

Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers

PCAOB Release No. 2020-001

August 20, 2020

PCAOB

Public Company Accounting Oversight Board

Executive Summary

The Public Company Accounting Oversight Board (PCAOB) has completed its 2019 inspections of auditors of brokers and dealers. This *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* provides a summary of inspection results as well as information auditors can use to improve audit quality.

There were 411 public accounting firms (firms) registered with the PCAOB that performed audits of broker-dealers registered with the U.S. Securities and Exchange Commission (SEC) this inspection period, and we selected 66 of these firms for inspection. Our inspections assess firms' compliance with professional standards and applicable rules and regulations, with a focus on risks to customers of broker-dealers.

While our 2019 inspections revealed modest improvement in the rate of deficiencies, we continue to see a high rate of deficiencies in certain areas of engagement performance. We also continue to see that firms that audit more than 100 broker-dealers generally have lower percentages of deficiencies compared to other firms.

We have observed similar deficiencies despite limited changes to auditing and attestation standards other than those involving related parties and the auditor's report. The recurring deficiencies described in this annual report highlight potential areas of improvement for all firms, whether or not they were recently inspected. While some have demonstrated progress, other firms have not taken sufficient steps to address audit and attestation engagement performance. We expect firms to take meaningful actions to address these recurring deficiencies.

All firms need to evaluate how they can improve their system of quality control. A strong system of quality control can serve to prevent engagement deficiencies from occurring. Firms should take what was learned from these 66 firm inspections, including the examples of effective procedures, and consider how to proactively implement improvements, rather than reacting as a result of a PCAOB inspection.

Auditors of brokers and dealers should focus their efforts on improving their system of quality control and their engagement performance in all areas described in this annual report, but particularly in these areas where we continue to observe frequent deficiencies:

- **Examination Engagements** – We frequently observe insufficient testing of the design and operating effectiveness of internal controls over compliance. We believe that focusing on the risks associated with a control will help firms develop appropriate testing procedures and lead to further improvement in this area. In 2019, examination engagements with deficiencies decreased to 69% from 75%.
- **Review Engagements** – Inquiries are required on all review engagements, and firms should document the results of inquiries made. Firms should also take into account evidence from financial statement audits, including evidence that appears to contradict assertions made in exemption reports, when planning, performing, and evaluating the results of review engagements. In 2019, review engagements with deficiencies decreased to 51% from 54%.
- **Financial Statement Audits** – Revenue and financial statement presentation and disclosure are commonly reviewed areas during an inspection. We believe that obtaining a sufficient understanding of internal control over financial reporting, and other risk assessment procedures, will help firms clearly identify and assess the risks of material misstatement in these areas, and prevent deficiencies from occurring in these areas of the audit. We encourage firms to consider the details of our observations in these areas as they conduct broker-dealer audits. In 2019, financial statement audits with deficiencies decreased to 71% from 76%.

The information contained in this annual report may be helpful for other stakeholders, including management and the audit committee (or equivalent body) of the broker-dealers, when engaging with the firms regarding audit quality and broker-dealer financial reporting.

For Additional Information

The PCAOB website includes additional information and resources for auditors of broker-dealers, including previous annual reports, information about outreach forums, periodic Spotlight publications, and more. To receive periodic updates from the PCAOB, please join our mailing list.

We Want to Hear from You

In an effort to continue to improve external communications and provide information that is timely, relevant, and accessible, we want to hear your views regarding this document. Please take two minutes to fill out our [short survey](#).

Inspections By the Numbers

2019



66 Firms Inspected

- 7 With No Deficiencies



106 Audit Engagements

- 31 With No Audit Deficiencies
- 53 With Audit and Attestation Deficiencies
- 22 With Audit Deficiencies but No Attestation Deficiencies



29 Examination Engagements

- 9 With No Deficiencies



74 Review Engagements

- 36 With No Deficiencies

2018



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

Contents

- Executive Summary 1**
- Overview 4**
- Inspection Observations 5**
 - Attestation and Audit Engagements 6**
 - Examination Engagements 6
 - Review Engagements 9
 - Auditing Financial Statements 11
 - Auditing Supplemental Information Accompanying Audited Financial Statements 17
 - Other Instances of Non-Compliance with PCAOB Standards 19**
 - Auditor’s Report on the Financial Statements and Supporting Schedules 19
 - Auditor Communications 20
 - Engagement Documentation 20
 - Quality Control 21**
 - Engagement Performance 21
 - Monitoring 22
 - Independence, Integrity, and Objectivity 22
 - Personnel Management 22
 - Auditor Independence 22**
- PCAOB Standards Associated with Inspection Observations 24**
- Appendix A: Selection of Firms and Engagements for Inspections A-1**
- Appendix B: Comparative Results from Our Inspections under the Interim Program B-1**

Overview

The PCAOB has registration, inspection, standard-setting, and disciplinary authority over the auditors of brokers and dealers registered with the SEC.

This *Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers* provides information on the inspections, an overview of the results of our inspections and related audit and attestation engagement reviews, and information on steps auditors can take to improve their performance. Hereinafter, the use of the term "broker-dealer" refers to entities that are registered with the SEC as both a broker and a dealer and to entities that are registered as only one or the other.

Overseeing the audits of SEC-registered broker-dealers is a key component of the PCAOB's mission to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. This report serves to advance our strategic goal to drive improvement in the quality of audit services through a combination of prevention, detection, deterrence, and remediation.

We noted that deficiencies are lower in 2019 than 2018 for each type of engagement.

- Audit engagements with deficiencies decreased to 71% from 76%.
- Review engagements with deficiencies decreased to 51% from 54%.
- Examination engagements with deficiencies decreased to 69% from 75%.

The percentages of deficiencies varied by audit area reviewed. Some decreased in 2019 compared to 2018, while others increased.

2019 Inspections Approach

Under the interim inspection program, the PCAOB assessed firms' compliance with applicable laws, rules, and professional standards when performing audit and attestation engagements for broker-dealers. We also evaluated elements of firms' systems of quality control. In 2019, we inspected 66 firms and reviewed 106 audits.¹ We reviewed 103 related attestation engagements, including 29 examination engagements and 74 review engagements.

In selecting firms to inspect and engagements for review, we primarily use risk-based selections, and consider various characteristics of the firms and broker-dealers. Our selections also include randomly selected firms and engagements to provide an element of unpredictability. We do not review every aspect of an audit or attestation engagement. Rather, we generally focus our attention on areas we believe to be of greater complexity and areas of greater significance or with a heightened risk of material misstatement to the broker-dealer's financial statements.

Our selection of firms for inspection and engagements for review does not constitute representative samples of the population of firms that audit broker-dealers or engagements. Additionally, our inspection findings are specific to the particular portions of the engagements reviewed. They are not an assessment of all work performed by the firms selected for inspection or all of the procedures performed for the engagements reviewed.

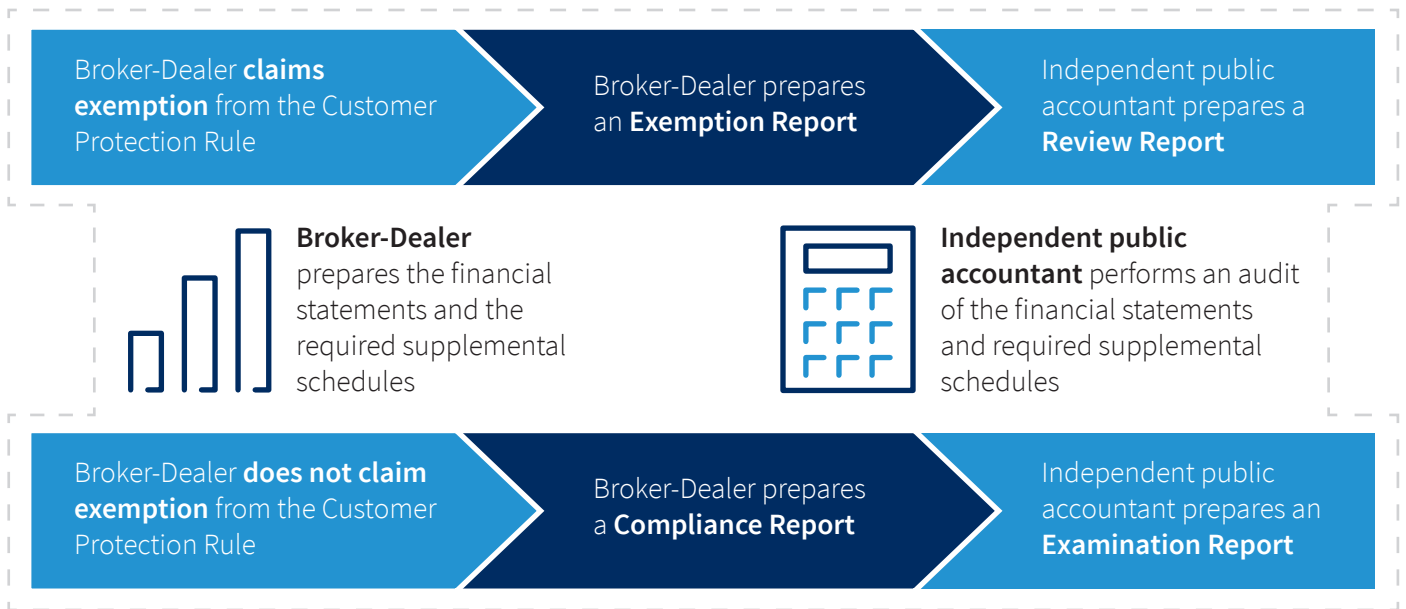
Further, the populations of firms and broker-dealers are not homogeneous. Therefore, the observations related to quality control, attestation and audit deficiencies, other instances of noncompliance with PCAOB standards, and independence findings are not necessarily representative of the population of all firms that perform broker-dealer audits or of all broker-dealer audit and attestation engagements.

