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SECURITIES AND EXCHANGE COMMISSION
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November 8, 2013

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, and Related Amendments to PCAOB Standards

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), notice is hereby given that on October 30, 2013, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or the "SEC") the proposed rules described in items I and II below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On October 10, 2013, the Board adopted Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, and related amendments to PCAOB standards (collectively, the "proposed rules"). The text of the proposed rules is set out below.

Attestation Standard No. 1

Examination Engagements Regarding Compliance Reports of Brokers and Dealers

Introduction

1. This standard establishes requirements that apply when an auditor is engaged to perform

an examination[1] of certain statements made by a broker[2] or dealer[3] in a compliance report ("compliance report") prepared pursuant to Securities and Exchange Act of 1934 ("Exchange Act") Rule 17a-5, 17 CFR § 240.17a-5 ("SEC Rule 17a-5") of the U.S. Securities and Exchange Commission ("SEC").[4]

2. SEC Rule 17a-5 requires a broker's or dealer's compliance report to include the following statements (hereinafter referred to as "assertions") by the broker or dealer as to whether:[5]

a. The Internal Control Over Compliance[6] of the broker or dealer was effective during the most recent fiscal year;

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[1] See paragraphs (d)(1)(i)(C) and (g)(2)(i) of SEC Rule 17a-5, which require that certain brokers or dealers file with the SEC a report prepared by an independent accountant based on an examination of the compliance report, if the broker or dealer is required to file a compliance report with the SEC.

[2] According to PCAOB Rule 1001(b)(iii), the term "broker" means a broker (as defined in Section 3(a)(4) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[3] According to PCAOB Rule 1001(d)(iii), the term "dealer" means a dealer (as defined in Section 3(a)(5) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[4] See paragraph (g)(2)(i) of SEC Rule 17a-5.

[5] The scope of the auditor's examination does not encompass the statement required by paragraph (d)(3)(i)(A)(1) of SEC Rule 17a-5, which is a statement as to whether the broker or dealer has established and maintained Internal Control Over Compliance as that term is defined in paragraph (d)(3)(ii) of SEC Rule 17a-5. See paragraphs (d)(3) and (g)(2)(i) of SEC Rule 17a-5.

[6] Terms defined in Appendix A, Definitions, are set in boldface type the first time they appear. The definitions of the terms in Appendix A are consistent with paragraphs (d)(3)(ii) and (iii) of SEC Rule 17a-5.

b. The Internal Control Over Compliance of the broker or dealer was effective as of the end of the most recent fiscal year;[7]

c. The broker or dealer was in compliance with 17 CFR §§ 240.15c3-1 (the "net capital rule") and 240.15c3-3(e) (the "reserve requirements rule") as of the end of the most recent fiscal year; and

d. The information the broker or dealer used to state whether it was in compliance with the net capital rule and the reserve requirements rule was derived from the books and records of the broker or dealer.

Objective

3. When performing an examination of the assertions made by a broker or dealer in a compliance report (an "examination engagement"), the auditor's objective is to express an opinion regarding whether the assertions made by the broker or dealer in its compliance report are fairly stated, in all material respects.

4. To express an opinion on the assertions made by a broker or dealer in a compliance report, the auditor must plan and perform the examination engagement to obtain appropriate evidence that is sufficient[8] to obtain reasonable assurance[9] about whether (1) one or more

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[7] See paragraph (d)(3)(iii) of SEC Rule 17a-5, which provides that "a broker or dealer is not permitted to conclude that its Internal Control Over Compliance was effective during the most recent fiscal year if there were one or more material weaknesses in its Internal Control Over Compliance during the most recent fiscal year. The broker or dealer is not permitted to conclude that its Internal Control Over Compliance was effective as of the end of the most recent fiscal year if there were one or more material weaknesses in its Internal Control Over Compliance as of the end of the most recent fiscal year."

[8] See the description of "sufficiency" and "appropriateness" in Auditing Standard No. 15, Audit Evidence.

[9] Although not absolute assurance, reasonable assurance is a high level of assurance.

Material Weaknesses existed during the most recent fiscal year specified in the broker's or dealer's assertion; (2) one or more Material Weaknesses existed as of the end of the most recent fiscal year specified in the broker's or dealer's assertion; and (3) one or more instances of non-compliance with the net capital rule or the reserve requirements rule existed as of the end of the most recent fiscal year specified in the broker's or dealer's assertion.

Note: Because the broker's or dealer's assertions include assertions regarding Internal Control Over Compliance and its compliance with both the net capital rule and the reserve requirements rule, the auditor's examination should evaluate (a) the effectiveness of Internal Control Over Compliance with each financial responsibility rule[10] during, and as of the end of, the most recent fiscal year, and (b) compliance with the net capital rule and with the reserve requirements rule as of the end of the most recent fiscal year.

Note: The auditor is not required to express an opinion on the process the broker or dealer used to arrive at the conclusions stated in the broker's or dealer's assertions.

5. The auditor also must plan and perform the examination engagement to obtain appropriate evidence that is sufficient to obtain reasonable assurance to support the auditor's opinion regarding whether the assertion by the broker or dealer that the information used to

[10] The term "financial responsibility rules" refers to: 17 CFR § 240.15c3-1 ("SEC Rule 15c3-1" or the "net capital rule"); 17 CFR § 240.15c3-3 ("SEC Rule 15c3-3"); 17 CFR § 240.17a-13 ("SEC Rule 17a-13"); and any rule of the designated examining authority ("DEA") of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer. The financial responsibility rules are the same as the rules cited in paragraph (d)(3)(ii) of SEC Rule 17a-5.

assert compliance with the net capital rule and the reserve requirements rule was derived from the books and records of the broker or dealer, is fairly stated, in all material respects.

Performing the Examination Engagement

General Requirements

6. An auditor who performs an examination engagement pursuant to this standard must:

   a. Have adequate technical proficiency in attestation engagements;

   b. Obtain an understanding of the financial responsibility rules and other rules and regulations that are relevant to the broker's or dealer's assertions;

   c. Determine the auditor's compliance with independence and ethics requirements; and

   d. Exercise due professional care, which includes application of professional skepticism, in planning and performing the examination and the preparation of the report.

   Note: Due professional care imposes a responsibility on each engagement team member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.[11]

   Note: Auditing Standard No. 3, Audit Documentation, establishes the documentation requirements for examination engagements performed pursuant to this standard.

[11] The auditor's responsibility to exercise due professional care is consistent with the description in paragraphs .40–.41 of AT sec. 101, Attest Engagements.

7. The engagement partner is responsible for the examination engagement and performance of the examination procedures. Accordingly, the engagement partner is responsible for proper planning of the examination engagement, proper supervision of the work of engagement team members, and compliance with the requirements of this standard. The engagement partner may seek assistance from appropriate engagement team members in fulfilling these responsibilities.

Note: For purposes of this standard, the term "engagement partner" means the member of the engagement team with primary responsibility for the examination engagement.

Note: Proper planning includes establishing an overall strategy for the examination engagement and developing a plan for the engagement, which includes, in particular, the nature, timing, and extent of procedures necessary to obtain reasonable assurance. Proper supervision includes supervising the work of engagement team members so that the work is performed as directed and supports the conclusions reached.

Relationship Between the Examination Engagement and the Audit of the Financial Statements and the Audit Procedures Performed on Supplemental Information

8. The examination engagement should be coordinated with the audit of the financial statements and the audit procedures performed on supplemental information of the broker or dealer.[12] In planning and performing procedures for, and evaluating the results of the procedures

[12] Under the definition of supplemental information included in Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, supplemental information includes the supporting schedules described in paragraph (d)(2) of SEC Rule 17a-5, which are required to be filed with the SEC, DEA, and the Securities Investor Protection Corporation ("SIPC") by brokers and dealers. Such supporting schedules include a Computation of Net Capital Under SEC Rule 15c3-1, a Computation for Determination of the Reserve Requirements under Exhibit A of SEC Rule 15c3-3, and Information Relating to Possession or Control Requirements Under SEC Rule 15c3-3.

performed in, the examination engagement, the auditor should take into account relevant evidence from the audit of the financial statements and the audit procedures performed on the supplemental information. However, the objectives of the financial statement audit and the examination engagement are not the same, so the auditor must plan and perform the work to meet the objectives of both engagements.

