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January 28, 2015

The Board is issuing this document to provide timely insight into the observations from these initial inspections under these new requirements, and to remind registered public accounting firms that audit brokers and dealers of certain new requirements relating to their audit and attestation engagements. Auditors are encouraged to take action to ensure compliance with the new requirements of SEC rules and PCAOB standards for these engagements and to prevent the types of deficiencies described in this report. The Board believes that drawing attention to these issues is particularly important at this time, as auditors are currently performing or preparing to perform, for the first time, audits under the new requirements of the many brokers and dealers that have fiscal years that ended on December 31, 2014.

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Inspections staff observed deficiencies in all five of the audits included in these inspections, and four of the five attestation engagements, as described below. The term "deficiencies," as used in this report, refers to failures by firms to perform, or perform sufficiently, certain required audit or attestation procedures. Inspections staff focused on areas relevant to the amendments of Rule 17a-5, which became effective June 1, 2014, and on areas that are unique to audits and other engagements conducted pursuant to PCAOB standards, including [Auditing Standard No. 7, Engagement Quality Review \("AS No. 7"\)](#), [Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers \("AT No. 1"\)](#), and [Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers \("AT No. 2"\)](#). Inspections staff observed deficiencies in the auditors' compliance with these standards, including deficiencies with respect to the audit and attestation reports, procedures performed on the audit and attestation engagements, and the engagement quality reviews. Inspections staff also focused on areas with noted observations from past inspections, as described in the previous reports on the progress of the interim inspection program for auditors of brokers and dealers registered with the SEC¹, and had similar observations in these areas.

The observations covered in this report are concerning and warrant consideration by all firms that perform audit and attestation engagements of brokers and dealers, as all five firms were deficient in complying with the auditing or attestation standards in some respect. In addition, in light of the deficiencies identified by Inspections staff, combined with the need to adapt to amended SEC rules and to follow PCAOB standards, the Board urges firms that audit brokers and dealers to re-examine their audit approaches. The Board encourages firms that audit brokers and dealers to review the Staff Guidance for Auditors of SEC-Registered Brokers and Dealers issued on June 26, 2014, which provides guidance on new requirements to auditors of brokers and dealers and guidance for those firms that have not previously conducted audits or attestations under PCAOB standards.² Firms should raise any questions regarding

¹ The Board issued its first report on the progress of its interim inspection program for auditors of brokers and dealers registered with the SEC on August 20, 2012, its second progress report on August 19, 2013, and its third progress report on August 18, 2014, all of which are available on the PCAOB website at: <http://pcaobus.org/Inspections/Pages/PublicReports.aspx>. Later this year, the Board will issue the fourth annual report that will include observations identified during inspections conducted on audits selected with fiscal years ending prior to June 1, 2014 and not yet subject to the application of PCAOB standards.

² See http://pcaobus.org/Standards/Documents/06262014_Staff_Guidance.pdf.

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implementation of the standards to Keith Wilson, Deputy Chief Auditor (202/207-9134, wilsonk@pcaobus.org); Barbara Vanich, Associate Chief Auditor (202/207-9363, vanichb@pcaobus.org); and Lisa Calandriello, Assistant Chief Auditor (202/207-9337, calandriello@pcaobus.org).

Inspection Observations

Observations were identified in portions of all five audits selected for inspection. At the time of the inspections, three of the firms were subject to regular inspection as they also audited issuers, generally referred to as public companies. One firm audited more than 100 brokers and dealers; three firms audited 21 to 100 brokers and dealers; and one firm audited fewer than 21 brokers and dealers.

Of the five audit and attestation engagements selected, three of the brokers and dealers were required to file a compliance report (and an auditor's examination report) with the SEC as part of their annual report. The other two were required to file an exemption report (and an auditor's review report) as part of their annual report.