¹ The 2019 inspection of one firm and review of one audit conducted by that firm occurred in January 2020.

The deficiencies we identified do not necessarily mean that the broker-dealer’s financial statements, supporting schedules, or compliance or exemption reports are not fairly presented or stated, in all material respects. It is often not possible for us to reach a conclusion on those points based on our inspection because we have only the information in the broker-dealer’s filings and the information the auditor retained. We do not have direct access to the broker-dealer’s management, underlying books and records, and other information.

Broker-Dealer Annual Reporting Pursuant to SEC Rule 17a-5

This graphic depicts certain broker-dealer annual reporting requirements and related auditor responsibilities. Further discussion of the requirements and inspection observations appear elsewhere in this report.



This graphic is being provided as an example; it is not intended to, and does not, cover all instances where a broker-dealer may be eligible to file an exemption report. Certain broker-dealers do not claim exemption from the Customer Protection Rule (a broker-dealer financial responsibility rule²), because they do not meet the exemption conditions of paragraph (k) of that rule, and instead, prepare an exemption report pursuant to SEC and SEC staff guidance.

Inspection Observations

Inspections of selected firms under the interim inspection program included review of selected engagements and evaluation of elements of the firms’ systems of quality control. Inspections staff communicated the following, as applicable, to each inspected firm:

- Observations related to its system of quality control;
- Deficiencies in its audits of broker-dealer financial statements and supporting schedules, and its examination and review attestation engagements;

² For purposes of this Annual Report, the term “financial responsibility rules” refers to the Securities Exchange Act of 1934 (“Exchange Act”) Rule 15c3-1, *Net Capital Requirements for Brokers or Dealers* (the “Net Capital Rule”); Exchange Act Rule 15c3-3, *Customer Protection – Reserves and Custody of Securities* (the “Customer Protection Rule”); Exchange Act Rule 17a-13, *Quarterly Security Counts to be Made by Certain Exchange Members, Brokers and Dealers* (“Quarterly Security Count Rule”); and any rule of a designated examining authority that required the broker-dealer to send account statements to customers (“Account Statement Rule”). Paragraph (e) of the Customer Protection Rule is referred to as the “Reserve Requirements Rule.”

- Other instances of non-compliance with PCAOB standards; and
- Independence findings.



Throughout this report, we highlight effective procedures that describe brief scenarios and possible procedures that may be effective to address that scenario. These effective procedures are provided as examples and do not modify or establish auditing or attestation standards. Auditors should consider the specific facts and circumstances of their engagements when designing audit procedures.



In a few instances in this report, we summarize—solely for the purpose of providing basic context to readers—rules and standards (or aspects thereof) that, while not promulgated by the PCAOB, are relevant to our inspection activities. Readers should not rely on our summaries as authoritative; instead, they should refer directly to those rules and standards, along with any associated authoritative interpretive materials.

Attestation and Audit Engagements

This section of our report discusses certain observations from our inspections related to attestation and audit engagements when firms did not perform—or did not sufficiently perform—certain required procedures, or otherwise comply with the applicable standards.

As further described in Appendix B, we have reclassified certain deficiencies from 2018 inspections reported in the previous Annual Report to conform to the classification of deficiencies from 2019 inspections.

Examination Engagements

The auditor must plan and perform an examination of statements made by the broker-dealer in its compliance report in accordance with AT No. 1. The examination includes obtaining evidence about whether one or more material weaknesses existed in the broker-dealer’s internal control over compliance (ICOC) with the broker-dealer financial responsibility rules during, and as of the end of, the broker-dealer’s most recent fiscal year. The examination also includes performing tests of the broker-dealer’s compliance with the Net Capital Rule and the Reserve Requirements Rule as of the end of the broker-dealer’s fiscal year.

Deficiencies in Examination Engagements

	2019			2018
	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage	Percentage
Examination Engagements	29	20	69%	75%

The following deficiencies were identified in the examination engagements:

Planning for the Examination Engagement

Firms did not obtain a sufficient understanding of broker-dealer processes, including relevant controls, regarding compliance with the financial responsibility rules. (AT No. 1.09)

Testing of ICOC

Firms did not perform, or sufficiently perform, testing of ICOC for one or more financial responsibility rules. (AT No. 1.11)

Firms did not test, or sufficiently test, important controls, in particular the following specific types of controls:

- Management review controls, in particular not obtaining a sufficient understanding of the nature and extent of management's review, including understanding and evaluating the expectations and criteria used by management to identify matters for investigation, as well as the nature and resolution of the investigation procedures performed;
- Controls over the accuracy and completeness of information produced by either the broker-dealer or the broker-dealer's service organizations upon which the design and operating effectiveness of ICOC depended; and
- Information technology controls or automated application controls.

Firms did not test controls that were important to the auditor's conclusion about whether the broker-dealer maintained effective ICOC as of its fiscal year-end.

ICOC: Management Review Controls

The auditor considered management's review of its monthly net capital computation an important control and one that the auditor was required to test. The auditor inquired of the control owner regarding the nature of the review, information used, expectations, thresholds for variances requiring investigation, and resolution of variances. In addition, the auditor inquired about the nature of errors in applying the Net Capital Rule identified through the review during the year. The auditor selected a sample of monthly net capital computations and inspected evidence of management's review, including evidence that variances exceeding the threshold were resolved. The auditor determined that the control owner used a securities borrowed and loaned report to determine the appropriate net capital charge, and that the control owner also verified that amounts from the report were accurately captured and included in the computation. The auditor separately tested controls over the accuracy and completeness of the information included in the securities borrowed and loaned report.



Firms did not test, or sufficiently test, important controls over processes related to compliance with the Customer Protection Rule, including:

- Determining credit and debit balances reported within the reserve computations pursuant to Exhibit A of the Customer Protection Rule;
- Making timely deposits to special reserve bank accounts;

- Identifying and resolving deficits that required action by the broker-dealer within the required timeframe; and
- Maintaining custodial accounts free of any right, charge, security interest, lien, or claim.

Firms did not test, or sufficiently test, important controls over processes related to compliance with the Quarterly Security Count Rule, including:

- Accounting for all securities subject to the broker-dealer's control or direction, but not in its physical possession, and verifying all such securities in that status for more than 30 days; and
- Assigning appropriate broker-dealer personnel to make or supervise the quarterly security counts.

Firms did not test, or sufficiently test, important controls over processes related to compliance with the Account Statement Rule, including producing and delivering complete and accurate account statements, either electronically or by mail, to all customers.

ICOC: Account Statement Rule

All of a broker-dealer's customers elect to access their customer account statement in electronic form and decline receipt of a paper statement. A broker-dealer relied on an internally developed application to create account statements that included securities positions, money balances, and account activity as required by the Account Statement Rule. The auditor tested controls over the production of the statements and controls over the accuracy and completeness of information included in the statements. The controls tested included automated application controls, manual controls, and relevant information technology controls. The auditor also tested controls related to electronic delivery of statements.



Account Statement Rule

Financial Industry Regulatory Authority (FINRA) Rule 2231 replaced NASD Rule 2340, *Customer Account Statements*, effective May 8, 2019. FINRA Rule 2231 requires each general securities member to send account statements to customers at least once each calendar quarter containing a description of any securities positions, money balances, or account activity in the accounts since the prior account statements were sent, except if carried on a Delivery versus Payment/Receive versus Payment basis and certain requirements are met.



