting estimates has consistently been one of the top three PCAOB inspection findings
- Single uniform risk-based updated standard replaced three standards
- Provides better expectations and clarity on what is expected of auditors related to data, significant assumptions, and the methods used in the estimates
- Provides an appendix to specifically address certain aspects related to auditing fair value of financial instruments especially when pricing comes from a third-party source

# OCA Professional Practice Update – Audit

## New Auditing Standards – Specialists

- The amendments provide separate requirements for auditors use of:
  - Company specialist
  - Auditor-employed specialist
  - Auditor-engaged specialist
- Applies a supervision approach to both auditor-employed and auditor-engaged specialists
- Amendments are meant to be risk-based and scalable by focusing the work effort to be commensurate with risk of material misstatement

# OCA Professional Practice Update – Audit Standard-Setting Projects

- Quality Control
  - In August 2019, project was moved from the research agenda to the standard-setting agenda
  - PCAOB staff is considering whether revisions to the quality control standards will drive improvement in the quality of audit services
  - PCAOB staff is monitoring IAASB developments in this area
  - PCAOB staff developing a concept release for the Board's consideration

# OCA – Professional Practice Update

## Auditor Independence

# Auditor Independence

- Overview of OCA Activities and Consultation Process
- Rule 2-01(b) and 2-01(c)
- Areas of Focus
- Audits of Brokers and Dealers
- Loan Rule
- Independence FAQs
- Key Resources



# Auditor Independence

## Overview of OCA Activities

- Scope includes 1933 & 1934 Act filers, registered investment companies (RICs), Unregistered Funds, Brokers and Dealers
- Informal & formal consults and interpretive questions
  - Formal submissions generally result in more substantive staff feedback
- Team consults with others at the SEC as appropriate (e.g., Division of Corporation Finance, Investment Management, and Trading and Markets).
- Other divisions, including the Division of Enforcement, also consult with us on independence matters coming to their attention.

# Auditor Independence

## Consultation Process

- Guidance can be found on the OCA webpage:  
<https://www.sec.gov/page/oqa-auditor-independence-matters#>
- Helpful tips for consultations:
  - Provide clear and detailed information regarding the specific facts and circumstances
  - Provide company, audit committee, and audit firm analysis and conclusions considering SEC and PCAOB rules
  - Highlight timing considerations at the beginning
  - Be clear re: what is being asked of the SEC staff

# Auditor Independence

## Key Points

- Shared responsibility
  - Audit committees of listed issuers are directly responsible for the appointment, compensation, and oversight of auditors
- Majority of consultations are from audit firms
  - Expanding range of matters submitted for consultation (e.g., partner rotation, bookkeeping/financial statement preparation, other non-audit services)

# Auditor Independence

## Rule 2-01

- The General Standard, Rule 2-01(b)
  - The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.

# Auditor Independence

## Rule 2-01

- *Four principles:* As a starting point, consider whether a relationship or the provision of a service:
  - Creates a mutual or conflicting interest between the accountant and the audit client;
  - Places the accountant in the position of auditing his or her own work;
  - Results in the accountant acting as management or an employee of the audit client; or
  - Places the accountant in a position of being an advocate for the audit client

# Auditor Independence

## Rule 2-01

- Rule 2-01(c) specifically addresses:
  1. Financial relationships
  2. Employment relationships
  3. Business relationships
  4. Non-audit services
  5. Contingent fees
  6. Partner rotation
  7. Audit committee administration of the engagement
  8. Compensation

# Auditor Independence

## Areas of Focus – Non-Audit Services

1. Bookkeeping
2. Financial information systems design and implementation
3. Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
4. Actuarial services
5. Internal audit outsourcing services
6. Management functions
7. Human resources
8. Broker-dealer, investment adviser, or investment banking services
9. Legal services
10. Expert services unrelated to the audit

# Auditor Independence

## Areas of Focus – Non-Audit Services

- Examples of prohibited services:
- Financial statement preparation - Includes typing, word processing services, or any other administrative support related to the production of the financial statements
- Templates - Includes any templates used, for example, to calculate amounts to support journal entries or to be presented or disclosed in financial statements or footnotes.



# Auditor Independence

## Audits of Brokers and Dealers

- Auditors of both issuer and non-issuer broker-dealers are required to be qualified and independent in accordance with Rule 2-01
- Certain PCAOB independence rules also apply
- Key points:
  - Auditors and those charged with governance of a broker-dealer should assess the impact of an independence violation
  - The SEC staff consultation process is available to broker-dealers and their auditors

# Auditor Independence

## Audits of Brokers and Dealers

- Auditors of non-issuer brokers-dealers are not subject to SEC rules related to:
  - Partner rotation
  - Certain partner compensation arrangements
  - Audit committee administration
  - “Cooling off” period (under employment relationships)

# Auditor Independence

## Auditor Independence with Respect to Loans or Debtor-Creditor Relationships (“Loan Rule”)

- Adopted in June 2019, effective October 3, 2019
  - informal option to early adopt.
- The final amendments:
  - focus the analysis on beneficial ownership;
  - replace the existing 10% bright-line shareholder ownership test with a “significant influence” test;
  - add a “known through reasonable inquiry” standard;
  - amend the definition of “audit client” for a fund under audit to exclude from the provision funds that otherwise would be considered affiliates of the audit client.

# Auditor Independence

## Auditor Independence with Respect to Loans or Debtor-Creditor Relationships (“Loan Rule”)

- Broad applicability - applies broadly to entities beyond the investment management industry, including operating companies and registered broker-dealers.
- Evaluating “significant influence”:
  - Refers to the principles in FASB ASC Topic 323.
  - In the fund context, the operating and financial policies relevant to the significant influence test would include the fund’s investment policies and day-to-day portfolio management processes.