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The following tables present a summary of the audit and attestation deficiencies discussed in this report:

Attestation Engagements	Number of Engagements with Deficiencies	Number of Applicable Engagements
Examination Procedures	2	3
Review Report	2	2
Audit Engagements		
Audit Procedures:		
Related to Customer Protection and Exchange Act Rule 15c3-1 ("Rule 15c3-1" or the "Net Capital Rule"):		
Customer Protection Rule	1	3
Net Capital Rule	1	5
Related to the Financial Statement Audit: ³		
Revenue Recognition	5	5
Risks of Material Misstatement Due to Fraud	3	5
Financial Statement Presentation and Disclosures	3	5
Related Party Transactions	2	5
Reliance on Records and Reports	2	5
Fair Value Estimates	1	5
Audit Documentation	2	5
Engagement Quality Review	4	5
Auditor's Report	1	5

³ The observations identified in the financial statement audit areas were similar to certain observations described in the previously issued progress reports, which discussed audits performed in accordance with generally accepted auditing standards ("GAAS"). See the Appendix for a table providing PCAOB standards references that correspond to certain clarified generally accepted auditing standards referenced in the Board's most recent progress report issued on August 18, 2014.

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Attestation Engagements

The PCAOB's attestation standards, AT No. 1 and AT No. 2, specifically address the auditor's responsibilities for examining certain statements made in compliance reports or reviewing statements made in exemption reports under Exchange Act Rule 17a-5. Inspections staff identified deficiencies in the procedures performed or reports issued for four of the attestation engagements included in these five inspections.

Examination Procedures

In two of the three examination engagements, Inspections staff observed the firms failed to perform tests of controls and, therefore, did not determine in accordance with AT No. 1, whether the broker or dealer maintained effective Internal Control Over Compliance ("ICOC"), both during the year and as of year-end. AT No. 1 requires the auditor to identify and test internal controls that are important to the auditor's conclusion about whether the broker or dealer maintained effective ICOC.

Inspections staff also observed in one of these examination engagements that the firm failed to perform sufficient procedures related to the broker and dealer's statement that the broker and dealer was in compliance with Rule 15c3-1 and Rule 15c3-3(e) as of year-end. The engagement team failed to test the accuracy and completeness of the information contained in the computation of net capital and the customer reserve computation.

Review Reports

In the two review engagements, Inspections staff observed that the auditor's review report did not comply with the requirements of AT No. 2. In one engagement, the auditor issued a review report that incorrectly referred to a document filed by the broker and dealer that was not an exemption report and that did not include the statements required by Rule 17a-5. In the other review engagement, Inspections staff observed that the auditor's review report covered a period of time beyond that which the broker and dealer's statements covered in its exemption report. The auditor's report and review procedures needed to address the statements by the broker and dealer for the period stated in its exemption report.

Audit Engagements

Audit Procedures

Inspections staff focused on audit procedures related to the supplemental schedules required by Rule 17a-5(d)(2)(ii), which includes computation of net capital under Rule 15c-3-1, computation for determination of reserve requirements under Rule

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15c3-3, and information relating to the possession or control requirements under Rule 15c3-3, and certain aspects of the audit of the financial statements where previous inspections resulted in observations as described in the previously issued progress reports.

Inspections staff identified deficiencies related to the procedures on the supplemental information required to be performed in accordance with [Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements](#) ("AS No. 17"), which became effective for fiscal years ending on or after June 1, 2014. AS No. 17 applies when the auditor reports on the supporting schedules of a broker or dealer.

Inspections staff observed in one of the audits that the firm did not evaluate whether the computation of net capital and the customer reserve computation, including their form and content, complied with Rules 15c3-1 and 15c3-3, respectively. The firm limited its procedures to agreeing amounts reported in the computation of net capital to schedules prepared by the broker and dealer and did not perform procedures to determine whether components of the computation, such as allowable assets, deductions and charges, and haircuts on securities positions were determined in accordance with Rule 15c3-1. The firm also did not test the completeness and accuracy of significant components of the customer reserve computation. In addition, the firm did not sufficiently test whether the broker and dealer promptly obtained and maintained the physical possession or control of all fully paid and excess margin customer securities carried by the broker and dealer for the account of customers.

Inspections staff also identified deficiencies related to the financial statement audit in all of the five audits selected for inspection. Deficiencies were identified in various financial statement audit areas, as listed in the table above, which were similar to certain deficiencies described in the previously issued progress reports.