Performing Compliance Tests

Firms did not perform, or sufficiently perform, tests of compliance with the Net Capital Rule or the Reserve Requirements Rule as of the end of the broker-dealer's fiscal year, including : (AT No. 1.21)

- Evaluating whether the amounts reported within the schedules were determined in accordance with the applicable rules;

- Testing the accuracy and completeness of the information in the schedules, including information produced by the broker-dealer (or the broker-dealer's service organizations) that was used by the broker-dealer to prepare its schedules; and
- Determining whether the broker-dealer maintained a special reserve bank account for the exclusive benefit of its customers or for broker-dealers in accordance with the Reserve Requirements Rule.

Performing Compliance Tests

A broker-dealer used an internal system to allocate securities positions according to the broker-dealer's identified allocation pairings for determining balances in its customer reserve computation. As part of the audit of the financial statements, the auditor performed valuation, confirmation, and securities position reconciliation procedures to determine whether the broker-dealer's fiscal year-end stock record was complete and accurate. As part of its compliance tests over the customer reserve, the auditor selected a sample of securities from the stock record and re-performed the allocation to determine whether the broker-dealer allocated the securities in accordance with its identified allocation pairings. The auditor also reviewed the broker-dealer's allocation pairings hierarchy and compared it to the requirements of Exhibit A of the Customer Protection Rule.



Evaluating Results of the Examination Procedures

Firms did not sufficiently evaluate results of examination procedures to determine whether individually, or in combination with other deficiencies, one or more material weaknesses in ICOC existed. (AT No. 1.25 and .26)

Obtaining a Representation Letter

Firms did not obtain written representations from management of the broker-dealer. (AT No. 1.32)

Reporting on the Examination Engagement

In examination reports, firms included statements that referred to a required assertion that broker-dealers did not include in their compliance reports. (AT No. 1.36)

Review Engagements

In accordance with AT No. 2, the auditor must plan and perform the review of assertions made by the broker-dealer in its exemption report. The objective of the review includes obtaining evidence about whether one or more conditions exist that would cause one or more of the broker-dealer's assertions not to be fairly stated, in all material respects. The auditor should coordinate the review engagement with the audit of the financial statements and supplemental information, taking into account relevant evidence obtained in the audit when planning, performing, and evaluating the results of the review engagement.

Deficiencies in Review Engagements

	2019			2018
	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage	Percentage
Review Engagements	74	38	51%	54%

The following deficiencies were identified in the review engagements:

Performing the Review Engagement

Firms did not obtain a sufficient understanding of the exemption provisions identified by the broker-dealer and other rules and regulations relevant to the broker-dealer’s assertions in its exemption report, which was necessary to properly perform the review engagement. (AT No. 2.05)

Firms did not make required inquiries, including inquiries about controls in place to maintain compliance with the exemption provisions, and those involving the nature, frequency, and results of related monitoring activities. (AT No. 2.10)

Inquiries of Management

Auditors should make the inquiries required by AT No. 2 to identify exceptions to the exemption provisions. The auditor inquired of the broker-dealer’s Finance and Operations Principal (FINOP) and the Chief Compliance Officer regarding findings the broker-dealer received in a regulatory examination report from its designated examining authority. The findings indicated the broker-dealer’s written supervisory procedures related to prompt transmittal of customer funds were deficient. The auditor inquired of the FINOP regarding how those deficiencies were taken into account when preparing the statement in the broker-dealer’s exemption report that identifies each exception to the identified exemption provision. The auditor also inspected documentation that corroborated the FINOP’s response.



Staff Guidance Regarding Coordination of the Audit and Review Engagements

Examples of financial statement audit procedures that may provide information relevant to the broker-dealer’s compliance with the exemption provision(s) from the Customer Protection Rule identified in the broker-dealer’s exemption report include:

- Testing customer trades;
- Testing of specially designated cash accounts;
- Testing investment inventory or transactions related to the broker-dealer’s trading for its own account; and
- Reading the clearing agreement in connection with testing trade fee or commission revenue or expenses.

Source: Staff Guidance for Auditors of SEC-Registered Brokers and Dealers (June 2014)

Firms did not perform, or sufficiently perform, an evaluation of evidence obtained in the audit of the financial statements that contradicted the broker-dealer’s assertions regarding compliance with the claimed exemption provision. (AT No. 2.10)

Firms did not sufficiently evaluate results of review procedures, because they did not evaluate information that should have caused them to believe that one or more of the broker-dealer's assertions regarding the claimed exemption provision were not fairly stated, in all material respects. (AT No. 2.11)

Evaluating the Results of the Review Procedures

The auditor should evaluate whether information has come to the auditor's attention that causes the auditor to believe that one or more of the broker-dealer's assertions are not fairly stated, in all material respects. A broker-dealer stated in its exemption report that it complied with the exemption provisions of paragraph (k)(2)(ii) of the Customer Protection Rule throughout the year without exception. During its audit of the broker-dealer's financial statements, the auditor obtained information that the broker-dealer did not have an arrangement with a clearing broker-dealer at any point during the year, and that the broker-dealer's revenue was earned primarily from private placements. The auditor took into account this evidence from the audit of the financial statements and modified its review report to indicate the broker-dealer's assertion regarding the exemption claimed was not fairly stated in all material respects because it did not reflect the nature of the broker-dealer's private placement services.



Firms did not obtain written representations from management of the broker-dealer. (AT No. 2.13)

Reporting on the Review Engagement

In review reports, firms included statements that referred to a required assertion that broker-dealers did not include in their exemption reports, or referred to different exemption provisions than as specified in related exemption reports. (AT No. 2.16)

Auditing Financial Statements

The financial statements broker-dealers include in their annual filings with the SEC are required to be audited in accordance with PCAOB standards. Our standards require auditors to obtain sufficient appropriate audit evidence to support the opinion expressed in the auditor's report (i.e., as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with GAAP).

Areas of the Financial Statement Audit with Deficiencies

Audit Areas	2019			2018
	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage	Percentage
Revenue	97	51	53%	60%
Financial Statement Presentation and Disclosures	106	39	37%	27%
Identifying and Assessing Risks of Material Misstatement	106	16	15%	23%
Related Party Relationships and Transactions	37	10	27%	55%
Receivables and Payables	26	7	27%	21%
Consideration of an Entity's Ability to Continue as a Going Concern	9	6	67%	40%
Consideration of Materiality in Planning and Performing an Audit	106	4	4%	3%
Post-Audit Matters	7	3	43%	0%
Risks of Material Misstatement Due To Fraud	8	3	38%	12%

The following deficiencies were identified in the audits of financial statements:

Revenue

Firms used information produced by the broker-dealer as audit evidence, but did not sufficiently test the accuracy and completeness of that information, whether by testing controls, testing the information, or a combination of both. (AS 1105.10)

Firms did not perform audit procedures to address the assessed risks of material misstatement for one or more relevant assertions. (AS 2301.08)

Firms did not perform tests of details specifically responsive to the assessed risks of fraud related to improper revenue recognition. (AS 2301.13)

Firms did not perform sufficient tests of controls, including information technology controls and automated application controls, to support control risk assessments at less than the maximum when the nature, timing, and extent of substantive procedures were based on that lower assessment. (AS 2301.16)

Firms did not perform sufficient substantive procedures for relevant assertions. (AS 2301.36)

Firms did not obtain sufficient evidence about the effectiveness of controls at the broker-dealers' service organizations to support the assessed level of control risk at less than the maximum and the related modification of the nature, timing, and extent of substantive procedures. (AS 2601.14 and .15)

Responses to Significant Risks, Including Fraud Risks



For significant risks, auditors should perform substantive procedures, including tests of details, that are specifically responsive to the assessed risks. A broker-dealer advises clients on mergers and acquisitions and is compensated through a combination of retainer and success fees. The auditor identified a fraud risk related to the occurrence of success fees for private transactions. The auditor selected recorded success fees from private transactions throughout the year and subsequent to year-end. In addition to vouching cash receipts and requesting confirmation of related receivables, the auditor requested confirmation of key transaction terms, including closing date, from the broker-dealer's customers. The auditor also inspected closing documents to corroborate the information obtained through the confirmation process.

FASB ASC Topic 606



FASB ASC Topic 606, *Revenue from Contracts with Customers*, became effective for annual periods beginning after December 15, 2017. FASB ASC Topic 606 replaced most industry-specific revenue recognition guidance, including broker-dealer guidance, with a five-step model. Under the model, an entity should:

1. Identify the contract(s) with a customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract; and
5. Recognize revenue when (or as) each performance obligation is satisfied.