Planning the Examination Engagement

9. The auditor should plan the examination engagement to perform procedures that are sufficient to provide a reasonable basis for determining whether the broker's or dealer's assertions are fairly stated, in all material respects. In planning the examination engagement, the auditor should:

a. Evaluate the nature of instances of non-compliance with the financial responsibility rules and Deficiencies in Internal Control Over Compliance identified during previous examination engagements;

b. Obtain an understanding of the broker's or dealer's processes, including relevant controls, regarding compliance with the financial responsibility rules[13];

Note: The nature, timing, and extent of procedures that are necessary to obtain an understanding of the broker's or dealer's processes, including relevant controls, regarding compliance with the financial responsibility rules depend on the size and complexity of the broker or dealer; the auditor's existing knowledge of the broker's or dealer's processes and controls; the degree to which the

[13] Appendix B of this standard discusses considerations for brokers and dealers with multiple divisions or branches.

broker's or dealer's compliance depends on the completeness and accuracy of the broker's or dealer's internally generated data; the nature and extent of changes in systems and operations, if any; and the nature of the broker's or dealer's documentation of its processes and controls.

Note: Obtaining an understanding of the broker's or dealer's processes, including relevant controls, includes evaluating the design of controls that are relevant to the examination and determining whether the controls have been implemented.

c. Obtain an understanding of instances of non-compliance with the financial responsibility rules and Deficiencies in Internal Control Over Compliance identified by management during the most recent fiscal year;

d. Assess the risks associated with related parties,[14] including related parties that are investment advisors or entities with which the broker or dealer has a custodial or clearing relationship, that are relevant to compliance and controls over compliance;

e. Obtain an understanding of management's competence regarding the relevant rules and regulations;

[14] The auditor should look to the definition in the applicable financial reporting framework with respect to the term "related parties."

f. Read the Financial and Operational Combined Uniform Single Reports ("FOCUS Reports")[15] filed by the broker or dealer and obtain an understanding of the reasons for resubmissions, if any;

g. Read reports of internal auditors, others who perform an equivalent function, compliance functions, and other auditors that are relevant to the broker's or dealer's assertions;

h. Inquire of management, and, if applicable, other individuals at the broker or dealer who have relevant knowledge regarding regulatory examinations and correspondence between the SEC or the broker's or dealer's DEA and the broker or dealer that are relevant to the broker's or dealer's assertions;

i. Read correspondence and notifications regarding non-compliance that the broker or dealer has sent to or received from the SEC or the broker's or dealer's DEA that are relevant to the broker's or dealer's assertions, and, when necessary in the circumstances, make inquiries of the regulatory agencies; and

j. Obtain an understanding of the nature and frequency of customer complaints that are relevant to compliance with the financial responsibility rules.

10. In addition, in planning the examination engagement, the auditor should assess the risk of fraud, including the risk of misappropriation of customer assets, relevant to compliance with the net capital rule and the reserve requirements rule and the effectiveness of the broker's or dealer's Internal Control Over Compliance.

Testing Controls over Compliance

[15] The FOCUS Reports are: Form X-17A-5 Schedule I; Form X-17A-5 Part II; Form X-17A-5 Part IIa; Form X-17A-5 Part IIb; and Form X-17A-5 Part III.

11. The auditor must test those controls that are important to the auditor's conclusion about whether the broker or dealer maintained effective Internal Control Over Compliance for each financial responsibility rule during the fiscal year and as of the end of the fiscal year. The auditor must obtain evidence that the controls over compliance selected for testing are designed effectively and operated effectively during the fiscal year and as of the fiscal year end.

12. For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a Material Weakness would result. As the risk associated with the control being tested increases, the persuasiveness of the evidence that the auditor should obtain also increases.

Note: Although the auditor must obtain evidence about the effectiveness of the selected controls for each financial responsibility rule, the auditor is not responsible for obtaining sufficient evidence to support an opinion about the effectiveness of each individual control.

13. Factors that affect the risk associated with a control include:

- The nature of the financial responsibility rule;
- The risk associated with non-compliance with the financial responsibility rule and the significance of potential non-compliance;
- Changes in the broker's or dealer's policies or procedures or personnel that might adversely affect control design or operating effectiveness;
- The broker's or dealer's history of instances of non-compliance with the financial responsibility rule that the control is intended to prevent or detect;
- The existence and effectiveness of controls that monitor other controls;

- The risk of management override of controls over compliance;
- The nature of the control and the frequency with which it operates;
- The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information technology general controls);
- The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance;
- The extent of use of part-time personnel to perform controls over compliance;
- Whether the control relies on performance by an individual or is automated (i.e., an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and
- The complexity of the control and the significance of the judgments made in connection with its operation.

Testing Design Effectiveness

14. The auditor should test the design effectiveness of the selected controls by determining whether the broker's or dealer's controls, if they are operating as prescribed by persons possessing the necessary authority and competence to perform the control effectively, can effectively prevent or detect instances of non-compliance with the financial responsibility rules on a timely basis.

Note: If a broker or dealer makes changes to its policies and procedures or key personnel during the fiscal year, the auditor should obtain evidence regarding the design effectiveness of the selected controls before and after the change.

15. Procedures the auditor performs to obtain evidence about design effectiveness include inquiry of appropriate personnel, observation of the broker's or dealer's operations, and inspection of relevant documentation. Walkthroughs that include these procedures ordinarily are sufficient to evaluate design effectiveness.

Testing Operating Effectiveness

16. The auditor should test the operating effectiveness of the selected controls by determining whether each selected control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.

Note: The auditor should obtain evidence regarding the operating effectiveness of the selected controls throughout the entire year and as of the end of the fiscal year.

17. Procedures the auditor performs to test operating effectiveness include a mix of inquiry of appropriate personnel, observation of the broker's or dealer's operations, inspection of relevant documentation, and re-performance of the control.

18. The evidence provided by the auditor's tests of the effectiveness of controls depends upon the mix of the nature, timing, and extent of the auditor's procedures. Further, for an individual control, different combinations of the nature, timing, and extent of testing might provide sufficient evidence in relation to the risk associated with the control.

Note: Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.

Using Evidence Obtained in Past Examination Engagements

19. The auditor should obtain evidence during the current fiscal year about the design and operating effectiveness of controls selected for testing. If controls selected for testing in the

current year were tested in past examination engagements, and if the auditor plans to use evidence about the effectiveness of those controls that was obtained in prior years, the auditor should take into account the factors discussed in paragraph 13 and the following factors to determine the evidence needed during the current fiscal year examination:

- The nature, timing, and extent of procedures performed in previous examination engagements;
- The results of the previous years' testing of the control; and
- Changes in the control or the process in which the control operates since the previous examination engagement.

Using Tests of Controls that are Modified During the Year

20. A broker or dealer might implement changes to controls over compliance to make them more effective or efficient or to address control deficiencies. The auditor should obtain an understanding of the reason for the change and obtain evidence regarding the design and operating effectiveness of the new and superseded controls. The nature, timing, and extent of the testing of new and superseded controls depend on the evidence needed to support the auditor's conclusions about the effectiveness of Internal Control Over Compliance during and as of the end of the fiscal year.

Performing Compliance Tests

21. The auditor must perform procedures ("compliance tests") that are sufficient to support the auditor's conclusions regarding whether the broker or dealer was in compliance with the net capital rule and reserve requirements rule as of the end of its most recent fiscal year. This

includes performing the following procedures on the schedules[16] the broker or dealer used to determine compliance with the net capital rule and the reserve requirements rule as of its fiscal year end:

a. Evaluate whether the amounts in the schedules were determined in accordance with the net capital rule or reserve requirements rule, as applicable;

b. Test the accuracy and completeness of the information in the schedules;

c. Determine whether the broker or dealer maintained the required level of net capital in accordance with the net capital rule;

d. Determine whether the broker or dealer maintained a special reserve bank account for the exclusive benefit of customers and deposited funds in at least the required amount in accordance with the reserve requirements rule;

e. Determine whether the information in the schedules was derived from the books and records of the broker or dealer; and

f. Determine whether the broker or dealer made the notifications, if any, required by the net capital rule and reserve requirements rule as of the end of the most recent fiscal year.

Note: Procedures performed as part of the audit of the financial statements and audit procedures performed on supplemental information also might provide evidence regarding the broker's or dealer's compliance with the net capital rule and the reserve requirements rule.

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[16] The term "schedules" used in this paragraph refers to the computations of the broker or dealer, in whatever form, that are performed to determine the broker's or dealer's compliance with the net capital rule and the reserve requirements rule.

22. The auditor should plan and perform compliance tests that are responsive to the risks, including fraud risks, associated with non-compliance with the net capital rule and the reserve requirements rule. As the risk associated with non-compliance with the net capital rule or the reserve requirements rule increases, the persuasiveness of the evidence that the auditor should obtain from compliance tests also increases. The evidence provided by the auditor's compliance tests depends upon the mix of the nature, timing, and extent of those procedures. Inquiry alone does not provide sufficient appropriate evidence to support the auditor's conclusions about the broker's or dealer's compliance with the net capital rule or the reserve requirements rule.

23. In conjunction with performing the compliance tests pursuant to paragraphs 21 and 22, the auditor must perform procedures to obtain evidence about the existence of customer funds or securities held for customers.