# Auditor Independence

## Staff Frequently-Asked Questions (FAQs)

- Posted revised FAQs on June 27, 2019:  
<https://www.sec.gov/info/accountants/ocafaqaudind080607.htm>
- Purpose of the FAQ updates:
  - Change the flow to match the structure of the Independence Rules to make it easier to find FAQs that relate to specific topics;
  - Remove transition FAQs as they were no longer needed;
  - Make reference and other minor updates; and
  - Add ten new FAQs and make substantive changes to certain existing FAQs principally based on our consultation trends since the last update.

# Auditor Independence

## Key Resources

- Rule 2-01 of Regulation S-X:  
[https://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:3.0.1.1.8&rgn=div5#se17.3.210\\_12\\_601](https://www.ecfr.gov/cgi-bin/text-idx?SID=8e0ed509ccc65e983f9eca72ceb26753&node=17:3.0.1.1.8&rgn=div5#se17.3.210_12_601)
- SEC Release (2003) - Strengthening the Commission's Requirements Regarding Auditor Independence  
<https://www.sec.gov/rules/final/33-8183.htm>
- SEC Release (2000) - Revision of the Commission's Auditor Independence Requirements  
<https://www.sec.gov/rules/final/33-7919.htm>
- SEC staff - Auditor Independence FAQ's - see prior slide
- Loan Rule Release - <https://www.sec.gov/rules/final/2019/33-10648.pdf>

**SEC19**

Questions?

# Q&A and Closing Remarks

*All presenters*



# Closing Remarks

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- Evaluations
- CPE submission

# Small Business and Broker-Dealer Auditor Forum

*October 2-3, 2019*  
*Jersey City, NJ*

# **Welcome – October 3, 2019**

*Kent Bonham, Office of External Affairs*

# Disclaimer

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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 Objectives

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- 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.
- On September 25, the morning session, intended for issuer auditors, features a panel discussion on the new auditor's report, including critical audit matters. Separately, PCAOB staff from the Division of Registration and Inspections will facilitate a case study, focusing on inventory, and will also discuss recent inspection findings.
- The afternoon session on September 25, intended for issuer and broker-dealer auditors, features updates from the PCAOB's Standards and Enforcement groups. In addition, staff from the Securities and Exchange Commission's Office of the Chief Accountant will join us to provide an update on SEC activities.
- On September 26, presentations for auditors of broker-dealers include a multi-topic panel discussion, an overview of inspection findings, and case studies facilitated by DRI staff covering auditing of revenue, audit sampling, and review procedures for broker-dealers with various lines of business. In addition, staff from FINRA will provide an update and cover various topics of current interest.

# Course Description

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The PCAOB Small Business and Broker-Dealer Forum is a 1.5 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 Information Hub

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<https://pcaobext.cnf.io>

Used for:

- Polling
- Q&A
- Session and Course Evaluations
- CPE

# Contact the PCAOB

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## ***Contact Link***

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

## ***General Information***

[info@pcaobus.org](mailto:info@pcaobus.org) **OR** [outreach@pcaobus.org](mailto:outreach@pcaobus.org)



# Stay Connected

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Stay up-to-date on current PCAOB activities (including announcements about future forums) by signing up for our email list or following us on social media.

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



<https://www.facebook.com/PublicCompanyAccountingOversightBoard/>



<https://www.linkedin.com/company/pcaob>



[https://twitter.com/PCAOB\\_News](https://twitter.com/PCAOB_News)

# **Panel: Broker-Dealer Auditor Oversight: Overview and Current Topics**

*Kent Bonham, Office of External Affairs*

*Greg MacCune, Division of Registration and Inspections*

*Kate Ostasiewski, Division of Registration and Inspections*

*Mike Walters, Division of Registration and Inspections*

# How We Got Here

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- 2002 – Sarbanes-Oxley Act
- 2008 – Expiration of SEC waiver from PCAOB registration for auditors of non-public broker-dealers
- 2010 – Dodd Frank Wall Street Reform and Consumer Protection Act
- 2011 – PCAOB adopts Rule 4020T, *Interim Inspection Program Related to Audits of Brokers and Dealers*, and inspections begin in the fourth quarter
- 2013 – SEC adopts amendments to Rule 17a-5 and Financial Responsibility Rules
- 2013 – PCAOB adopts AT No.1 and AT No. 2
- 2014 – PCAOB standards required for audits and attestation engagements and broker-dealers required to file Compliance or Exemption Reports (fiscal years ended on or after June 1)

# Poll: Which option best describes your firm?

1. My firm audits Exemption Report and Compliance Report filers
2. My firm audits Exemption Report filers only
3. My firm audits Compliance Report filers only
4. My firm audits issuers, but does not audit broker-dealers
5. My firm does not audit issuers or broker-dealers

# System of Quality Control

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The quality control policies and procedures applicable to a firm's accounting and auditing practice should encompass the following elements:

- Independence, Integrity, and Objectivity
- Personnel Management
- Acceptance and Continuance of Clients and Engagements
- Engagement Performance
- Monitoring

# **Poll: Which element of quality control do you view as the strongest at your firm?**

1. Independence, Integrity, and Objectivity
2. Personnel Management
3. Acceptance and Continuance of Clients and Engagements
4. Engagement Performance
5. Monitoring

# Audit Materiality

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Materiality affects each phase of the audit:

- Planning and Risk Assessment
- Execution
- Evaluating Audit Results

# **Poll: Which of the following have you most frequently used as a benchmark when establishing materiality for broker-dealer audits?**

1. Revenues
2. Net Income
3. Assets
4. Net Capital
5. Excess Net Capital
6. Something Else



# Internal Controls

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- Management review controls
- Controls-reliance strategies

# **Poll: Which of the following technologies have you encountered in broker-dealer audits?**

1. Distributed Ledger Technology Applications (such as cryptocurrencies)
2. Web-Based Applications
3. Robotic Process Automation
4. All of the above
5. None of the above

# Emerging Technologies

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Consider the following questions as you encounter emerging technologies:

- Have you performed an appropriate risk assessment?
- Do you have the right people?
- Do you understand the audit evidence you need?