When using substantive analytical procedures, firms did not establish that there were plausible and predictable relationships between the data, develop expectations that were sufficiently precise to identify misstatements, determine the amount of difference from expectations that could be accepted without further explanation, or evaluate the reliability of the data from which their expectations were developed. (AS 2305.11 and .20)

When testing a sample, firms did not plan and design an appropriate sample, did not select sample items in such a way that the sample could be expected to be representative of the population, and did not project the results of the sample to the items from which the sample was selected. (AS 2315.16, .21, .24, and .26)

Revenue Recognition



Auditors should perform procedures to address the risks of material misstatement related to improper revenue recognition. A broker-dealer advises clients on mergers and acquisitions. The broker-dealer's contracts with its customers are nonstandard but generally include success fees and compensation for other services. The broker-dealer asserted that its contracts contain multiple performance obligations. The auditor tested management's assertion by inspecting a sample of contracts, and assessing the nature of the promises based on the contract terms. The auditor determined that each selected contract included a success fee (a percentage of the merger or acquisition price) and fixed fees for providing a fairness opinion in connection with the sale. The auditor tested that management determined the transaction price, allocated the transaction price to the performance obligations, and recognized revenue when (or as) the separate performance obligations were satisfied in accordance with FASB ASC Topic 606.

Financial Statement Presentation and Disclosures

Firms did not sufficiently evaluate or test:

- The classification of fair value of securities as Level 1, Level 2, or Level 3 as set forth in FASB ASC Topic 820, *Fair Value Measurement*; (AS 2502.15)
- Revenue presentation and disclosure, as financial statements appeared to include:
 - Presentation of revenues on a net basis that was not in conformity with FASB ASC Topic 940, *Financial Services – Brokers and Dealers*,
 - Incomplete revenue recognition policy disclosures under FASB ASC Topic 235, *Notes to Financial Statements*, and
 - Incomplete qualitative and quantitative disclosures of information regarding revenue from contracts with customers under FASB ASC Topic 606. (AS 2810.30)
- Statement of cash flows presentation and disclosure, as financial statements appeared not to have been presented in conformity with FASB ASC Topic 230, *Statement of Cash Flows* and excluded required disclosures regarding the related change in accounting principle under FASB ASC Topic 250, *Accounting Changes and Error Corrections*. (AS 2810.30)

Deficiencies related to the evaluation and disclosure of related parties and going concern are described on pages 15 and 16, respectively.

Identifying and Assessing Risks of Material Misstatement

Insufficient risk assessment procedures contributed to deficiencies in areas of the financial statement audit described in this report.

Firms did not:

- Obtain a sufficient understanding of the selection and application of accounting principles relating to the broker-dealers' implementation of FASB ASC Topic 606. (AS 2110.12)
- Obtain a sufficient understanding of the broker-dealers' internal control over financial reporting, including the broker-dealers' information systems and business processes and control activities, to identify and assess the risks of material misstatement and design further audit procedures. (AS 2110.18 and .28)
- Perform sufficient procedures to identify and assess the risks of material misstatement because firms did not, among other deficiencies, identify and assess the risks of material misstatement at the assertion level for one or more significant accounts. (AS 2110.59)
- Identify improper revenue recognition as a fraud risk, or did not evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks. (AS 2110.68)
- Evaluate the design of the broker-dealers' controls intended to address fraud or other significant risks, and determine whether those controls had been implemented. (AS 2110.72)

Related Party Relationships and Transactions

Firms did not sufficiently:

- Address the identified and assessed risks of material misstatement because firms performed insufficient testing of allocated revenues and expenses that related to formal agreements between broker-dealers and their parents or affiliates, including not sufficiently testing whether the data used to determine the allocated revenues and expenses was accurate and complete. (AS 2410.11)
- Test the accuracy and completeness of the broker-dealers' identification of related parties and relationships and transactions with related parties because firms did not take into account information gathered during the audit. (AS 2410.14)
- Evaluate disclosures, as financial statements omitted disclosures necessary to understand related party relationships and the effects of related party transactions as set forth in FASB ASC Topic 850, *Related Party Disclosures*. (AS 2410.17)

Risk Assessment

As part of their risk assessment procedures, auditors should obtain an understanding of the broker-dealer and its environment, and its internal control over financial reporting. Effectively performed risk assessment procedures enable the auditor to identify and assess the risks of material misstatement at the financial statement level and the assertion level, including the risk of material misstatement due to fraud. The identification and assessment of risks of material misstatement should include risks associated with related parties and relationships and transactions with related parties. Factors that auditors should evaluate in determining which risks are significant risks include whether the risk is related to significant economic developments.

Source: PCAOB AS 2110: *Identifying and Assessing Risks of Material Misstatement*

Receivables and Payables

Firms did not:

- Sufficiently test the accuracy and completeness of information produced by the broker-dealer used as audit evidence, whether by testing controls, testing the information, or a combination of both. (AS 1105.10)
- Perform sufficient procedures that provided a reasonable basis for extending audit conclusions from an interim date to the period end. (AS 2301.08 and .45)
- Appropriately design sampling procedures to respond to the risks of material misstatement, which resulted in an insufficient extent of substantive testing. (AS 2301.08; AS 2315.16)
- Perform sufficient tests of controls, including information technology controls, to support control risk assessments at less than the maximum and the related modifications to the nature, timing, and extent of substantive procedures. (AS 2301.16)
- Perform, or sufficiently perform, substantive procedures for relevant assertions, including instances of the use of negative confirmations when the combined assessed level of inherent and control risk was not low and instances where the evidence obtained through alternative procedures was not sufficient. (AS 2301.36; AS 2310.20 and .33)

Confirmation Procedures

When the auditor has not received replies to positive confirmation requests, the auditor should apply alternative procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level. A broker-dealer recorded receivables from customers in its financial statements. The auditor assessed the risk of material misstatement and sent positive confirmation requests to a sample of customers. The auditor performed alternative procedures for the nonresponses to the confirmation requests, which included inspecting the customer statements used in the confirmation process, performing tests of detail of customer activity that affected the receivable balance (e.g., securities purchases and sales, cash deposits and withdrawals, and dividends and interest), and performing tests of detail of customer activity in the period subsequent to the financial statement date.



Consideration of an Entity's Ability to Continue as a Going Concern

Firms did not sufficiently evaluate:

- Conditions and events identified through audit procedures that indicated there could be substantial doubt about broker-dealers' abilities to continue as a going concern. (AS 2415.03 and .06)
- Management's plans for dealing with the conditions and events that indicated that there could be substantial doubt because they did not obtain sufficient information to consider whether the plans would have a mitigating effect, and if so, whether the plans could be effectively implemented. (AS 2415.07)
- Disclosures, as financial statements omitted disclosures regarding conditions and events that indicated there could be substantial doubt, broker-dealer managements' evaluations of their significance, and any mitigating factors as set forth in FASB ASC Topic 205, *Presentation of Financial Statements*, when substantial doubt was alleviated based primarily on consideration of managements' plans. (AS 2415.11)

Consideration of Materiality in Planning and Performing an Audit

Firms did not establish materiality levels for the financial statements as a whole or did not establish tolerable misstatement at an amount less than planning materiality. (AS 2105.06 and .08)

Post-Audit Matters

In auditors' reports on revised broker-dealer financial statements, firms did not refer to the reasons the financial statements were revised, including instances associated with broker-dealers' implementation of ASC Topic 606. (AS 2905.06)

Risks of Material Misstatement Due to Fraud

Firms did not sufficiently examine journal entries and other adjustments to address the risk of management override of controls. (AS 2401.58)

Auditing Supplemental Information Accompanying Audited Financial Statements

The supporting schedules broker-dealers are required to include in their annual filings with the SEC are required to be audited in accordance with PCAOB standards. AS 2701 requires auditors to obtain sufficient appropriate audit evidence to support the auditor's opinion regarding whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Supplemental Information

The supplemental information required by Exchange Act Rule 17a-5(d)(2)(ii) consists of supporting schedules that present the net capital computation under the Net Capital Rule, the reserve requirement computations under Exhibit A of the Customer Protection Rule, and information relating to the requirement for possession or control of customer securities under the Customer Protection Rule. The reserve requirement computations include the customer reserve computation and the Proprietary Securities Account of a Broker-Dealer (PAB) account reserve computation.



Deficiencies in Auditing Supporting Schedules

	2019			2018
	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage	Percentage
Net Capital Rule	65	20	31%	29%
Customer Protection Rule	33	14	42%	36%

In particular, when compared to the prior year, we observed an increase in deficient procedures for determining whether the broker-dealer prepared stock record allocation adjustments pursuant to Exhibit A of the Customer Protection Rule.