> Note: Examples of procedures that provide evidence about the existence of customer assets include: (1) counting customer securities or observing and testing the broker's or dealer's procedures for physical inspection and (2) confirming customer security positions directly with depositories and clearing organizations. Procedures performed in the audit of the financial statements and the audit procedures performed on supplemental information to test the existence of assets held for customers also may provide evidence that is relevant to the requirement in this paragraph.

Effect of Tests of Internal Controls on Compliance Tests

24. The auditor should take into account the results of the auditor's tests of controls over compliance with the net capital rule and the reserve requirements rule in determining the necessary nature, timing, and extent of compliance tests. If the test results indicate that the

controls are effective, less evidence is needed from compliance tests. If the test results indicate that the controls are ineffective, the auditor should revise the planned compliance tests as necessary to obtain more persuasive evidence regarding compliance.

Evaluating the Results of the Examination Procedures

25. In forming an opinion on whether the assertions made by the broker or dealer in the compliance report are fairly stated, in all material respects, the auditor should evaluate all evidence obtained, regardless of whether the evidence corroborates or contradicts the broker's or dealer's assertions.

26. The auditor should evaluate:

a. Identified instances of non-compliance with the net capital rule and the reserve requirements rule to determine whether any instance of non-compliance existed as of the end of the most recent fiscal year;

b. Identified instances in which the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived from the broker's or dealer's books and records to determine whether they are material, individually or in combination; and

c. Identified Deficiencies in Internal Control Over Compliance to determine whether the deficiencies, individually or in combination, are Material Weaknesses.

Note: A Material Weakness can exist even when no instances of non-compliance exist. However, instances of non-compliance might indicate the existence of one or more Deficiencies in Internal Control Over Compliance.

Note: The auditor cannot assume that an identified instance of non-compliance or an identified Deficiency in Internal Control Over Compliance is an isolated occurrence. The auditor should evaluate the effect of any instance of non-compliance or identified control deficiency on the auditor's assessment of the risks associated with controls and non-compliance.

Note: The auditor also should evaluate the effect on the audit of the financial statements and audit procedures performed on supplemental information of any non-compliance, Material Weaknesses, or instances in which the information used to assert compliance with the net capital rule or reserve requirements rule was not derived, in all material respects, from the broker's or dealer's books and records.

27. The auditor should evaluate whether he or she has obtained sufficient appropriate evidence to support the conclusions to be presented in the examination report taking into account the risks associated with controls and non-compliance, the results of the examination procedures performed, and the appropriateness (i.e., the relevance and reliability) of the evidence obtained.

28. If the auditor has not obtained sufficient appropriate evidence about an assertion or has substantial doubt about an assertion, the auditor should perform procedures to obtain further evidence to address the matter.

29. If the auditor is unable to obtain sufficient appropriate evidence about an assertion, the auditor should express a disclaimer of opinion.[17]

Subsequent Events

30. For the period from the end of the period specified in the broker's or dealer's assertions to the date of the auditor's examination report (the "subsequent period"), the auditor should perform procedures to identify subsequent events relevant to the auditor's conclusions about the assertions made by the broker or dealer in the compliance report. Such procedures should include, but are not limited to:

a. Reading relevant reports of internal auditors, others who perform an equivalent function, compliance functions, and other auditors, and correspondence that the broker or dealer has sent to or received from the SEC or the broker's or dealer's DEA during the subsequent period that is relevant to the broker's or dealer's assertions; and

b. Evaluating information obtained through other engagements performed by the auditor for the broker or dealer, including subsequent events procedures performed in the audit of the financial statements and the audit procedures performed on supplemental information.

31. The auditor should evaluate the results of the procedures described in the previous paragraph to determine whether the results corroborate or contradict the broker's or dealer's assertions.

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[17] See Appendix C of this standard, "Examination Report Modifications," which describes the situations in which the auditor should modify his or her examination report and the specific modifications to be made to the auditor's examination report. The requirement in paragraph 29 does not preclude the auditor from withdrawing from the examination engagement.

Obtaining a Representation Letter

32. The auditor should obtain written representations from management of the broker or dealer:

a. Acknowledging management's responsibility for establishing and maintaining a system of internal control with the objective of providing the broker or dealer with reasonable assurance that any instances of non-compliance with the financial responsibility rules will be prevented or detected on a timely basis;

b. Stating the broker's or dealer's assertions included in the compliance report are the responsibility of management;

c. Stating that management has made available to the auditor all records and other information relevant to the broker's or dealer's assertions, including all known matters contradicting the assertions, and all communications from regulatory agencies, internal auditors, others who perform an equivalent function, compliance functions, and other auditors, that are relevant to the broker's or dealer's assertions, received through the date of the auditor's report; and

d. Stating whether there were, subsequent to the period addressed in the broker's or dealer's assertions, any known events or other factors that might significantly affect the broker's or dealer's assertions.

33. The failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the engagement, as described in Appendix C of this standard.

Communication Requirements

34. The auditor should communicate to management all identified Deficiencies in Internal Control Over Compliance.

35. The auditor should communicate to management and the audit committee[18] identified instances of non-compliance with the financial responsibility rules, identified Material Weaknesses, and identified instances in which information used to determine compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the broker's or dealer's books and records.

> Note: The auditor also must comply with the requirements of paragraph (h) of SEC Rule 17a-5, which contains notification requirements that apply to auditors of brokers and dealers.

Reporting on the Examination Engagement

36. The auditor's examination report must include the following elements, modified as necessary in the circumstances and manner discussed in Appendix C:

a. A title that includes the word independent;

b. An identification of the compliance report and the broker's or dealer's assertions regarding the effectiveness of Internal Control Over Compliance during the fiscal year and as of the fiscal year end, compliance with the net capital rule and the reserve requirements rule as of the fiscal year end, and whether the information used to assert compliance with those rules was derived from the broker's or dealer's books and records;

[18] For purposes of this standard, the term "audit committee" has the same definition as that in Auditing Standard No. 16, Communications with Audit Committees.

c. A statement that management of the broker or dealer is responsible for establishing and maintaining a system of internal control that has the objective of providing the broker or dealer with reasonable assurance that any instances of non-compliance with the financial responsibility rules will be prevented or detected on a timely basis;

d. A statement that the auditor's responsibility is to express an opinion on the broker's or dealer's assertions based on his or her examination;

e. A statement that the examination was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States);

f. A statement that the standards of the Public Company Accounting Oversight Board require that the auditor plan and perform the examination engagement to obtain reasonable assurance about whether the broker's or dealer's Internal Control Over Compliance was effective during and as of the end of the most recent fiscal year, whether the broker or dealer complied with the net capital rule and the reserve requirements rule as of the end of the most recent fiscal year, and whether the information used to assert compliance with the net capital rule and the reserve requirements rule was derived from the books and records of the broker or dealer;

g. A statement that an examination engagement includes evaluating the design and operating effectiveness of Internal Control Over Compliance; testing and evaluating the broker's or dealer's compliance with the net capital rule and the reserve requirements rule; determining whether the information used to assert compliance with the net capital rule and reserve requirements rule was derived

from the broker's or dealer's books and records; and performing such other procedures as the auditor considered necessary in the circumstances;

h. A statement that the auditor believes the examination provides a reasonable basis for his or her opinion;[19]

i. The auditor's opinion on whether the assertions made by the broker or dealer in the compliance report are fairly stated, in all material respects;

j. The manual signature of the auditor's firm;

k. The city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's examination report has been issued; and

l. The date of the examination report.

37. The following example examination report expressing an unqualified opinion on the assertions made by a broker or dealer in a compliance report illustrates the report elements described in this section.

Report of Independent Registered Public Accounting Firm

[Introductory paragraph]

We have examined W Broker's statements, included in the accompanying [title of the compliance report], that (1) W Broker's internal control over compliance was effective during the most recent fiscal year ended [date]; (2) W Broker's internal control over compliance was effective as of [date]; (3) W Broker was in compliance with 17 CFR §§ 240.15c3-1 and 240.15c3-3(e) as of [date]; and (4)

[19] When management has made an interpretation of the financial responsibility rules and the auditor has determined that it is necessary to emphasize this interpretation in the auditor's report, the auditor may include a paragraph stating the description and the source of the interpretation made directly following the scope paragraph.

the information used to state that W Broker was in compliance with 17 CFR §§ 240.15c3-1 and 240.15c3-3(e) was derived from W Broker's books and records. W Broker's management is responsible for establishing and maintaining a system of internal control over compliance that has the objective of providing W Broker with reasonable assurance that non-compliance with 17 CFR § 240.15c3-1, 17 CFR § 240.15c3-3, 17 CFR § 240.17a-13, or Rule [fill in name/number] of [fill in DEA] that requires account statements to be sent to the customers of W Broker will be prevented or detected on a timely basis. Our responsibility is to express an opinion on W Broker's statements based on our examination.