# SEC FAQ Concerning Rule 17a-5

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Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule:

*“The broker-dealer’s exemption report should fully reflect the nature of all of its business activities. It is common for both of the exemption provisions in paragraph (k)(2) of Rule 15c3-3 to apply to the business activities of an introducing broker-dealer. In such cases, the broker-dealer should reflect both exemption provisions supporting its claim of exemption in the exemption report, and should also identify any applicable exceptions under each.”*

(Updated November 29, 2018)

# Poll: Which of the following best describes your broker-dealer client base?

1. Broker-dealers that have included more than one exemptive provision in their Exemption Report
2. Broker-dealers that have filed Exemption Reports without specifying a provision under paragraph (k) of Rule 15c3-3
3. Both 1 and 2
4. Neither 1 nor 2

# Questions

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**BDPN19**



# Inspections Update

*Alan Kerwin, Division of Registration and Inspections*

*Greg MacCune, Division of Registration and Inspections*

*Kate Ostasiewski, Division of Registration and Inspections*

*Mike Walters, Division of Registration and Inspections*

# Agenda

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- Inspection Program Overview
- 2019 Inspections
- 2018 Inspection Results
  - Overview
  - System of Quality Control
  - Review Engagements (AT No. 2)
  - Audit Engagements
- Actions for Auditors



# Inspection Program Overview

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- 2002 – Sarbanes-Oxley Act
- 2008 – Expiration of SEC waiver from PCAOB registration for auditors of non-public broker-dealers
- 2010 – Dodd Frank Wall Street Reform and Consumer Protection Act
- 2011 – PCAOB adopts Rule 4020T, *Interim Inspection Program Related to Audits of Brokers and Dealers*, and inspections begin in the fourth quarter
- 2013 – SEC adopts amendments to Rule 17a-5 and Financial Responsibility Rules
- 2013 – PCAOB adopts AT No.1 and AT No. 2
- 2014 – PCAOB standards required for audits and attestation engagements and broker-dealers required to file Compliance or Exemption Reports (fiscal years ended on or after June 1)

# Inspection Program Objectives

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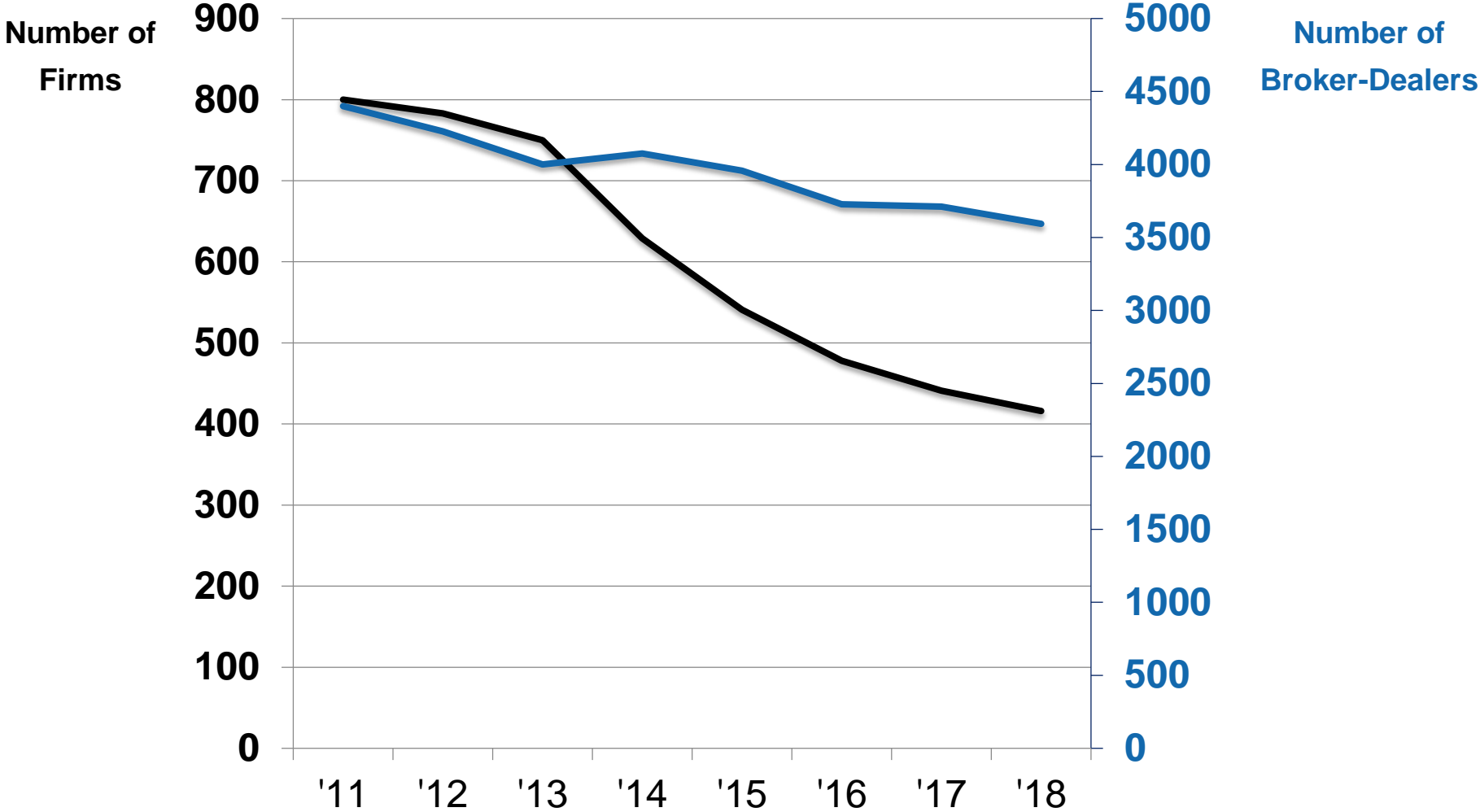
- Assess compliance with applicable Board and Commission rules and PCAOB standards
- Help inform the Board's eventual determinations about the scope and elements of a permanent inspection program
- Assist in the development of the approach to inspections under a permanent inspection program