The following deficiencies were identified in the audit procedures related to supporting schedules:

Performing Audit Procedures on Supplemental Information

Firms did not perform, or sufficiently perform, procedures to evaluate whether the following aspects of net capital computations were determined in compliance with the Net Capital Rule: (AS 2701.04)

- Adjustments to net worth, specifically the addition of discretionary and subordinated liabilities;
- Allowable assets and assets not readily convertible into cash, including commissions and concessions receivable;
- Haircuts for securities positions and undue concentration charges; or
- Operational charges and other deductions, including failed security transactions.

Securities Haircuts

A broker-dealer held long positions in government securities in inventory, and used a report from an internal application that included issuer, maturity, and fair value information for each security to determine the haircuts on those securities to report in its computation of net capital. The auditor tested the completeness of the haircut report by reconciling the government securities included on the report to the broker-dealer's securities inventory, which was tested during the financial statement audit. The auditor tested the accuracy of the haircut report by selecting a sample of government securities from the report and comparing the maturity dates to the securities inventory, recalculating the days to maturity, obtaining the applicable haircut percentages from the Net Capital Rule, and recalculating the haircuts per the report for the securities selected.



Firms did not perform, or sufficiently perform, procedures to test whether the information in the customer and PAB reserve computations was complete, accurate, and compliant with relevant regulatory requirements. This includes whether the notification obtained from the banks applicable to the special reserve bank account for the exclusive benefit of customers met the requirements of the Reserve Requirements Rule, and procedures related to stock record allocation adjustments. (AS 2701.04)

Firms did not perform, or sufficiently perform, procedures to test the completeness and accuracy of information related to the possession or control requirements of the Customer Protection Rule, including excess margin computations, segregation deficit reporting, and segregation instructions. (AS 2701.04)



Possession or Control

A broker-dealer reported no reportable items in the possession or control schedule included in its financial statements. The auditor tested the completeness and accuracy of the broker-dealer’s stock record and customer balances during the financial statement audit. To test the schedule, the auditor obtained a deficit report generated by the broker-dealer’s internal system. The auditor tested that the system was programmed to properly calculate deficits pursuant to the Customer Protection Rule, and tested the relevant information technology controls over the system. The auditor tested completeness of the deficit report by reviewing the report logic to determine that it was configured to properly report all deficits. The auditor tested the accuracy of the report by selecting securities deficits from the stock record and the deficit report and inspecting evidence that these securities were subject to segregation, both instructed and accomplished.

Firms did not determine that supporting schedules included information inconsistent with the financial statements or the most recent FOCUS report. (AS 2701.04)

Obtaining a Representation Letter

Firms did not obtain written representations from management of the broker-dealer. (AS 2701.05)

Other Instances of Non-Compliance with PCAOB Standards

This section of our report discusses certain deficiencies we identified that relate to other instances of non-compliance with PCAOB standards. These deficiencies do not relate directly to the sufficiency or appropriateness of evidence firms obtained to support their audit opinions or attestation reports.

Auditor’s Report on the Financial Statements and Supporting Schedules

Deficiencies in the Auditor’s Report

	2019			2018
	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage	Percentage
Auditor’s Report on the Financial Statements and Supporting Schedules	106	15	14%	18%

Certain auditors’ reports on broker-dealer financial statements and supporting schedules were not presented in accordance with PCAOB standards. The most frequently occurring deficiency related to the identification of the supplemental information. (AS 2701.10) In certain instances, auditors’ reports on broker-dealer financial statements reflected the requirements of AS 3101 prior to its amendment, even though the amended standard was effective. (AS 3101.05-.10) In other instances, auditors’ reports omitted or did not properly present one or more of the required elements listed below:

- A required element from the opinion on the financial statement section of the auditor’s report; (AS 3101.08)

- A statement that the auditor believes that the audit provides a reasonable basis for the auditor’s opinion; (AS 3101.09)
- Tenure for the firm; and (AS 3101.10)
- A required element from the auditor’s report on supplemental information. (AS 2701.10)

In addition, certain auditors’ reports on broker-dealer financial statements and supporting schedules included report dates prior to the completion of the audit procedures performed by the firms. (AS 3110.01; AS 2701.12)

Auditor Communications

Deficiencies in Auditor Communications

	2019			2018
	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage	Percentage
Auditor Communications	106	5	5%	12%

The following deficiencies were identified relating to communications required to be made to the broker-dealer’s audit committee (or equivalent body):

Communications with Audit Committees (or Equivalent Body)

Firms did not document oral communications made to the audit committee (or equivalent body). (AS 1301.25)

Communications about Control Deficiencies

Firms did not communicate in writing to management and the audit committee (or equivalent body) identified significant deficiencies and material weaknesses. (AS 1305.04)

Engagement Documentation

Deficiencies in Documentation

	2019			2018
	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage	Percentage
Audit Documentation	106	26	25%	25%
Review Documentation	74	8	11%	16%

Firms did not properly complete an engagement completion document, assemble a complete and final set of audit and review documentation (“engagement file”) by the documentation completion date, and properly document additions to the engagement file after the report release date. (AS 1215.13, .15, and .16)

Quality Control

This section of our report includes observations of firms' systems of quality control. Our standards require firms to have a system of quality control that provides reasonable assurance that personnel comply with applicable professional and firm standards. Observations from our oversight activities have shown that firms' improvements in quality control systems can enhance the quality of audits.

Consistent with what we have historically emphasized, a firm's system of quality control, among other things, should provide reasonable assurance that for broker-dealer audit and attestation engagements:

- Firms assign engagement partners with knowledge and experience in broker-dealer accounting and regulatory requirements and PCAOB audit and attestation standards;
- Firms assign engagement quality reviewers that meet the qualifications required by PCAOB standards and establish policies and procedures that cover the execution of engagement quality reviews pursuant to PCAOB standards;
- Auditors participating in audit and attestation engagements exercise due professional care, including professional skepticism; and
- Engagement teams identify and document all significant findings and issues related to the audit and attestation engagements.

The results of our 2019 inspections indicate, however, that there is room for improvement. Our observations indicate that firms' systems of quality control did not appear to provide reasonable assurance that firm personnel will comply with applicable professional standards in the areas of: 1) engagement performance; 2) monitoring; 3) independence, integrity, and objectivity; and 4) personnel management, which are required elements of a system of quality control. We explore each of these topics further below.

Engagement Performance

Our staff made the following observations related to engagement performance:

- Policies and procedures did not provide reasonable assurance that a complete and final set of audit and attestation documentation was assembled for retention as of the documentation completion date, and any documentation subsequent to the report release date indicated the date the information was added, the name of the person who prepared the additional documentation, and the reasons for adding it, in accordance with AS 1215. (QC 20.17)
- Policies and procedures did not provide reasonable assurance that engagement partners reviewed and supervised audit and attestation engagements with due professional care in accordance with AS 1201, which contributed to not identifying deficiencies in those engagements. (QC 20.18)
- Engagement quality reviews were not performed (AS 1220.01) or did not include a sufficient evaluation of the engagement team's significant judgments and the related conclusions reached that formed the overall conclusion in the engagement report. Based on deficiencies identified in audit and attestation engagements, it appears engagement quality reviewers did not sufficiently evaluate the engagement team's assessment of, and audit responses to, significant risks, including fraud risks, and did not sufficiently review the financial statements, documents containing management's assertions, and related engagement reports. (AS 1220.09, .10, and .18A) In addition, it appears engagement quality reviewers did not perform their review with due professional care, which contributed to not identifying deficiencies in engagement areas requiring review. (AS 1220.12 and .18B)

Audit and Attestation Engagements with Deficiencies in the Engagement Quality Review Area

	2019			2018
	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage	Percentage
Audit Engagements	80	54	68%	65%
Review Engagements	38	27	71%	43%
Examination Engagements	21	2	10%	26%

Engagement Quality Review

Engagement quality reviewers should evaluate audit responses to significant risks identified by the engagement team, including fraud risks. The engagement team assessed a fraud risk related to the improper timing of underwriting revenue recognition. The engagement quality reviewer evaluated the engagement team’s judgments and conclusions regarding the identified fraud risk by reviewing the substantive testing of underwriting revenue and holding discussions with the engagement team.