[Scope paragraph]

We conducted our examination in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the examination to obtain reasonable assurance about whether W Broker's internal control over compliance was effective as of and during the most recent fiscal year ended [date]; W Broker complied with 17 CFR §§ 240.15c3-1 and 240.15c3-3(e) as of [date]; and the information used to assert compliance with 17 CFR §§ 240.15c3-1 and 240.15c3-3(e) as of [date] was derived from W Broker's books and records. Our examination includes testing and evaluating the design and operating effectiveness of internal control over compliance, testing and evaluating W Broker's compliance with 17 CFR §§ 240.15c3-1 and 240.15c3-3(e), determining whether the information used to assert compliance with 240.15c3-1 and 240.15c3-3(e) was derived from W Broker's books and records, and performing such other procedures as we considered

necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

[Opinion paragraph]

In our opinion, W Broker's statements referred to above are fairly stated, in all material respects.

[Signature]

[City and State or Country]

[Date]

Examination Report Date

38. The auditor should date the examination report no earlier than the date on which the auditor obtains sufficient appropriate evidence to support his or her opinion.

Note: Because of the coordination between the examination engagement, the audit of the financial statements and the audit procedures performed on supplemental information, the date of the examination report should not be earlier than the date of the auditor's report on the financial statements and supplemental information.

APPENDIX A – Definitions

A1. For purposes of this standard, the terms listed below are defined as follows:

A2. Deficiency in Internal Control Over Compliance – A Deficiency in Internal Control Over Compliance exists when the design or operation of a control does not allow the management or employees of the broker or dealer, in the normal course of performing their assigned functions, to prevent or detect on a timely basis non-compliance with 17 CFR § 240.15c3-1, § 240.15c3-3,

§ 240.17a-13 or any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer.[20]

A3. Internal Control Over Compliance – Internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with 17 CFR § 240.15c3-1, § 240.15c3-3, § 240.17a-13, or any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer, will be prevented or detected on a timely basis.[21]

A4. Material Weakness – A Material Weakness is a deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with 17 CFR §240.15c3-1 or 17 CFR § 240.15c3-3(e) will not be prevented or detected on a timely basis or that non-compliance to a material extent with 17 CFR §240.15c3-3, except for paragraph (e), 17 CFR § 240.17a-13, or any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer will not be prevented or detected on a timely basis.[22]

APPENDIX B – Considerations for Brokers and Dealers with Multiple Divisions or Branches

B1. When the broker or dealer has multiple divisions or branches, the auditor should determine the extent to which he or she should perform examination procedures at selected divisions or branches to obtain sufficient appropriate evidence to support the conclusions

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[20] The definition of "Deficiencies in Internal Control Over Compliance" is consistent with the same term in paragraph (d)(3)(iii) of SEC Rule 17a-5.

[21] The definition of "Internal Control Over Compliance" is consistent with the same term in paragraph (d)(3)(ii) of SEC Rule 17a-5.

[22] The definition of a "Material Weakness" is consistent with the same term in paragraph (d)(3)(iii) of SEC Rule 17a-5.

expressed in the auditor's examination report. This includes determining the divisions or branches at which to perform examination procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual divisions or branches. In determining the extent of the examination procedures to be performed, the auditor should take into account:

a. The degree to which the financial responsibility rules relate to activities at the division or branch level;

b. The nature and significance of the related assets, transactions, or activities at the division or branch to the financial responsibility rules;

c. The degree of centralization of records or information processing relevant to the financial responsibility rules; and

d. The degree and effectiveness of management supervision and monitoring of the relevant activities of the division or branch.

APPENDIX C – Examination Report Modifications

C1. The auditor should modify his or her examination report if any of the following conditions exist:

a. There is non-compliance with the net capital rule or the reserve requirements rule as of the end of the most recent fiscal year, one or more Material Weaknesses in Internal Control Over Compliance during or as of the end of the most recent fiscal year, or the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the books and records of the broker or dealer (paragraphs C2–C3).

b. There is a restriction on the scope of the examination engagement (paragraphs C4–C8).

c. There is information other than the assertions and descriptions required under paragraph (d)(3)(i) of SEC Rule 17a-5 contained in the compliance report (paragraphs C9–C10).

Non-Compliance, Material Weakness, or Instance in which Information Used to Assert Compliance was not Derived from the Broker's or Dealer's Books and Records

C2. If (1) one or more instances of non-compliance with the net capital rule or the reserve requirements rule exist as of the end of the fiscal year; (2) one or more Material Weaknesses in Internal Control Over Compliance exist during or as of the end of the fiscal year; or (3) the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the books and records of the broker or dealer, the auditor must express an adverse opinion directly on the subject matter of the respective assertions, rather than on the assertions themselves, unless there is a restriction on the scope of the examination engagement.

Note: The requirement in this paragraph to express an adverse opinion applies regardless of whether the non-compliance, Material Weakness, or other matters preventing the unqualified opinion were identified by management or by the auditor.

C3. When expressing such an adverse opinion, the auditor's examination report should include, as applicable:

a. A statement that non-compliance with the net capital rule or the reserve requirements rule has been identified and an identification of each instance of non-compliance described in the broker's or dealer's compliance report as of the end of the most recent fiscal year.

b. A statement that one or more Material Weaknesses in Internal Control Over Compliance have been identified during the fiscal year and an identification of each Material Weakness described in the compliance report.

c. A statement that one or more Material Weaknesses in Internal Control Over Compliance have been identified as of the end of the fiscal year and an identification of each Material Weakness described in the compliance report.

d. A statement that one or more instances in which the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the broker's or dealer's books and records have been identified.

> Note: If a description of all identified instances of non-compliance with the net capital rule or the reserve requirements rule and all identified Material Weaknesses has not been included in the broker's or dealer's compliance report, the examination report must be modified to describe those instances of non-compliance or Material Weaknesses that the auditor has identified but that are not described in the broker's or dealer's compliance report.[23]

Scope Limitations

C4. The auditor can express an opinion on whether the assertions made by a broker or dealer in a compliance report are fairly stated, in all material respects, only if the auditor has been able

[23] Paragraphs (d)(3)(i)(B) and (C) of SEC Rule 17a-5 require the broker's or dealer's compliance report to contain a description of each material weakness in Internal Control Over Compliance during the most recent fiscal year and any instance of non-compliance with the net capital rule or the reserve requirements rule as of the end of the most recent fiscal year.

to apply the procedures necessary in the circumstances. If there are restrictions on the scope of the examination engagement, the auditor should withdraw from the engagement or disclaim an opinion. A disclaimer of opinion should state that the auditor does not express an opinion on the assertions made by the broker or dealer in the compliance report.

C5. When disclaiming an opinion because of a scope limitation, the auditor should state that the scope of the examination engagement was not sufficient for the auditor to express an opinion and, in a separate paragraph or paragraphs, the substantive reasons for the disclaimer, including the procedures that were deemed necessary by the auditor that have been omitted and the reason for their omission. The auditor should not identify the procedures that were performed nor include the statements describing the characteristics of an examination engagement.

C6. When the auditor plans to disclaim an opinion and the limited procedures performed by the auditor caused the auditor to conclude that: (1) one or more instances of non-compliance with the net capital rule or the reserve requirements rule existed as of the end of the fiscal year; (2) one or more Material Weaknesses in Internal Control Over Compliance existed during or as of the end of the most recent fiscal year; or (3) the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the books and records of the broker or dealer, the auditor's report also must include the matters described in paragraph C3, as applicable.

C7. The auditor may issue a report disclaiming an opinion on the assertions made by a broker or dealer in a compliance report as soon as the auditor concludes that a scope limitation will prevent the auditor from obtaining the reasonable assurance necessary to express an opinion. The auditor is not required to perform any additional work before issuing a disclaimer when the

auditor concludes that he or she will not be able to obtain sufficient evidence to express an opinion.

Note: In this case, in following the direction in paragraph 38 of this standard regarding dating the auditor's examination report, the report date is the date on which the auditor concludes that he or she will not be able to obtain sufficient evidence to express an opinion.

C8. If the auditor concludes that he or she cannot express an opinion because of a limitation on the scope of the examination engagement, the auditor should communicate on a timely basis, in writing, to management and the audit committee that the examination engagement cannot be satisfactorily completed.

Other Information in the Compliance Report

C9. If the compliance report contains other information besides the statements and descriptions required by SEC Rule 17a-5,[24] the auditor should disclaim an opinion on the other information.

C10. If the auditor believes that the other information in the compliance report contains a material misstatement of fact, he or she should discuss the matter with management of the broker or dealer. If, after discussing the matter with management, the auditor concludes that a material misstatement of fact remains, the auditor should notify management and the audit committee of the auditor's views concerning the information.[25]

Attestation Standard No. 2

Review Engagements Regarding Exemption Reports of Brokers and Dealers

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[24] See paragraph (d)(3)(i) of SEC Rule 17a-5.