# PCAOB Webpage for Auditors of Broker-Dealers

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- Information for Auditors of Broker-Dealers:  
<https://pcaobus.org/Pages/BrokerDealers.aspx>
- Annual Report on Inspections of Broker-Dealer Auditors during 2018
- Inspection Program Background
- Useful Links
  - Previous Annual Reports and Staff Inspection Briefs
  - Standards and Staff Guidance
  - Other Releases and Guidance
  - Enforcement, Including Recent Settled Orders
  - Outreach, Including Forums and Webinars

# Firms Auditing Broker-Dealers and Number of Broker-Dealers



Source: PCAOB Office of Economic and Risk Analysis

# Firms Auditing Broker-Dealers

<b>Broker-Dealer Audits per Firm</b>	<b>Number of Firms - 2018</b>	<b>Percentage of Firms - 2018</b>	<b>Number of Firms - 2012</b>	<b>Percentage of Firms - 2012</b>
1	128	31%	363	46%
2 to 20	247	59%	383	49%
21 to 50	26	6%	23	3%
51 to 100	11	3%	8	1%
More than 100	4	1%	6	1%
<b>Total</b>	<b>416</b>	<b>100%</b>	<b>783</b>	<b>100%</b>

*Source: PCAOB Office of Economic and Risk Analysis*

# 2019 Inspections

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- Firm quality control procedures
- Audits of the financial statements and supporting schedules, required to be performed in accordance with PCAOB standards
- Examination and review engagements, required to be performed in accordance with PCAOB standards

# Inspection Results

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- Not necessarily indicative of the full population of firms, or of all audit and attestation engagements of brokers and dealers
- The selection of firms for inspection and the audit and attestation engagements for brokers and dealers covered by the inspections are not necessarily representative of these populations

# **Poll: Have you read the most recent Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, issued August 20, 2019?**

1. Yes
2. No



# 2018 Inspections By the Numbers

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<b>2018 Inspections By the Numbers</b>	
67	Firms inspected
3	with no deficiencies
105	Audit engagements
25	with no audit deficiencies
55	with audit and attestation deficiencies
25	with audit deficiencies, but no attestation deficiencies
24	Examination engagements
6	with no deficiencies
79	Review engagements
36	with no deficiencies

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019*

# Systems of Quality Control

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- Engagement Performance
  - Audit Methodology
  - Engagement Quality Review
  - Auditor's Report
  - Audit Documentation
- Monitoring

# Summary of Findings and Deficiencies – 2018

Percentage of				
Audits with Independence Findings	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
5%	76%	32%	75%	54%

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019*

# Audits per Firm – Cumulative\* Deficiencies

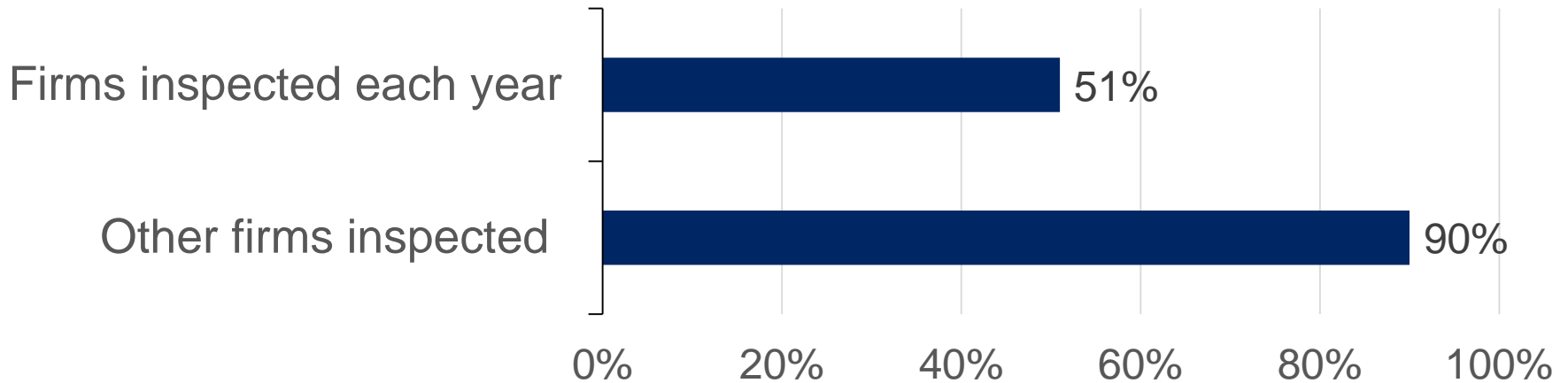
Number of Broker-Dealer Audits per Firm	Percentage of			
	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
1	90%	54%	100%	69%
2 to 20	94%	45%	93%	61%
21 to 50	72%	31%	100%	32%
51 to 100	78%	35%	100%	35%
More than 100	55%	14%	55%	19%

\* Includes inspections conducted 2014 - 2018 that covered engagements required to be performed in accordance with PCAOB standards.