Monitoring

Procedures for internal inspections did not provide reasonable assurance that firms would detect significant audit and attestation deficiencies through their monitoring activities. (QC 30.04-.07)

Independence, Integrity, and Objectivity

Policies and procedures did not provide reasonable assurance that the firms would maintain their independence, particularly related to the general standard of independence and the financial relationship requirements of Rule 2-01 of SEC Regulation S-X. (QC 20.09)

Personnel Management

Policies and procedures did not provide reasonable assurance that engagement personnel assigned to broker-dealer engagements complied with the firms’ education requirements. (QC 20.13)

Auditor Independence

SEC rules require auditors of broker-dealers to comply with SEC independence requirements. This section of our report discusses related findings from our inspections.

Independence Findings

	2019			2018
	Number of Applicable Audits Reviewed	Number of Audits with Findings	Percentage	Percentage
Auditor Independence	29	5	17%	5%

Firms assisted in the preparation of broker-dealer financial statements and supplemental information, which impaired their independence. Assistance by the auditor with the preparation of financial statements and supplemental information being audited is not a permissible service as prescribed by Rule 2-01(c)(4)(i) of SEC Regulation S-X.

Firms included indemnification clauses in engagement letters, which impaired their independence based on the general standard of independence as prescribed by Rule 2-01(b) of SEC Regulation S-X.

PCAOB Standards Associated with Inspection Observations

QC 20	System of Quality Control for a CPA Firm's Accounting and Auditing Practice
QC 30	Monitoring a CPA Firm's Accounting and Auditing Practice
AS 1105	Audit Evidence
AS 1201	Supervision of the Audit Engagement
AS 1215	Audit Documentation
AS 1220	Engagement Quality Review
AS 1301	Communications with Audit Committees
AS 1305	Communications About Control Deficiencies in an Audit of Financial Statements
AS 2105	Consideration of Materiality in Planning and Performing an Audit
AS 2110	Identifying and Assessing Risks of Material Misstatement
AS 2301	The Auditor's Responses to the Risks of Material Misstatement
AS 2305	Substantive Analytical Procedures
AS 2310	The Confirmation Process
AS 2315	Audit Sampling
AS 2401	Consideration of Fraud in a Financial Statement Audit
AS 2410	Related Parties
AS 2415	Consideration of an Entity's Ability to Continue as a Going Concern
AS 2502	Auditing Fair Value Measurements and Disclosures
AS 2601	Consideration of an Entity's Use of a Service Organization
AS 2701	Auditing Supplemental Information Accompanying Audited Financial Statements
AS 2810	Evaluating Audit Results
AS 2905	Subsequent Discovery of Facts Existing at the Date of the Auditor's Report
AS 3101	The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion
AS 3110	Dating of the Independent Auditor's Report
AT No. 1	Examination Engagements Regarding Compliance Reports of Brokers and Dealers
AT No. 2	Review Engagements Regarding Exemption Reports of Brokers and Dealers

Appendix A: Selection of Firms and Engagements for Inspections

The following information provides an overview of the firms that have been subject to our inspection procedures. Because our inspection process evolves over time, it can, and often does, focus on a different mix of firms and engagements from year to year. We selected 66 firms for inspection during 2019.³ These inspections covered 106 audits of financial statements and 103 attestation engagements of broker-dealers that had financial statement periods ended during the period April 1, 2018 through March 31, 2019. These selections were made from the population of firms and broker-dealer audits depicted in the following table.

Number of Broker-Dealer Audits Per Firm	Number of Firms	Number of Broker-Dealer Audits
1	123	123
2 to 20	245	1,287
21 to 50	27	822
51 to 100	12	810
More than 100	4	579
Total	411	3,621

The firms and the audit and attestation engagements were generally selected based on characteristics of the firms and the broker-dealers. The firm characteristics included, among others:

- The number of broker-dealer audits performed;
- Whether the firm conducted examination engagements;
- Whether the firm also issued audit reports for issuers;
- Previous inspection results;
- History of the firm or firm personnel in auditing broker-dealers; and
- The existence of disciplinary actions against the firm or engagement partner by the SEC, PCAOB, or other regulatory authorities.

The selection of the firms' broker-dealer engagements was based on various characteristics, including:

- Whether the broker-dealer filed a compliance report with the SEC pursuant to Exchange Act Rule 17a-5;
- Whether the broker-dealer was a subsidiary of an issuer and its significance to the issuer's consolidated financial statements;
- Changes in auditors and certain circumstances related to the changes;
- Financial metrics;

³ See footnote 1 on page 4.

- Existence of disciplinary actions against the broker-dealer by the SEC, FINRA, or other regulatory authorities; and
- Engagement partner's workload, experience in auditing broker-dealers, and previous inspection results.

We also selected a number of engagements randomly.

Selection of Firms for Inspection and Audit and Attestation Engagements for Review in 2019

The following tables present information about the firms inspected in 2019 and the number of audits and attestation engagements reviewed during those inspections. The tables provide the number of broker-dealer audits performed by the inspected firms, as determined at the time of the inspection, whether or not the firms also audited issuers, and whether the firms audited broker-dealers that filed a compliance report or only audited broker-dealers that filed an exemption report.

Number of Broker-Dealer Audits Per Firm	Number of Firms Inspected	Number of Audits Reviewed
1	10	10
2 to 20	32	33
21 to 50	14	19
51 to 100	6	12
More than 100	4	32
Total	66	106

Firms	Number of Firms Inspected	Number of Audits Reviewed
Also Audited Issuers	37	73
Did Not Audit Issuers	29	33
Total	66	106

At the time of the 2019 inspections, of the 37 firms that also audited issuers, four audited more than 100 issuers and 33 audited 100 or fewer issuers.

Firms	Number of Firms Inspected	Number of Audits Reviewed
Audited Broker-Dealers That Filed Compliance Reports	21	58
Only Audited Broker-Dealers That Filed Exemption Reports	45	48
Total	66	106

The following tables present the number of audits and attestation engagements reviewed during the inspections in 2019, the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers that filed either a compliance report or an exemption report, stratified by whether the broker-dealer did or did not claim an exemption, and whether the broker-dealer filed a compliance report or an exemption report (on the basis of either one or more exemptions claimed or applicable SEC and SEC staff guidance).

Broker-Dealers	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (Thousands)	Range of Actual Net Capital Reported at Fiscal Year End (Thousands)
Did Not Claim Exemption	33	\$30 - \$3,000,000	\$250 - \$17,000,000
Claimed Exemption	73	\$5 - \$1,600	\$9 - \$180,000
Total	106	\$5 - \$3,000,000	\$9 - \$17,000,000

Broker-Dealers Filed	Number of Attestations Covered	Range of Minimum Net Capital Requirements (Thousands)	Range of Actual Net Capital Reported at Fiscal Year End (Thousands)
Compliance Report	29	\$250 - \$3,000,000	\$250 - \$17,000,000
Exemption Report	74	\$5 - \$1,600	\$9 - \$180,000

Three of the 106 audits reviewed during the inspections had a related attestation engagement that was not reviewed during the inspection.

Selection of Firms for Inspections and Audit and Attestation Engagements for Reviews since Inception of the Interim Program in 2011

The following table presents the number of firms inspected, the number of audits reviewed during the inspections, and the number of attestation engagements covered by the inspections, stratified by the number of broker-dealer audits per firm.

Number of Broker-Dealer Audits Per Firm	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
1	77	78	5	44
2 to 20	253	329	34	188
21 to 50	41	125	11	54
51 to 100	17	70	8	43
More than 100	7	239	72	94
Total	370	841	130	423

The sum of the number of firms inspected does not total to 370 because 25 firms that were inspected more than once since the inception of the interim inspection program are reported in multiple stratifications due to changes in the number of broker-dealer audits performed by those firms. In addition, one firm that audited one broker-dealer was inspected more than once.

The following table presents the number of firms inspected, the number of audits reviewed during the inspections, and the number of attestation engagements covered by the inspections, stratified by whether or not the firms also audited issuers.

Firms	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
Also Audited Issuers	159	546	115	266
Did Not Audit Issuers	217	295	15	157
Total	370	841	130	423

The sum of the number of firms inspected does not total to 370 because six firms that were inspected more than once since the inception of the interim inspection program are reported in both stratifications due to a change over time in whether the firms also audited issuers.

The following table presents the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers whose engagements were covered in the inspections that filed either a compliance report or an exemption report, stratified by whether the broker-dealer did or did not claim exemption from the Customer Protection Rule.