[25] See also AU sec. 317, Illegal Acts by Clients, which describes the auditor's responsibilities in a financial statement audit regarding illegal acts.

Introduction

1. This standard establishes requirements that apply when an auditor is engaged to perform a review[26] of the statements made by a broker[27] or dealer[28] in an exemption report ("exemption report") prepared pursuant to Securities and Exchange Act of 1934 ("Exchange Act") Rule 17a-5, 17 CFR § 240.17a-5 ("SEC Rule 17a-5") of the U.S. Securities and Exchange Commission ("SEC").[29]

2. SEC Rule 17a-5 requires a broker's or dealer's exemption report to contain the following statements by the broker or dealer:

a. A statement that identifies the provisions in paragraph (k) of SEC Rule 15c3-3[30] (the "exemption provisions") under which the broker or dealer claimed an exemption from SEC Rule 15c3-3 (the "identified exemption provisions");

b. A statement that the broker or dealer (1) met the identified exemption provisions throughout the most recent fiscal year without exception or (2) met the identified

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[26] See paragraphs (d)(1)(i)(C) and (g)(2)(ii) of SEC Rule 17a-5, which require that certain brokers or dealers file with the SEC a report prepared by an independent accountant based on a review of the statements in the exemption report, if the broker or dealer is required to file an exemption report with the SEC.

[27] According to PCAOB Rule 1001(b)(iii), the term "broker" means a broker (as defined in Section 3(a)(4) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[28] According to PCAOB Rule 1001(d)(iii), the term "dealer" means a dealer (as defined in Section 3(a)(5) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[29] See paragraph (g)(2)(ii) of SEC Rule 17a-5.

[30] See 17 CFR § 240.15c3-3 ("SEC Rule 15c3-3").

exemption provisions throughout the most recent fiscal year except as described in the exemption report; and

c. If applicable, a statement that identifies each exception during the most recent fiscal year in meeting the identified exemption provisions (an "exception") and that briefly describes the nature of each exception and the approximate date(s) on which the exception existed.[31]

Objective

3. When performing a review of the statements (hereinafter referred to as "assertions") made by a broker or dealer in an exemption report (a "review engagement"), the auditor's objective is to state whether, based upon the results of the review procedures, the auditor is aware of any material modifications that should be made to the broker's or dealer's assertions for the assertions to be fairly stated, in all material respects.

4. The auditor must plan and perform the review engagement to obtain appropriate evidence that is sufficient to obtain moderate assurance[32] about whether one or more conditions exist that would cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects. Such conditions include:

a. The broker's or dealer's assertion that identifies the provisions in paragraph (k) of SEC Rule 15c3-3 under which the broker or dealer claimed an exemption for SEC Rule 15c3-3 is inaccurate;

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[31] See paragraph (d)(4) of SEC Rule 17a-5.

[32] Moderate assurance is obtained by performing with due professional care the inquiries and other procedures required by this standard in order to reach a conclusion about whether there is a need to modify the broker's or dealer's assertions regarding the exemption provisions for the assertions to be fairly stated, in all material respects. Further, this standard is consistent with the concept of moderate assurance as described in paragraph .55 of AT sec. 101, Attest Engagements.

b. The broker or dealer asserts that it met the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 without exception when the auditor is aware of exceptions in meeting the exemption provisions; or

c. The broker's or dealer's assertion that identifies and describes each exception during the most recent fiscal year in meeting the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 is inaccurate or incomplete.

Performing the Review Engagement

General Requirements

5. An auditor who performs a review engagement must:

a. Have adequate technical proficiency in attestation engagements;

b. Obtain an understanding of the exemption conditions and other rules and regulations that are relevant to the broker's or dealer's assertions;

c. Determine the auditor's compliance with independence and ethics requirements; and

d. Exercise due professional care, which includes application of professional skepticism, in planning and performing the review and preparation of the report.

Note: Due professional care imposes a responsibility on each engagement team member to comply with this standard. The exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including preparing the report.[33]

[33] The auditor's responsibility to exercise due professional care is consistent with the description in paragraphs .40–.41 of AT sec. 101.

Note: Auditing Standard No. 3, Audit Documentation, establishes the documentation requirements for review engagements performed pursuant to this standard.

6. The engagement partner is responsible for the review engagement and performance of the review procedures. Accordingly, the engagement partner is responsible for proper planning of the review engagement, proper supervision of the work of engagement team members, and compliance with the requirements of this standard. The engagement partner may seek assistance from appropriate engagement team members in fulfilling these responsibilities.

Note: For purposes of this standard, the term "engagement partner" means the member of the engagement team with primary responsibility for the review engagement.

Note: Proper planning includes determining the nature, timing, and extent of procedures necessary to obtain moderate assurance. Proper supervision includes supervising the work of engagement team members so that the work is performed as directed and supports the conclusions reached.

Relationship Between the Review Engagement and the Audit of Financial Statements and the Audit Procedures Performed on Supplemental Information

7. The review engagement should be coordinated with the audit of the financial statements and the audit procedures performed on supplemental information of the broker or dealer.[34] In planning and performing procedures for, and evaluating the results of the procedures performed

[34] Under the definition of supplemental information included in Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, supplemental information includes the supporting schedules described in paragraph (d)(2) of SEC Rule 17a-5, which are required to be filed by brokers and dealers with the SEC and the broker's and dealer's designated examining authority ("DEA") and the Securities Investor Protection Corporation ("SIPC"). Such supporting schedules consist of, as applicable, a

in, the review engagement, the auditor should take into account relevant evidence from the audit of the financial statements and the procedures performed on the supplemental information. However, the objectives of the financial statement audit and the review engagement are not the same, so the auditor must plan and perform the work to meet the objectives of both engagements.

Review Procedures

8. A review engagement includes the following procedures:

   a. Reading the exemption report to determine the exemption provisions under which the broker or dealer asserts its exemption and the identified exceptions to the exemption provisions;

   b. Performing inquiries and other review procedures set forth in this standard; and

   c. Evaluating whether the evidence indicates that there should be modifications to the broker's or dealer's assertions based on the results of the procedures performed.

9. The nature, timing, and extent of the necessary inquiries and other review procedures depend on:

   a. The following risk factors:

      (1) The broker's or dealer's history of instances of non-compliance with the exemption provisions;

      (2) Changes in the broker's or dealer's procedures, controls, or the environment in which the controls operate since the prior year;

(3) Changes in the broker's or dealer's operations that are relevant to compliance with the exemption provisions;

(4) Competence of the personnel who are responsible for compliance with the exemption provisions or who perform important controls over compliance, and whether there have been changes in those personnel during the period of the review;

(5) The risk of fraud, including the risk of misappropriation of customer assets, relevant to the exemption provisions;

(6) Potential non-compliance associated with related parties,[35] including related parties that are investment advisors or entities with which the broker or dealer has a custodial or clearing relationship;

(7) The degree to which the broker's or dealer's processes that relate to the exemption provisions are performed, monitored, or controlled in a centralized or decentralized environment; and

b. Evidence about the broker's or dealer's compliance with the exemption provisions or about the effectiveness of controls over compliance with the exemption provisions obtained from the audit of the financial statements and the audit procedures performed on supplemental information.

10. The auditor should perform procedures to identify exceptions to the exemption provisions, including the following:

a. If the broker or dealer identified exceptions to the exemption provisions during the year under review, the auditor should read the broker's or dealer's

[35] The auditor should look to the definition in the applicable financial reporting framework with respect to the term "related parties."

documentation regarding the exceptions to the exemption provisions and compare it to the information included in the exemption report.

b. Inquire of management, and, if applicable, other individuals at the broker or dealer who have relevant knowledge regarding:

(1) Whether the broker or dealer was in compliance with the exemption provisions throughout the year under review or whether exceptions have been identified.

(2) Regulatory examinations and correspondence between the SEC or the broker's or dealer's DEA and the broker or dealer that are relevant to compliance with the exemption provisions.

Note: If the broker or dealer has sent or received correspondence with the SEC or the broker's or dealer's DEA that is relevant to compliance with the exemption provisions, the auditor should read such correspondence and, when necessary in the circumstances, make inquiries of the regulatory agencies.

(3) Subsequent events through the date of the auditor's review report that might have a material effect on the broker's or dealer's assertions.

c. Inquire of individuals at the broker or dealer who have relevant knowledge of controls relevant to the broker's or dealer's compliance with the exemption provisions regarding:

(1) The controls that are in place to maintain compliance with the exemption provisions, including the nature of the controls and their frequency of operation.

Note: The auditor should take into account procedures performed during the audit of the financial statements and the audit procedures performed on supplemental information in obtaining an understanding of controls or other activities relevant to the broker's or dealer's compliance with the exemption provisions.