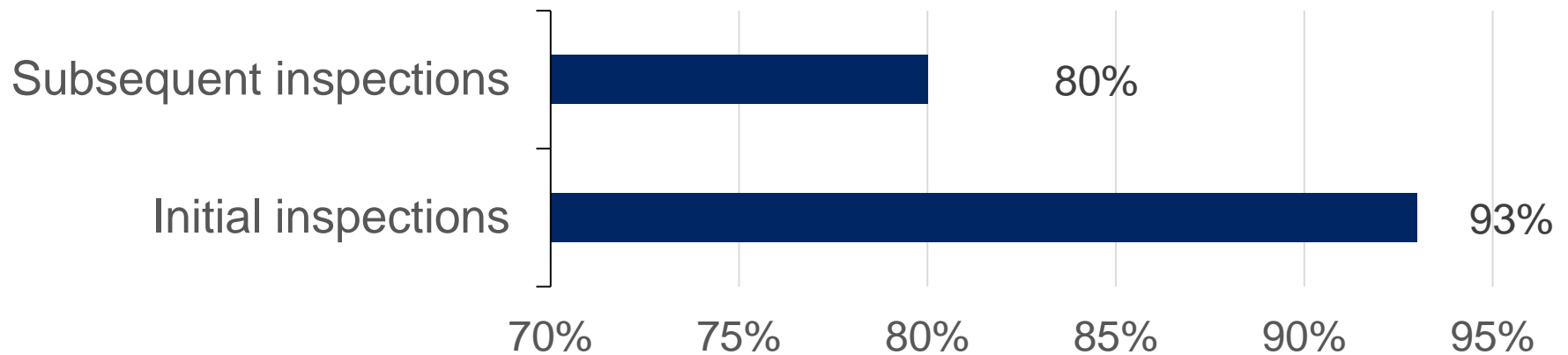
*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019*

# Inspection Frequency – 2015 through 2018

## Percentage of 2018 Audits with Deficiencies



## Audit Deficiency Percentage for Firms Inspected Twice



Sources: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019 and 2018 inspection results.

# Attestation, Audit, and Other Deficiencies

Deficiencies	Applicable Engagements with Deficiencies	
	Number	Percentage
<b>Deficiencies in Attestation Procedures</b>		
Examination Engagements	18	75%
Review Engagements	40	51%
<b>Deficiencies in Auditing Supporting Schedules</b>		
Net Capital Rule	19	29%
Customer Protection Rule	9	36%
<b>Deficiencies in Auditing Financial Statements</b>		
Revenue	60	60%
Risks of Material Misstatement Due to Fraud	8	47%
Related Party Relationships and Transactions	21	45%
Financial Statement Presentation and Disclosures	38	36%
Receivables and Payables	6	21%
Fair Value Measurements	3	14%

*Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019*

# Attestation, Audit, and Other Deficiencies

Deficiencies	Applicable Engagements with Deficiencies	
	Number	Percentage
<b>Deficiencies in Auditor's Report</b>		
Auditor's Report on the Financial Statements and Supporting Schedules	19	18%
<b>Deficiencies in Auditor Communications</b>		
Communications to the Audit Committee (or equivalent)	9	18%
Communications about Control Deficiencies	4	4%
<b>Deficiencies in Documentation</b>		
Audit Documentation	26	25%
Examination Documentation	0	0%
Review Documentation	13	16%
<b>Deficiencies in Engagement Quality Reviews</b>		
Audit Engagements	54	65%
Examination Engagements	5	26%
Review Engagements	22	43%

Source: Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers, August 20, 2019

# Revenue

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- Risk Assessment Procedures
- Extent of Testing
- Substantive Analytical Procedures
- Information about Controls at the Broker-Dealer's Service Organization
- Information Produced by the Broker-Dealer or the Broker-Dealer's Service Organization
- Other Procedures to Test Revenue



# Review Engagements

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- An Understanding of Exemption Provisions
- Inquiries of Management
- Evaluation of Evidence
- Evaluation of Results
- Management Representations
- Auditor's Review Report

# Financial Statement Presentation and Disclosures

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- Financial Statement Presentation
- Related Party Disclosures
- Going Concern Disclosures
- Revenue Recognition Policy Disclosures
- Risks and Uncertainties Disclosures
- Fair Value Disclosures

# Supporting Schedules - Net Capital Rule

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- Minimum Net Capital Requirements
- Adjustments to Net Worth
- Allowable Assets and Assets not Readily Convertible into Cash
- Haircuts for Securities Positions
- Operational Charges and Other Deductions
- Securities Classified as Marketable

# Related Party Relationships and Transactions

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- Risk Assessment Procedures
- Audit Responses to Risks of Material Misstatement
- Evaluation of the Broker-Dealer's Identification of Related Parties and Relationships and Transactions with Related Parties

# Engagement Quality Reviews

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- Reviews were not performed
- Qualifications for reviewers
- Evaluation of the engagement team's significant judgments and conclusions

# Actions for Auditors

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- Improving Systems of Quality Control
- Understanding of PCAOB Standards
- Testing Internal Controls

# Questions

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**BDIN19**



**BREAK (15 minutes)**





# FINRA Perspectives

PCAOB Forum

Ann Duguid, Senior Director - Member  
Supervision

Anthony Vinci, Director – Member Supervision  
10/03/2019

**FINR19**

## AGENDA

- 01 | Update on Regulatory Notices
- 02 | FINRA Risk Monitoring & Examination Priorities
- 03 | FINRA Risk Monitoring & Examination Observations

## Update on Regulatory Notices

- **Regulatory Notice 19-11:** FINRA Announces Update of the Interpretations of Financial and Operational Rules (Backstop Agreements)
- **Regulatory Notice 19-08:** Guidance on FOCUS Reporting for Operating Leases
- **Regulatory Notice 19-05:** FINRA Extends Effective Date of Margin Requirements for Covered Agency Transactions
- **Regulatory Notice 19-02:** FINRA Updates Supplemental Statement of Income
- **Regulatory Notice 18-38:** Amendments to the SEC's Financial Reporting Requirements- eFOCUS System Updates and Annual Audit Requirements
- **Regulatory Notice 18-31:** SEC Staff Issues Guidance on Third-Party Recordkeeping Services