Audit Documentation

In two audit and attestation engagements, Inspections staff found the engagement team failed to prepare an engagement completion document necessary to support the auditor's final conclusions related to significant findings and issues, actions taken to address them, and the basis for the conclusions reached in connection with the audit. [AS No. 3, Audit Documentation](#) sets forth the requirements the auditor should consider when preparing and retaining documentation in connection with audits and attestation engagements conducted pursuant to the standards of the PCAOB, including an engagement completion document.

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Engagement Quality Review

In four of the five engagements, Inspections staff found that either the engagement quality review was insufficient or the reviewer did not have the required qualifications prescribed by AS No. 7. For example, in one audit, the engagement quality reviewer concurred with the auditor's issuance of a review report despite the fact that the review report incorrectly referenced statements in a filing by the broker and dealer that was not an exemption report. In another audit, the engagement quality review was performed by the person who served as the engagement partner during the preceding audit, which is prohibited under AS No. 7.⁴

AS No. 7 requires an engagement quality review to be performed by a qualified reviewer for audits performed under PCAOB standards and for examination or review engagements performed pursuant to AT No. 1 or AT No. 2, respectively. The standard also requires the engagement quality reviewer to provide concurring approval of issuance only if, after performing with due professional care the review required by AS No. 7, the engagement quality reviewer is not aware of a significant engagement deficiency.

Auditor's Report

In one audit, the auditor appeared to approach performing the audit pursuant to PCAOB standards; however, the auditor's report on the financial statements stated the firm conducted the audit in accordance with GAAS rather than referencing PCAOB standards as required by Rule 17a-5.

Other Observations

Staff in PCAOB's Office of Research and Analysis looked at a number of annual reports filed by brokers and dealers with fiscal years that ended on June 30, 2014, to obtain an initial impression of compliance with newly applicable requirements. The staff observed several audit reports on the brokers' and dealers' financial statements in which the auditors described conducting the audit under GAAS. The Board reminds auditors of the new requirements that the audits of the financial statements must be performed in accordance with PCAOB standards.

The staff also observed that several filings did not include an auditor's examination report or review report. In these cases, the omissions suggested that the auditors did not comply with the new requirement to perform either an examination of

⁴ Registered firms that qualify for the exemption under Rule 2-01(c)(6)(ii) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(6)(ii), are exempt from this requirement.

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certain statements made in the broker's or dealer's compliance report or a review of the statements made in the broker's or dealer's exemption report, respectively, and to issue a corresponding report.

Interim Inspection Program – Plan for 2015

During 2015, the Board plans to inspect approximately 75 firms and portions of approximately 115 audit and attestation engagements required to be conducted pursuant to PCAOB standards. The Board will issue future reports that will describe significant observations from the inspections. In addition, the Board will use information obtained from the interim inspection program and other research and outreach efforts to inform its future standards-setting activities relevant to the audits of brokers and dealers.

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Appendix

References from Certain PCAOB Standards to Previously Applicable Clarified Generally Accepted Auditing Standards

The table below provides references to PCAOB standards that correspond to certain clarified generally accepted auditing standards referenced in the Board's most recent progress report issued on August 18, 2014.

PCAOB Auditing Standards and Interim Standards	AICPA Clarified Standards
AS No. 12, <i>Identifying and Assessing Risks of Material Misstatement</i>	AU-C 315, <i>Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</i>
AS No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	AU-C 330, <i>Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</i>
AS No. 14, <i>Evaluating Audit Results</i>	AU-C 500, <i>Audit Evidence</i>
AS No. 15, <i>Audit Evidence</i>	AU-C 500, <i>Audit Evidence</i>
AU 316, <i>Consideration of Fraud in a Financial Statement Audit</i>	AU-C 240, <i>Consideration of Fraud in a Financial Statement Audit</i>
AU 324, <i>Service Organizations</i>	AU-C 402, <i>Audit Considerations Relating to an Entity Using a Service Organization</i>
AU 328, <i>Auditing Fair Value Measurements and Disclosures</i>	AU-C 540, <i>Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures</i>
AU 329, <i>Substantive Analytical</i>	AU-C 520, <i>Analytical Procedures</i>
AU 334, <i>Related Parties</i> ⁵	AU-C 550, <i>Related Parties</i>

⁵ Effective for audits of fiscal years beginning on or after December 15, 2014, Auditing Standard No. 18, *Related Parties* supersedes the Board's interim auditing standard, AU sec. 334, *Related Parties*.