(2) Whether the individual is aware of:

i. Any exceptions to the exemption provisions and, if so, the nature, frequency, timing, and cause (if known) of the exceptions to the exemption provisions, during the year under review.

ii. Any deficiencies in controls over compliance with the exemption provisions and, if so, the nature, frequency, and cause (if known) of the control deficiencies during the year under review.

d. Inquire of individuals who are responsible for monitoring compliance with the exemption provisions or the controls over compliance regarding:

(1) The nature and frequency of the monitoring activities.

(2) The results of those monitoring activities, including the nature, frequency, timing, and cause (if known) of any exceptions to the exemption provisions or deficiencies in controls over compliance.

(3) The nature and frequency of customer complaints that are relevant to the broker's or dealer's compliance with the exemption provisions.

e. Read reports of internal auditors, others who perform an equivalent function, compliance functions, and other auditors that are relevant to the broker's or dealer's compliance with the exemption provisions.

f. Read regulatory filings of the broker or dealer that are relevant to the broker's or dealer's compliance with the exemption provisions.

g. Evaluate whether the evidence obtained and the results of the procedures performed in the audit of the financial statements and the audit procedures performed on supplemental information corroborate or contradict the broker's or dealer's assertions regarding compliance with the exemption provisions.

Note: Examples of procedures performed during the audit of the financial statements that might provide evidence relevant to the broker's or dealer's compliance with the exemption provisions include: (i) testing related to customer trades; (ii) testing of specially designated cash accounts; (iii) testing investment inventory or transactions related to the broker's or dealer's trading for its own account; and (iv) reading the clearing agreement in connection with testing trade fee or commission revenue or expenses.

h. Perform other procedures as necessary in the circumstances to obtain moderate assurance regarding whether a material modification should be made to the

broker's or dealer's assertions for the assertions to be fairly stated, in all material respects.

Evaluating the Results of the Review Procedures

11. 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's or dealer's assertions are not fairly stated, in all material respects.[36] If a broker's or dealer's assertion is not fairly stated, in all material respects, the auditor should:

a. Modify the review report, as discussed in paragraph 19 of this standard; and

b. Evaluate the effect of the matter on the audit of the financial statements and the audit procedures performed on supplemental information.

12. If information coming to the auditor's attention indicates that one or more exceptions to the exemption provisions occurred during the year under review or might exist at year-end, other than exceptions disclosed in the exemption report, that might cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects, or if the auditor has substantial doubt about one or more of the broker's or dealer's assertions, the auditor should perform additional procedures as necessary to address the matter.

Obtaining a Representation Letter

13. The auditor should obtain written representations from management of the broker or dealer:

a. Acknowledging management's responsibility for compliance with the identified exemption provisions throughout the fiscal year;

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[36] See paragraph 4 of this standard, which provides examples of conditions that would cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects.

b. Stating the broker's or dealer's assertions and that they are the responsibility of management;

c. Stating that management has made available to the auditor all records and other information relevant to the broker's or dealer's assertions, including all communications from regulatory agencies, internal auditors, others who perform an equivalent function, compliance functions, and other auditors concerning possible exceptions to the exemption provisions, received through the date of the auditor's review report; and

d. Stating whether there were, subsequent to the period addressed in the broker's or dealer's assertions, any known events or other factors that might significantly affect the broker's or dealer's compliance with the identified exemption provisions.

14. The failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the review engagement as described in paragraph 20 of this standard.

Communication Requirements

15. The auditor should communicate to management and to the audit committee[37] any exceptions to the exemption provisions identified by the auditor and information that causes the broker's or dealer's assertions about the exemption provisions not to be fairly stated, in all material respects.

[37] For purposes of this standard, the term "audit committee" has the same definition as that in Auditing Standard No. 16, Communications with Audit Committees.

Note: The auditor must also comply with the requirements of paragraph (h) of SEC Rule 17a-5, which contains notification requirements that apply to auditors of brokers and dealers.

Reporting on the Review Engagement

16. The auditor's review report must include the following elements, modified as necessary in the circumstances and manner discussed in paragraphs 19–20:

a. A title that includes the word independent;

b. An identification of the exemption report and the broker's or dealer's assertions;

c. A statement that management of the broker or dealer is responsible for compliance with the identified exemption provisions throughout the fiscal year and for its assertions;

d. A statement that the review was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and, accordingly, included inquiries and other required procedures to obtain evidence about the broker's or dealer's compliance with the exemption provisions;

e. A statement that a review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's assertions, and accordingly, no such opinion is expressed;

f. A statement about whether the auditor is aware of any material modifications that should be made to the assertions for them to be fairly stated, in all material respects;

g. The manual signature of the auditor's firm;

h. The city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's review report has been issued; and

i. The date of the review report.

17. The following example report illustrates the report elements described in this section.

Report of Independent Registered Public Accounting Firm

[Introductory paragraph – no exceptions to the exemption provisions included in the broker's or dealer's assertion]

We have reviewed management's statements, included in the accompanying [title of the exemption report], in which (1) Z Broker identified the following provisions of 17 CFR § 15c3-3(k) under which Z Broker claimed an exemption from 17 CFR § 240.15c3-3: ([fill in which exemption provision – (1), (2)(i), (2)(ii), or (3)]) (the "exemption provisions") and (2) Z Broker stated that Z Broker met the identified exemption provisions throughout the most recent fiscal year without exception. Z Broker's management is responsible for compliance with the exemption provisions and its statements.

[Introductory paragraph – exceptions to the exemption provisions included in the broker's or dealer's assertion]

We have reviewed management's statements, included in the accompanying [title of the exemption report], in which (1) Z Broker identified the following provisions of 17 CFR § 15c3-3(k) under which Z Broker claimed an exemption from 17 CFR § 240.15c3-3: ([fill in which exemption provision – (1), (2)(i), (2)(ii), or (3)]) (the "exemption provisions") and (2) Z Broker stated that Z Broker met the identified exemption provisions throughout the most recent fiscal year

except as described in its exemption report. Z Broker's management is responsible for compliance with the exemption provisions and its statements.

[Scope paragraph]

Our review was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and, accordingly, included inquiries and other required procedures to obtain evidence about Z Broker's compliance with the exemption provisions. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's statements. Accordingly, we do not express such an opinion.

[Review results paragraph]

Based on our review, we are not aware of any material modifications that should be made to management's statements referred to above for them to be fairly stated, in all material respects, based on the provisions set forth in paragraph (k)([fill-in which exemption provision – (1), (2)(i), (2)(ii), or (3)]) of Rule 15c3-3 under the Securities Exchange Act of 1934.

[Signature]

[City and State or Country]

[Date]

Review Report Date

18. The auditor should date the review report no earlier than the date on which the auditor has completed his or her review procedures.

Note: Because of the coordination between the review engagement and the audit of the financial statements and the audit procedures performed on supplemental

information, the date of the review report should not be earlier than the date of the auditor's report on the financial statements and supplemental information.

Modifications of the Report

19. If one or more of the broker's or dealer's assertions are not fairly stated, in all material respects, the auditor must modify the review report to describe the reasons the assertions are not fairly stated, in all material respects. If a broker's or dealer's assertion is not fairly stated, in all material respects, because of one or more omitted exceptions, the auditor's review report should disclose each omitted exception.

20. Scope Limitations. If the auditor cannot perform the procedures required by this standard or other procedures that the auditor deems necessary in the circumstances, the review is incomplete because of the scope limitation. An incomplete review is not a sufficient basis for stating a conclusion regarding the broker's or dealer's assertions. In those circumstances, the auditor should withdraw from the engagement or should modify the review report to:

a. Describe the scope limitation and any review procedures deemed necessary by the auditor that have been omitted and the reason for their omission;

b. State that the auditor does not express any form of assurance on the broker's or dealer's assertions; and, if applicable,

c. Describe any circumstances that cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects.

Amendments to PCAOB Standards

Auditing Standards

Auditing Standard No. 3, "Audit Documentation"

Auditing Standard No. 3, "Audit Documentation," as amended, is amended as follows:

a. The following is added at the end of footnote 2 in paragraph 6:

In an engagement conducted pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, the relevant assertions are the assertions expressed by management or the responsible party regarding the subject matter of the attestation engagement. The documentation requirements in this standard regarding assertions apply to the aspects of the subject matter to which the assertions relate.

b. The following note is added at the end of paragraph 12:

Note: In an engagement conducted pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, significant findings or issues include, when applicable: (a) the assessment of, and the responses to, risks requiring special consideration by the auditor; (b) significant matters involving systems, processes, and controls to ensure the appropriateness of the subject matter and management's related assertions; and (c) the evaluation of identified instances of nonconformity with the evaluation criteria (e.g., errors, instances of non-compliance, or control deficiencies).

c. The following note is added as the second note to paragraph 13:

Note: When conducting an attestation engagement pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance

Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, the auditor may include the documentation of significant findings or issues related to the attestation engagement in the engagement completion document prepared in connection with the audit of the financial statements.