# FOCUS Change Illustration

- Form FOCUS Part II – Balance Sheet

<u>Ownership Equity</u>			
27. Sole proprietorship .....		\$ _____	1770
28. Partnership - limited partners .....	\$ _____	1020	1780
29. Corporation:			
A. Preferred stock .....			1791
B. Common stock .....			1792
C. Additional paid- in capital .....			1793
D. Retained Earnings .....			1794
E. Accumulated other comprehensive income .....			1797
F. Total .....			1795
G. Less capital stock in treasury .....		( _____ )	1796
30. TOTAL OWNERSHIP EQUITY .....		\$ _____	1800
31. TOTAL LIABILITIES AND OWNERSHIP EQUITY .....		\$ _____	1810

OMIT PENNIES

# FOCUS Change Illustration

- Form FOCUS Part II – Statement of Income

<b>STATEMENT OF INCOME (LOSS) or STATEMENT OF COMPREHENSIVE INCOME</b>	
<b>(as defined in §210.1-02 of Regulation S-X), as applicable</b>	
<b>NET INCOME/COMPREHENSIVE INCOME</b>	
29. Income (loss) before Federal income taxes and items below (Item 12 less Item 28)	\$ 4210
30. Provision for Federal Income taxes (for parent only)	4220
31. Equity in earnings (losses) of unconsolidated subsidiaries not included above	4222
a. After Federal income taxes of	4238
32. [RESERVED]	
a. [RESERVED]	
33. [RESERVED]	
34. Net income (loss) after Federal income taxes	\$ 4230
35. Other comprehensive income (loss)	4226
a. After Federal income taxes of	4227
36. Comprehensive income (loss)	\$ 4228
<b>MONTHLY INCOME</b>	
37. Income (current month only) before provision for Federal income taxes	\$ 4211

# SSOI Change Illustration

- Form SSOI

**NET INCOME/COMPREHENSIVE INCOME**

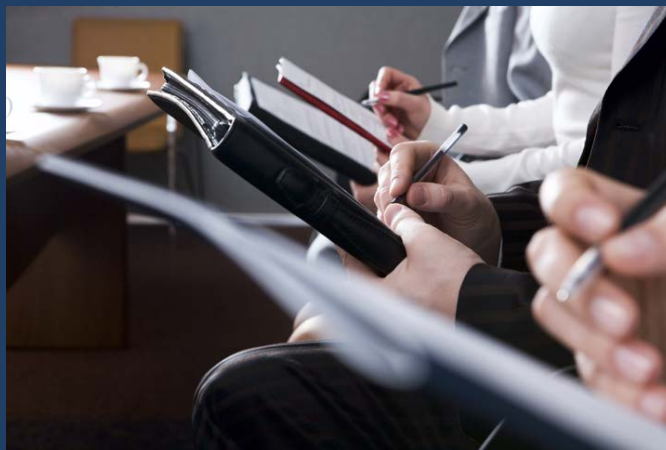
19. Net Income/Comprehensive Income			
A. Income (loss) before Federal income taxes and items below	.....	\$ _____	14210
B. Provision for Federal income taxes (for parent only)	.....	\$ _____	14220
C. Equity in earnings (losses) of unconsolidated subsidiaries not included above	.....	\$ _____	14222
D. Net income (loss) after Federal income taxes	.....	\$ _____	14230
E. Other comprehensive income (loss)	.....	\$ _____	14226
F. Comprehensive income (loss)	.....	\$ _____	14228

## Other Resources

- **FAQ Concerning the July 30, 2013 Amendments to the Broker-Dealer Financial Reporting Rule**  
Division of Trading and Markets  
(Updated November 29, 2018)
- **ASC 606: Revenue from Contract with Customers**  
Division of Trading and Markets No-Action Letter  
(January 4, 2018)
- **Lease Accounting**  
Division of Trading and Markets No-Action Letter  
(October 23, 2018)

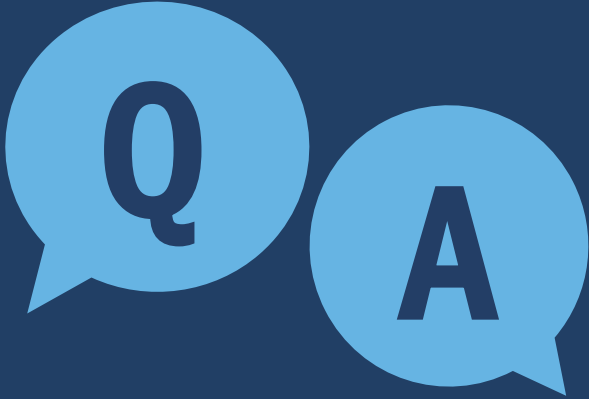
# FINRA Risk Monitoring & Examinations

- FINRA Risk Monitoring & Exam Priorities
- FINRA Risk Monitoring & Examination Observations





**FINR19**



# Case Studies

*Greg MacCune, Division of Registration and Inspections*  
*Kate Ostasiewski, Division of Registration and Inspections*  
*Mike Walters, Division of Registration and Inspections*

# Auditing Revenue

# Revenue Recognition – ASC 606

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**Step 1:**

Identify the contract(s) with a customer

**Step 2:**

Identify the performance obligations in the contract

**Step 3:**

Determine the transaction price

**Step 4:**

Allocate the transaction price to the performance obligations

**Step 5:**

Recognize revenue when (or as) each performance obligation is satisfied

## **Poll: The accounting for which of the following was NOT affected by ASC 606?**

1. Interest and dividend income from financial instruments owned
2. Interest income from reverse repos and securities borrowed
3. Proprietary trading income
4. All of the above
5. None of the above