Broker-Dealers	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (Thousands)	Range of Actual Net Capital Reported at Fiscal Year End (Thousands)
Did Not Claim Exemption	207	\$5 - \$3,000,000	\$250 - \$17,000,000
Claimed Exemption	634	\$5 - \$82,000	\$6 - \$2,250,000

The requirement for broker-dealer audits to be performed in accordance with PCAOB standards, and the requirement for broker-dealers to file compliance or exemption reports, was effective for broker-dealer annual reports with fiscal years ended on or after June 1, 2014. The following table presents the number of firms where inspections addressed whether engagements were conducted in accordance with PCAOB standards. The table also presents the number of audits reviewed during the inspections, and the number of attestation engagements covered by the inspections, stratified by whether the firms audited broker-dealers that filed compliance reports or only audited broker-dealers that filed exemption reports.

Firms	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
Audited Broker-Dealers That Filed Compliance Reports	64	292	130	158
Only Audited Broker-Dealers That Filed Exemption Reports	221	268	N/A	265
Total	276	560	130	423

The number of firms inspected does not total to 276 because nine firms that were inspected more than once are included in both stratifications due to a change over time in whether the firms also audited broker-dealers that filed compliance reports. In addition, two of the firms inspected that only audited one broker-dealer and those broker-dealers did not file either a compliance or an exemption report are not included in this table. Certain audits reviewed during the inspections also (1) did not have a related attestation engagement, (2) had a related attestation engagement not covered during the inspection, or (3) had more than one related attestation engagement covered during the inspection.

The following table presents the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers whose engagements were covered in the inspections that filed either a compliance report or an exemption report, stratified by the type of report filed.

Broker-Dealers Filed	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (Thousands)	Range of Actual Net Capital Reported at Fiscal Year End (Thousands)
Compliance Report	130	\$100 - \$3,000,000	\$250 - \$17,000,000
Exemption Report	423	\$5 - \$82,000	\$6 - \$300,000

Appendix B: Comparative Results from Our Inspections under the Interim Program

Since the inception of the interim inspection program in 2011, the PCAOB has performed 542 inspections of 370 of the firms that conducted audits of broker-dealers. The 542 inspections covered portions of 841 audits, of which 562 were required to be performed in accordance with PCAOB standards, and 279 were required to be performed in accordance with generally accepted auditing standards. These audits had financial statement periods ended December 31, 2010 through March 31, 2019.

The inspections covered 553 attestation engagements that were required to be performed in accordance with PCAOB standards. These attestation engagements had financial statement periods ended June 30, 2014 through March 31, 2019.

Deficiency Classification

We have reclassified certain deficiencies from 2018 and 2017 inspections reported in the previous annual report to conform to the classification of deficiencies from 2019 inspections. The classification of 2019 inspections deficiencies includes areas not previously reported, either due to the frequency with which we observed the deficiency in prior years, or because some or all of the deficiencies were combined with another deficiency area. The purpose of the reclassification was to align the deficiencies with the primary standard to which the deficiency related. The areas affected by the reclassification are:

- Revenue;
- Financial Statement Presentation and Disclosures;
- Identifying and Assessing the Risks of Material Misstatement;
- Related Party Relationships and Transactions;
- Receivables and Payables;
- Consideration of an Entity's Ability to Continue as a Going Concern;
- Risks of Material Misstatement Due to Fraud; and
- Auditor Communications.

In this appendix, the term cumulative refers to the inspections conducted during 2014 through 2019 that covered audits and attestation engagements required to be performed in accordance with PCAOB standards. Cumulative results include inspections results from years 2014 through 2016, which have not been reclassified.

We do not review every aspect of the audit, and not all areas were included for each broker-dealer audit engagement inspected. Rather, we generally focus our attention on areas we believe to be of greater complexity, and areas of greater significance or with a heightened risk of material misstatement to the broker-dealer's financial statements.

Summary of Findings and Deficiencies

The table below summarizes the independence findings and audit, attestation, and other deficiencies identified from reviews of audits and attestation engagements performed in accordance with PCAOB standards under the interim inspection program through 2019.⁴ Attestation and other deficiencies in this table include deficiencies in attestation procedures, documentation, and engagement quality reviews.

Inspection Year	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
2019	17%	71%	27%	69%	51%
2018	5%	76%	29%	75%	54%
2017	8%	76%	28%	70%	40%
Cumulative	9%	77%	31%	72%	47%

On an overall basis, the percentages of audits, areas, and attestation engagements with deficiencies identified in 2019 remained high, though the percentages of audits, areas, and examination engagements with deficiencies decreased when compared to 2018 and 2017. The percentage of review engagements with deficiencies decreased in 2019 when compared to 2018, but increased when compared to 2017. The percentage of audits with independence findings in 2019 increased when compared to 2018 and 2017.

⁴ See footnote 1 on page 4.

Attestation, Audit, and Other Deficiencies

Deficiencies	Percentage of Applicable Engagements with Deficiencies		
	2019	2018	2017
Deficiencies in Attestation Procedures			
Examination Engagements	69%	75%	70%
Review Engagements	49%	51%	38%
Deficiencies in Auditing Supporting Schedules			
Customer Protection Rule	42%	36%	48%
Net Capital Rule	31%	29%	36%
Deficiencies in Auditing Financial Statements			
Consideration of an Entity's Ability to Continue as a Going Concern	67%	40%	50%
Revenue	53%	60%	65%
Post-Audit Matters	43%	0%	0%
Risks of Material Misstatement Due to Fraud	38%	12%	24%
Financial Statement Presentation and Disclosures	37%	27%	23%
Related Party Relationships and Transactions	27%	55%	42%
Receivables and Payables	27%	21%	31%
Identifying and Assessing Risks of Material Misstatement	15%	23%	24%
Consideration of Materiality in Planning and Performing an Audit	4%	3%	3%
Fair Value Measurements	0%	14%	20%
Other Instances of Non-Compliance with PCAOB Standards			
Audit Documentation	25%	25%	13%
Auditor's Report on the Financial Statements and Supporting Schedules	14%	18%	10%
Review Documentation	11%	16%	6%
Auditor Communications	5%	12%	20%
Examination Documentation	0%	0%	7%
Deficiencies in Engagement Quality Reviews			
Review Engagements	71%	43%	26%
Audit Engagements	68%	65%	59%
Examination Engagements	10%	26%	20%

Attestation, Audit, and Other Deficiencies by Firm Characteristics

The following tables present the percentages of audit, attestation, and other deficiencies for the periods indicated, stratified by certain firm characteristics.

Firms That Audited Broker-Dealers That Filed Compliance Reports and Firms That Audited Broker-Dealers That Filed Only Exemption Reports

	Percentage of					
	Audits with Audit and Other Deficiencies			Areas with Audit and Other Deficiencies		
	2019	2018	2017	2019	2018	2017
Firms That Audited Broker-Dealers That Filed Compliance Reports	57%	64%	66%	16%	21%	21%
Firms That Audited Broker-Dealers That Filed Only Exemption Reports	88%	91%	85%	40%	40%	35%

	Percentage of					
	Examinations with Attestation and Other Deficiencies			Reviews with Attestation and Other Deficiencies		
	2019	2018	2017	2019	2018	2017
Firms That Audited Broker-Dealers That Filed Compliance Reports	69%	75%	70%	30%	41%	17%
Firms That Audited Broker-Dealers That Filed Only Exemption Reports	N/A	N/A	N/A	64%	64%	52%

We noted for audit and review engagements that firms that audited broker-dealers that filed compliance reports had significantly lower percentages of deficiencies when compared to firms that audited broker-dealers that filed only exemption reports. Firms that audited broker-dealers that filed compliance reports also had lower percentages of audits, areas, and examination engagements with deficiencies in 2019, compared to 2018 and 2017; the percentage of review engagements with deficiencies was lower in 2019 compared to 2018, but higher compared to 2017.

Firms That Also Audited Issuers and Firms That Did Not Audit Issuers

	Percentage of					
	Audits with Audit and Other Deficiencies			Areas with Audit and Other Deficiencies		
	2019	2018	2017	2019	2018	2017
Firms That Also Audited Issuers:	59%	70%	70%	18%	24%	24%
Broker-Dealers That Filed a Compliance Report	59%	63%	83%	14%	20%	30%
Broker-Dealers That Filed an Exemption Report	59%	74%	65%	20%	26%	22%
Firms That Did Not Audit Issuers:	97%	91%	96%	47%	42%	41%
Broker-Dealers That Filed a Compliance Report	100%	100%	100%	47%	20%	44%
Broker-Dealers That Filed an Exemption Report	97%	90%	95%	47%	43%	41%

	Percentage of Attestations with Attestation and Other Deficiencies		
	2019	2018	2017
Firms That Also Audited Issuers:	49%	52%	43%
Broker-Dealers That Filed a Compliance Report	65%	73%	71%
Broker-Dealers That Filed an Exemption Report	40%	43%	32%
Firms That Did Not Audit Issuers:	72%	75%	64%
Broker-Dealers That Filed a Compliance Report	100%	100%	67%
Broker-Dealers That Filed an Exemption Report	69%	73%	64%

We noted that the corresponding deficiencies were generally lower at firms that also audited issuers for all stratifications. In addition, we noted that the percentage of attestation and other deficiencies was higher for examinations of broker-dealers that filed a compliance report compared to reviews of broker-dealers that filed an exemption report, both at firms that also audited issuers and those that did not, for all periods presented.