Auditing Standard No. 7, "Engagement Quality Review"

Auditing Standard No. 7, "Engagement Quality Review," is amended as follows:

a. Paragraph 1 is replaced with:

An engagement quality review and concurring approval of issuance are required for the following engagements conducted pursuant to the standards of the Public Company Accounting Oversight Board ("PCAOB"): (a) an audit engagement; (b) a review interim financial information; and (c) an attestation engagement performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers.

b. Paragraph 18A. is added:

Engagement Quality Review for an Attestation Engagement Performed Pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation

Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers

In an attestation engagement performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, the engagement quality reviewer should evaluate the significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the attestation engagement and in preparing the engagement report. To evaluate such judgments and conclusions, the engagement quality reviewer should, taking into account the procedures performed in the engagement quality review of the financial statement audit, (1) hold discussions with the engagement partner and other members of the engagement team, (2) read the engagement report and the document containing management's assertions, and (3) review the engagement completion document and other relevant documentation.

c. Paragraph 18B. is added:

In an attestation engagement performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, the engagement quality reviewer may provide concurring approval of issuance only if,

after performing with due professional care the review required by this standard, he or she is not aware of a significant engagement deficiency.

d. The following note is added after paragraph 18B.:

Note: A significant engagement deficiency in an attestation engagement performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, exists when (1) the engagement team failed to perform attestation procedures necessary in the circumstances of the engagement, (2) the engagement team reached an inappropriate overall conclusion on the subject matter of the engagement, (3) the engagement report is not appropriate in the circumstances, or (4) the firm is not independent of its client.

e. Paragraph 18C. is added:

In an attestation engagement performed pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, or Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, the firm may grant permission to the client to use the engagement report only after the engagement quality reviewer provides concurring approval of issuance.

Auditing Standard No. 16, "Communications with Audit Committees"

Auditing Standard No. 16, "Communications with Audit Committees," is amended as follows:

a. The following bullets are inserted after the third bullet in Appendix B:

- Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers, paragraphs 34 and 35.
- Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers, paragraph 15.

Attestation Standards

AT sec. 101, "Attestation Engagements"

AT sec. 101, "Attestation Engagements," as amended, is amended as follows:

a. The following is added at the end of paragraph .04:

g. Engagements in which a practitioner is engaged to perform an examination of certain statements of a broker or dealer in a compliance report that is prepared pursuant to SEC Rule 17a-5. Such engagements must be conducted pursuant to Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers.

h. Engagements in which a practitioner is engaged to perform a review of statements of a broker or dealer in an exemption report that is prepared pursuant to SEC Rule 17a-5. Such engagements must be conducted pursuant to Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers.

AT sec. 601, "Compliance Attestation"

AT sec. 601, "Compliance Attestation," is amended as follows:

a. Within paragraph .02, subparagraph e. is replaced with:

Apply to examination engagements of brokers and dealers covered by Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers.

b. Footnote 2 to paragraph .02.e. is deleted.

c. The last sentence of paragraph .06 is deleted.

d. Paragraph .07 is replaced with:

When a practitioner is engaged to perform a review of statements made by a broker or dealer in an exemption report that is prepared pursuant to SEC Rule 17a-5, the practitioner must conduct the review engagement pursuant to Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. In addition, since the attestation standards will apply solely in connection with audits of registered brokers and dealers pursuant to the Rule 17a-5 under the Securities Exchange Act of 1934, the Board defers to the SEC, pursuant to Section 103(a)(3)(c) of the Sarbanes-Oxley Act, on the applicability of Attestation Standards No. 1 and No. 2 to audits of emerging growth companies ("EGCs"), as that term is defined in Section 3(a)(80) of the Securities Exchange Act of 1934. The Board’s economic analysis is set forth in section C.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Section 103 of the Sarbanes-Oxley Act directs the Board, by rule, to establish, among other things, "auditing and related attestation standards . . . to be used by registered public accounting firm in the preparation and issuance of audit reports, as required by th[e] [Sarbanes-Oxley] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors." In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Sarbanes-Oxley Act to give the Board oversight authority with respect to audits of brokers and dealers that are registered with the Commission. On July 30, 2013, the SEC adopted amendments to Rule 17a-5[38] under the Securities Exchange Act of 1934 ("Exchange Act") to strengthen and clarify broker and dealer annual financial reporting requirements and also facilitate the ability of the PCAOB to implement the oversight of

[38] See Rule 17a-5, 17 CFR § 240.17a-5 ("SEC Rule 17a-5") and SEC Exchange Act Release No. 34-70073, Broker-Dealer Reports (July 30, 2013), 78 Federal Register 51910 (August 21, 2013) ("SEC Release"), available at http://www.sec.gov/rules/final/2013/34-70073.pdf.

independent public accountants of brokers[39] and dealers[40] provided by Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[41]

The Board is adopting two attestation standards, Examination Engagements Regarding Compliance Reports of Brokers and Dealers (the "examination standard") and Review Engagements Regarding Exemption Reports of Brokers and Dealers (the "review standard") (collectively, the "attestation standards"). These attestation standards will apply to examination engagements regarding compliance reports of brokers and dealers ("examination engagements") and review engagements regarding exemption reports of brokers and dealers ("review engagements"), pursuant to requirements contained in SEC Rule 17a-5.[42] Pursuant to SEC Rule 17a-5, the audits of brokers and dealers, including the attestation engagements, are required to be performed under PCAOB standards.[43] Before these amendments to SEC Rule 17a-5, audits of brokers and dealers were required to be performed under generally accepted auditing standards ("GAAS") established by the American Institute of Certified Public Accountants ("AICPA"). The attestation standards will be effective, subject to approval by the SEC, for examination engagements and review engagements for fiscal years ending on or after June 1, 2014. This

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[39] According to PCAOB Rule 1001(b)(iii), the term "broker" means a broker (as defined in Section 3(a)(4) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that Act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[40] According to PCAOB Rule 1001(d)(iii), the term "dealer" means a dealer (as defined in Section 3(a)(5) of the Exchange Act) that is required to file a balance sheet, income statement, or other financial statement under Section 17(e)(1)(A) of that Act, where such balance sheet, income statement, or financial statement is required to be certified by a registered public accounting firm.

[41] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[42] See paragraphs (g)(2)(i) and (ii) of SEC Rule 17a-5.

[43] See paragraph (g) of SEC Rule 17a-5.

effective date would coincide with the effective date for the corresponding amendments to SEC Rule 17a-5.

Background

Sections 17(a) and (e) of the Exchange Act and SEC Rule 17a-5 together generally require a broker or dealer to, among other things, file an annual report[44] with the SEC and the broker's or dealer's designated examining authority ("DEA").[45] SEC Rule 17a-5 requires the annual report to contain, among other things:

a. A financial report consisting of audited financial statements and supporting schedules;[46] and

b. A compliance report or an exemption report.[47]

The requirements for the compliance report and the exemption report are new requirements that are the result of the Commission's amendments to SEC Rule 17a-5. According

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[44] Paragraph (d) of SEC Rule 17a-5 contains general requirements for annual reports to be filed by SEC-registered brokers and dealers. Paragraphs (d)(1)(iii) and (iv) of SEC Rule 17a-5 provide certain limited exceptions to the requirement to file an annual report.

[45] Under SEC Rule 17d-1, 17 CFR § 240.17d-1, a registered broker or dealer that is a member of more than one securities self-regulatory organization may be assigned a "designated examining authority" or "DEA" that is responsible for examining the broker or dealer for compliance with SEC financial responsibility rules. An example of a securities self-regulatory organization that is a designated examining authority is the Financial Industry Regulatory Authority.

[46] See paragraph (d)(2) of SEC Rule 17a-5. Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements (PCAOB Release No. 2013-008) (October 10, 2013), applies to the audit procedures performed and the audit report on supporting schedules.

[47] See paragraphs (d)(3) and (4) of SEC Rule 17a-5. Attestation Standard No. 1 applies to an examination of certain statements made by the broker or dealer in the compliance report. Attestation Standard No. 2 applies to a review of the statements made by the broker or dealer in the exemption report.

to the SEC, these reports contain information regarding broker and dealer compliance with key SEC financial responsibility rules[48] that enhance the ability of the SEC to oversee the financial responsibility practices of registered brokers and dealers and, in particular, the safekeeping of customer assets.

Generally, SEC Rule 17a-5 provides that brokers or dealers that did not claim an exemption from SEC Rule 15c3-3 throughout the most recent fiscal year must prepare and file the compliance report. A broker or dealer must prepare and file the exemption report if the broker or dealer did claim that it was exempt from SEC Rule 15c3-3 throughout the most recent fiscal year.