# Poll: The accounting for which of the following was NOT affected by ASC 606?

1. Interest and dividend income from financial instruments owned
2. Interest income from reverse repos and securities borrowed
3. Proprietary trading income
- 4. All of the above**
5. None of the above

# Auditing Revenue - Case Study Facts

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- Broker-dealer provides advisory services related to mergers and acquisitions
- Contracts with customers include success fees and nonrefundable retainer fees; the retainer fees are payable at execution, and credited to success fees (if any)
- Engagement team assessed improper revenue recognition to be a fraud risk
- Engagement team procedures included reviewing a sample of customer contracts and obtaining an understanding of (1) the services to be provided and (2) the broker-dealer's compensation. In addition:
  - For success fees, obtaining evidence that the merger or acquisition closed, and vouching payments received
  - For retainer fees, reviewing invoices and vouching payments received

# **Poll: The engagement team's procedures for success fees provide sufficient evidence regarding which of the following?**

1. Completeness
2. Cutoff
3. Occurrence
4. Valuation or Allocation
5. Presentation & Disclosure



# Poll: The engagement team's procedures for success fees provide sufficient evidence regarding which of the following?

1. Completeness

2. Cutoff

**3. Occurrence**

4. Valuation or Allocation

5. Presentation & Disclosure

**Poll: For retainer fees, in addition to reviewing invoices and vouching payments received, the engagement team compared the invoiced amounts to the customer's contract with the broker-dealer. When evaluating the broker-dealer's recognition of the retainer fees, the engagement team should also evaluate the broker-dealer's consideration of which of the following?**

1. The performance obligation(s) in the contract
2. Whether the criteria for over time recognition has been met
3. Whether the customer simultaneously receives and consumes the benefits provided by the broker-dealer as the broker-dealer performs
4. All of the above

**Poll: For retainer fees, in addition to reviewing invoices and vouching payments received, the engagement team compared the invoiced amounts to the customer's contract with the broker-dealer. When evaluating the broker-dealer's recognition of the retainer fees, the engagement team should also evaluate the broker-dealer's consideration of which of the following?**

1. The performance obligation(s) in the contract
2. Whether the criteria for over time recognition has been met
3. Whether the customer simultaneously receives and consumes the benefits provided by the broker-dealer as the broker-dealer performs
- 4. All of the above**

# **Poll: Which of the following is a required disclosure under ASC 606?**

1. Revenue recognized from contracts with customers
2. Disaggregation of revenue
3. Information about performance obligations
4. Significant judgments in applying ASC 606
5. All of the above

# Poll: Which of the following is a required disclosure under ASC 606?

1. Revenue recognized from contracts with customers
2. Disaggregation of revenue
3. Information about performance obligations
4. Significant judgments in applying ASC 606
- 5. All of the above**

# Auditing Revenue – Example of Effective Procedures

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Auditors should perform procedures to assess whether revenue has been reported at the proper amount. A broker-dealer earns asset management fees based on the value of each customer's account holdings. After assessing the risks of material misstatement, the auditor performed procedures to test the occurrence and completeness of revenue transactions. The auditor also performed procedures to test the valuation of revenue by testing the completeness and accuracy of customer account holdings and the accuracy of the management fee rates that the broker-dealer used to determine the amount of revenue reported.

*Note: The example provides a brief scenario and related example of procedures that may be effective, depending on facts and circumstances, but do not modify or establish auditing or attestation standards. These procedures are not contemplated in isolation but rather in combination with other relevant procedures.*

# Audit Sampling

# **Poll: What factors should an auditor consider in determining an appropriate sample size for a substantive test of details?**

1. Tolerable misstatement
2. Allowable risk of incorrect acceptance
3. Expected size and frequency of misstatements
4. All of the above
5. None of the above



# Poll: What factors should an auditor consider in determining an appropriate sample size for a substantive test of details?

1. Tolerable misstatement
2. Allowable risk of incorrect acceptance
3. Expected size and frequency of misstatements
- 4. All of the above**
5. None of the above

# Audit Sampling - Case Study Facts

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- Commissions revenue = \$5,000,000
- Inherent risk = lower
- Control risk = maximum
- Assurance from other substantive procedures = some
- Substantive test of details sample size = 25 transactions
- Basis for sample size was the firm's attribute sampling methodology requirements

## **Poll: Did the engagement team establish a reasonable basis for its sample size?**

1. Yes, a sample of 25 is always a statistically valid sample for a large population
2. Yes, attribute sampling methodologies are appropriate to develop sample sizes for tests of detail
3. No, the engagement team should have taken into account other factors when establishing the sample size
4. No, the engagement team should have tested more to obtain an appropriate coverage of the account balance

# Poll: Did the engagement team establish a reasonable basis for its sample size?

1. Yes, a sample of 25 is always a statistically valid sample for a large population
2. Yes, attribute sampling methodologies are appropriate to develop sample sizes for tests of detail
- 3. No, the engagement team should have taken into account other factors when establishing the sample size**
4. No, the engagement team should have tested more to obtain an appropriate coverage of the account balance

# Audit Sampling - Case Study Facts

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- Commissions for domestic securities transactions are a fixed amount per transactions which varies by security type
- Commissions for foreign securities transactions are a percentage of the transaction
- Engagement team judgmentally selected four months to test commissions revenue
- For each of the four months, the engagement team selected domestic transactions to test substantively (one fourth of the sample size in each month)

## **Poll: Which of the following statements is true regarding the auditor's method of selecting items to test?**

1. The selections are not representative of the entire population
2. It allows all transactions in the population subject to testing an opportunity to be selected
3. The auditor should have selected foreign securities transactions from the four months, in addition to domestic securities

# Poll: Which of the following statements is true regarding the auditor's method of selecting items to test?

- 1. The selections are not representative of the entire population**
2. It allows all transactions in the population subject to testing an opportunity to be selected
3. The auditor should have selected foreign securities transactions from the four months, in addition to domestic securities