Firms	Cumulative 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
Also Audited Issuers	68%	23%	70%	35%
Did Not Audit Issuers	96%	50%	93%	69%

Number of Broker-Dealer Audits Per Firm

2019 Inspections								
Broker-Dealer Audits Per Firm	Number of Firms Inspected	Number of Audits Reviewed	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Examination Engagements Covered	Percentage of Examinations with Attestation and Other Deficiencies	Review Engagements Covered	Percentage of Reviews with Attestation and Other Deficiencies
1	10	10	90%	48%	N/A	N/A	9	67%
2 to 20	32	33	82%	35%	5	60%	27	70%
21 to 50	14	19	84%	31%	6	83%	13	69%
51 to 100	6	12	83%	32%	2	100%	9	22%
More than 100	4	32	41%	8%	16	63%	16	13%
Total	66	106	71%	27%	29	69%	74	51%

2018 Inspections								
Broker-Dealer Audits Per Firm	Number of Firms Inspected	Number of Audits Reviewed	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Examination Engagements Covered	Percentage of Examinations with Attestation and Other Deficiencies	Review Engagements Covered	Percentage of Reviews with Attestation and Other Deficiencies
1	8	8	88%	43%	2	100%	6	67%
2 to 20	43	46	93%	36%	7	100%	40	70%
21 to 50	5	6	83%	35%	N/A	N/A	6	83%
51 to 100	7	13	69%	29%	2	100%	11	45%
More than 100	4	32	50%	14%	13	54%	16	6%
Total	67	105	76%	29%	24	75%	79	54%

Number of Broker-Dealer Audits Per Firm	Cumulative 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%	50%	100%	68%
2 to 20	92%	42%	88%	62%
21 to 50	75%	30%	91%	41%
51 to 100	79%	32%	100%	33%
More than 100	53%	12%	57%	18%

We noted that firms that audited more than 100 broker-dealers had generally lower percentages of deficiencies, sometimes significantly so, than firms that audited 100 or fewer broker-dealers in 2019, 2018, and on a cumulative basis.

Attestation, Audit, and Other Deficiencies by Inspection Considerations

The following tables present the percentages of audit and attestation engagements with deficiencies, stratified by the frequency with which the firm has been inspected, and whether the broker-dealers whose engagements were reviewed were selected at random or based on risk characteristics:

Firms Inspected More Than Once

Six firms inspected during 2019 were also inspected during 2018, 2017, 2016, and 2015. The following table presents a summary of deficiencies for these firms by year.

Inspection Year	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
2019	44%	8%	65%	11%
2018	50%	15%	57%	11%
2017	59%	15%	65%	18%
2016	59%	11%	57%	22%
2015	49%	11%	46%	27%

For firms inspected in all five years, the percentage of audits and areas with deficiencies decreased in 2019 compared to the earlier years. The percentage of examination engagements with deficiencies increased in 2019 compared to the earlier years other than 2017, when the percentage was the same. The percentage of review engagements with deficiencies remained the same in 2019 compared to 2018, and decreased when compared to the earlier years. The individual firm results varied.

An additional 51 firms were inspected more than once, but not in all five years, during 2015 through 2019. Of these firms, 43 were inspected twice during that period, and 19 were inspected for the second time in 2019. The following table shows the results from the most recent inspections and the results from the initial inspections of these 51 firms. The table shows the percentage of audits, areas, and attestation engagements with deficiencies. Attestation deficiencies are included if the type of attestation engagement (examination or review) was the same for the most recent inspection and the initial inspection of a firm.

Inspection Year	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
Most Recent Inspections	83%	32%	90%	51%
Initial Inspections	92%	39%	100%	43%

We noted that the percentage of audits, areas, and examination engagements with deficiencies was lower in the subsequent inspections when compared to the initial inspections, while the percentage of review engagements with deficiencies was higher.

Broker-Dealers Selected on a Random Basis Whose Engagements Were Reviewed During 2019

During 2019, we selected 15 broker-dealers whose audits and attestation engagements were covered by the inspections at random. The areas reviewed during these inspections were selected individually based on risk factors, including past inspection experience. The following table shows the percentage of audits, areas, and review engagements with deficiencies for the engagements related to broker-dealers selected at random and those related to broker-dealers selected based on risk characteristics.

	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Reviews with Attestation and Other Deficiencies
Risk-Based Selections	71%	27%	56%
Random Selections	67%	24%	33%

We noted that the percentage of audits, areas, and review engagements with deficiencies was lower in the random selections when compared to the risk-based selections. Five of the 15 audits and related attestation engagements for broker-dealers selected at random had no deficiencies.

Attestation, Audit, and Others Deficiencies by Broker-Dealer Characteristics

The following tables present audit, attestation, and other deficiencies stratified by whether the broker-dealers did not claim, or claimed, exemption from the Customer Protection Rule.

Percentage of Audits with Audit, Attestation, and Other Deficiencies Stratified by Whether or Not the Broker-Dealer Claimed Exemption from the Customer Protection Rule

Broker-Dealers	Cumulative 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
Did Not Claim Exemption	73%	25%	72%	55%
Claimed Exemption	78%	33%	(•)	47%

- One broker-dealer claimed an exemption from Rule 15c3-3 and filed both a compliance report and exemption report. We identified deficiencies in the examination engagement.

Audit and Other Deficiencies Related to the Audit – Broker-Dealers that did not Claim Exemption from the Customer Protection Rule

Audit and Other Deficiencies	2019			2018	2017
	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Deficiencies in Auditing Supporting Schedules					
Net Capital Rule	18	5	28%	30%	47%
Customer Protection Rule	29	12	41%	33%	50%
Deficiencies in Auditing Financial Statements					
Revenue	29	12	41%	36%	71%
Financial Statement Presentation and Disclosures	33	2	6%	14%	7%
Identifying and Assessing Risks of Material Misstatement	33	4	12%	14%	29%
Related Party Relationships and Transactions	10	2	20%	58%	38%
Receivables and Payables	11	4	36%	21%	56%
Consideration of an Entity's Ability to Continue as a Going Concern	2	2	100%	0%	0%
Consideration of Materiality in Planning and Performing an Audit	33	1	3%	4%	11%
Post-Audit Matters	3	0	0%	0%	0%
Risks of Material Misstatement Due to Fraud	4	0	0%	25%	38%
Fair Value Measurements	10	0	0%	14%	0%
Other Instances of Non-Compliance with PCAOB Standards					
Auditor's Report on the Financial Statements and Supporting Schedules	33	1	3%	7%	4%
Auditor Communications	33	1	3%	14%	29%
Audit Documentation	33	3	9%	0%	14%
Deficiencies in Engagement Quality Reviews					
Audit Engagements	24	8	33%	44%	46%

Audit and Other Deficiencies Related to the Audit – Broker-Dealers that Claimed Exemption from the Customer Protection Rule

Audit and Other Deficiencies	2019			2018	2017
	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Deficiencies in Auditing Supporting Schedules					
Net Capital Rule	47	15	32%	29%	33%
Customer Protection Rule	4	2	50%	100%	0%
Deficiencies in Auditing Financial Statements					
Revenue	68	39	57%	69%	63%
Financial Statement Presentation and Disclosures	73	37	51%	31%	28%
Identifying and Assessing Risks of Material Misstatement	73	12	16%	26%	23%
Related Party Relationships and Transactions	27	8	30%	54%	44%
Receivables and Payables	15	3	20%	21%	6%
Consideration of an Entity's Ability to Continue as a Going Concern	7	4	57%	43%	54%
Consideration of Materiality in Planning and Performing an Audit	73	3	4%	3%	1%
Post-Audit Matters	4	3	75%	0%	0%
Risks of Material Misstatement Due to Fraud	4	3	75%	0%	18%
Fair Value Measurements	11	0	0%	14%	33%
Other Instances of Non-Compliance with PCAOB Standards					
Auditor's Report on the Financial Statements and Supporting Schedules	73	14	19%	22%	13%
Auditor Communications	73	4	5%	12%	17%
Audit Documentation	73	23	32%	34%	13%
Deficiencies in Engagement Quality Reviews					
Audit Engagements	56	46	82%	71%	64%