# Audit Sampling - Case Study Facts

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- Commissions revenue = \$5,000,000
- Materiality level = \$100,000
- Tolerable misstatement = \$75,000
- The 20 largest individual commission transactions were selected for testing, including all that were greater than tolerable misstatement
- The remaining population of \$2,000,000 was not tested



# **Poll: Which of the following statements regarding the auditor's method of selecting items to test is not true?**

1. The selection of individually significant items may result in more efficient overall approach
2. The selection of individually significant items constitutes audit sampling
3. The selections are not representative of the population
4. The auditor should perform procedures to address risk of material misstatement associated with the untested population

## Poll: Which of the following statements regarding the auditor's method of selecting items to test is not true?

1. The selection of individually significant items may result in more efficient overall approach
- 2. The selection of individually significant items constitutes audit sampling**
3. The selections are not representative of the population
4. The auditor should perform procedures to address risk of material misstatement associated with the untested population

# Audit Sampling – Example of Effective Procedures

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When sampling, auditors should make selections that can be expected to be representative of the entire population, and provide all items an opportunity to be selected. A broker-dealer earns a spread for underwriting securities offerings and also advises clients on mergers and acquisitions. Both sources of revenue are material. The auditor tested all individually significant underwriting transactions and a sample from the remaining population of underwriting transactions using a statistically valid sampling technique. The auditor also selected a representative sample from the population of advisory fee transactions using a random number generator.

*Note: The example provides a brief scenario and related example of procedures that may be effective, depending on facts and circumstances, but do not modify or establish auditing or attestation standards. These procedures are not contemplated in isolation but rather in combination with other relevant procedures.*

# **AT No. 2 Review Procedures**

# AT No. 2 – Case Study Facts

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## Broker-Dealer's Exemption Report

To the best of its knowledge and belief, the Broker-Dealer states the following:

- The Broker-Dealer claimed an exemption from 17 C.F.R. 240.15.15c3-3 under the following provision of 17 C.F.R. 240.15c3-3 (k)(2)(ii).

I, John Smith, affirm that, to the best of my knowledge and belief, this Exemption Report is true and correct.

[Signature]

# AT No. 2 – Case Study Facts

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## Report of Independent Registered Public Accounting Firm

We have reviewed management's statements, included in the accompanying Exemption Report, in which (1) the Broker-Dealer identified the following provisions of 17 C.F.R. 240.15c3-3(k) under which the Broker-Dealer claimed an exemption from 17 C.F.R. 240.15c3-3: (k)(2)(ii) (exemption provisions) and (2) the Broker-Dealer stated that it met the identified exemption provisions throughout the most recent fiscal year without exception. The Broker-Dealer's management is responsible for compliance with the exemption provisions and its statements.

[Scope Paragraph]

[Review Results Paragraph]

[Signature]

[City and State or County]

[Date]

# **Poll: Which of the following statements regarding the auditor's review report is true?**

1. The review report referred to an incorrect exemptive provision
2. The review report referred to management assertion that was not included in the broker-dealer's exemption report
3. The review report was not signed and dated
4. The review report included an inappropriate title

## Poll: Which of the following statements regarding the auditor's review report is true?

1. The review report referred to an incorrect exemptive provision
- 2. The review report referred to management assertion that was not included in the broker-dealer's exemption report**
3. The review report was not signed and dated
4. The review report included an inappropriate title



# AT No. 2 – Case Study Facts

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## Broker-Dealer's Exemption Report

To the best of its knowledge and belief, the Broker-Dealer states the following:

1. The Broker-Dealer may file an Exemption Report because the Broker-Dealer had no obligations under 17 C.F.R. 240.15c3-3, and
2. The Broker-Dealer had no obligations under 17 C.F.R. 240.15c3-3 throughout the most recent fiscal year ending December 31, 2018.

[Signature]

**Poll: In its exemption report, the broker-dealer did not include a statement that identifies the provisions under which it claimed exemption, but included other statements explaining its basis for filing an exemption report. How should the auditor respond?**

1. Obtain an understanding of the exemption conditions and other rules and regulations that were relevant to the broker-dealer's ability to file an exemption report
2. Perform procedures as necessary to obtain moderate assurance regarding whether a material modification should be made to the broker-dealer's statements
3. Refer to the statements made by the broker-dealer in the auditor's review report
4. All of the above

**Poll: In its exemption report, the broker-dealer did not include a statement that identifies the provisions under which it claimed exemption, but included other statements explaining its basis for filing an exemption report. How should the auditor respond?**

1. Obtain an understanding of the exemption conditions and other rules and regulations that were relevant to the broker-dealer's ability to file an exemption report
2. Perform procedures as necessary to obtain moderate assurance regarding whether a material modification should be made to the broker-dealer's statements
3. Refer to the statements made by the broker-dealer in the auditor's review report
- 4. All of the above**

## AT No. 2 – Example of Effective Procedures

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During its audit of revenue, the auditor obtained evidence that the broker-dealer, in addition to its business of introducing customers to its clearing broker, sold mutual fund shares to customers directly from the funds and not through a clearing broker. This mutual fund business did not fall within the exemption claimed by the broker-dealer under paragraph (k)(2)(ii) of the Customer Protection Rule, as stated in the broker-dealer's exemption report. The auditor, therefore, performed additional review procedures to address this evidence that indicated the broker-dealer's exemption report may not be fairly stated.

*Note: The example provides a brief scenario and related example of procedures that may be effective, depending on facts and circumstances, but do not modify or establish auditing or attestation standards. These procedures are not contemplated in isolation but rather in combination with other relevant procedures.*

# Questions

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**BDCS19**



# **Q&A and Closing Remarks**

*All presenters*

# Closing Remarks

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- Evaluations
- CPE submission