Brokers and dealers also must generally file reports prepared by a PCAOB-registered independent public accountant covering the financial report and the compliance report or exemption report, as applicable.[49]

The auditor's examination report or review report would replace the prior requirement in SEC Rule 17a-5 that the auditor report on material inadequacies identified in the broker's or dealer's accounting system, internal accounting controls, procedures of the broker or dealer for safeguarding securities, and certain practices and procedures related to customer protection and securities.

Considerations in Adopting the Attestation Standards

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[48] The SEC Release used the term "financial responsibility rules" to refer to: 17 CFR § 240.15c3-1 ("SEC Rule 15c3-1" or the "net capital rule"); 17 CFR § 240.15c3-3 ("SEC Rule 15c3-3"); 17 CFR § 240.17a-13 ("SEC Rule 17a-13"); and any rule of the DEA of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer (an "account statement rule"). See the SEC Release at 8-9. The terms "financial responsibility rules" and "account statement rule" have the same meaning in these standards as they have in the SEC Release.

[49] See paragraph (d)(1)(i)(C) of SEC Rule 17a-5.

The Board is adopting the attestation standards to establish requirements aligned with the auditor's responsibilities under SEC Rule 17a-5.[50] Specifically, the attestation standards establish requirements for examining certain statements in a broker's or dealer's compliance report and reviewing a broker's or dealer's statements in an exemption report. The Board is also adopting related amendments to certain PCAOB standards, including amendments regarding documentation and amendments to require engagement quality reviews of the examination and the review engagements.[51]

The attestation standards for the examination and review engagements represent stand-alone standards that are based on existing concepts and principles in the existing attestation standards but are tailored for the specific requirements under SEC Rule 17a-5.[52]

In general, both standards set forth a framework of specific procedures that are required for auditors to opine or conclude on a broker's or dealer's statements – referred to in the standards

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[50] See paragraphs (g) and (h) of SEC Rule 17a-5.

[51] In addition, on February 28, 2012, the Board proposed to update certain of its rules to conform to the Dodd-Frank Act amendments to the Sarbanes-Oxley Act of 2002. See Proposed Amendments to Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications, PCAOB Release No. 2012-002 (February 28, 2012). Among other things, these proposed amendments would amend the Board's rules to require that registered firms comply with the Board's interim standards in broker or dealer engagements. See proposed amendments to Rule 1001(a)(v), Rule 1001(a)(vi), Rule 3200T, and Rule 3300T, Rule 3400T, Rule 3500T, and Rule 3600T. The Board expects to act on these proposed amendments in a separate rulemaking in the near future.

[52] The requirements in the examination standard are generally consistent with the requirements of AT sec. 101, Attest Engagements, and AT sec. 601, Compliance Attestation. Similarly, the requirements in the review standard are generally consistent with AT sec. 101. However, when an auditor performs an engagement pursuant to the examination standard or a review pursuant to the review standard, AT sec. 101 and AT sec. 601 would not apply.

as "assertions"[53] – in compliance reports and exemption reports required by SEC Rule 17a-5, respectively.[54]

Furthermore, both of the attestation standards emphasize coordination between the examination engagement or review engagement, the audit of the broker's or dealer's financial statements and audit procedures performed on the supporting schedules (referred to as "supplemental information"). This emphasis on coordination, when properly executed, can promote overall audit effectiveness and avoid redundancy in the work performed. For example, auditors can take into account, when appropriate, evidence obtained while planning and performing the audit of the financial statements and the audit procedures performed on supplemental information in planning and performing the attestation engagement.

This emphasis on coordination is also a key aspect of Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements (the "auditing standard"),[55] which the Board is separately adopting. Auditing Standard No. 17 will apply when the auditor of the financial statements is engaged to perform audit procedures and report on supplemental information accompanying audited financial statements in accordance with

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[53] These standards use the term "assertion" to refer to the broker's or dealer's individual statements that are covered by the examination and review. In the examination standard, the term "assertion" also distinguishes the portion of the statements in the broker's or dealer's compliance report that are covered by the examination.

[54] See paragraphs (i)(3)(iii)(A) and (B) of SEC Rule 17a-5 for the specific requirement for an opinion or conclusion to be expressed in the auditor's report.

[55] See Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, PCAOB Release No. 2013-008 (October 10, 2013).

PCAOB standards, including supporting schedules prepared pursuant to SEC Rule 17a-5.[56] The auditing standard also includes requirements for the procedures on the supplemental information to be planned and performed in conjunction with the audit of the financial statements, and for the audits of brokers and dealers to be coordinated with the attestation engagements related to compliance or exemption reports.[57]

In the Board's view, the attestation standards further the public interest and promote investor protection because they are tailored to the corresponding requirements of SEC Rule 17a-5, which are designed to provide safeguards with respect to broker and dealer custody of customer securities and funds. For example, the specific requirements in the examination standard for evaluating Internal Control Over Compliance[58] can help auditors to identify deficiencies in a broker's or dealer's internal controls for safeguarding customer securities and funds or maintaining necessary capital or reserves. Similarly, the specific requirements in the review standard should focus auditors on whether the broker or dealer appropriately meets the exemption provisions in paragraph (k) of SEC Rule 15c3-3.

Also, the SEC Release states that SEC enforcement actions alleging fraudulent conduct by brokers and dealers highlight the need for enhancements to the rules governing broker and dealer custody of customer assets, including increased focus on compliance and internal

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[56] See paragraph (d)(2) of SEC Rule 17a-5.

[57] See the note to paragraph 3.c. of Auditing Standard No. 17.

[58] Consistent with SEC Rule 17a-5, the examination standard defines "Internal Control Over Compliance" as "internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with the [financial responsibility rules], will be prevented or detected on a timely basis." See paragraph (d)(3)(ii) of SEC Rule 17a-5.

compliance controls by brokers and dealers and their auditors.[59] The attestation standards include requirements related to the auditor's consideration of fraud risks, including the risk of misappropriation of customer assets. The new standard includes requirements for testing controls of the broker or dealer for safeguarding customer assets and funds and for performing procedures to obtain evidence about the existence of customer funds and securities held for customers.

Furthermore, PCAOB inspections staff in their inspections of broker and dealer audits have identified auditing deficiencies in 57 of 60 audits that were conducted under GAAS and the prior SEC Rule 17a-5.[60] The attestation standards – tailored for the new audit and reporting requirements under SEC Rule 17a-5 – establish an approach specific to examining compliance reports and reviewing exemption reports that should provide greater clarity as to the procedures that should be used and facilitate consistent compliance for auditors of SEC registered brokers and dealers.

The financial responsibility rules serve an important investor protection function by requiring brokers and dealers to maintain minimum levels of net capital and take steps to safeguard customer securities and cash.[61] As described in the SEC Release, the new requirements for engagement of accountants should result in higher levels of compliance with the financial responsibility rules by increasing the focus of carrying brokers and dealers and their independent public accountants on specific statements made in compliance reports and increasing the focus of non-carrying brokers and dealers and their independent public accountants regarding whether the

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[59] See the SEC Release at 206–207.

[60] See Second Report on the Progress of the Interim Inspection Program Related to Audits of Brokers and Dealers, PCAOB Release No. 2013-006 (August 19, 2013) at 6.

[61] See the SEC Release at 255.

broker or dealer meets applicable exemption provisions.[62] Moreover, in the Board's view, the involvement of auditors, under the attestation standards and PCAOB oversight, should enhance the quality of the compliance information provided to the SEC and used in its regulatory oversight, which is important to the protection of investors who entrust their cash and securities with brokers and dealers.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Sarbanes-Oxley Act.

B. Board's Statement on Burden on Competition

Not applicable.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rule amendment for public comment in PCAOB Release 2011-004 (July 12, 2011). The Board received eleven written comment letters. The Board has carefully considered all comments received. The Board's response to the comments it received and the changes made to the rules in response to the comments received are discussed below.

Attestation Standard No. 1, Examination Engagements Regarding Compliance Reports of Brokers and Dealers

As discussed more fully below, the examination standard has been designed specifically for an auditor's examination of certain statements made by a broker or dealer in a compliance report required by SEC Rule 17a-5. As a result of amendments to SEC Rule 17a-5, certain brokers and dealers (e.g., those that maintain custody of customer funds) must file a compliance report with the Commission making statements regarding compliance with and controls over

[62] See the SEC Release at 238.

certain financial responsibility rules.[63] Specifically, SEC Rule 17a-5 also requires the broker or dealer to engage an independent public accountant registered with the PCAOB to examine, and independently report on, certain statements made by the broker or dealer in the compliance report.[64]

According to the Commission, the amendments to SEC Rule 17a-5 strengthen audit requirements for brokers and dealers as well as provide additional safeguards with respect to brokers' and dealers' custody of customers' assets.[65] Previously, audits of brokers and dealers were subject to generally accepted auditing standards ("GAAS") established by the American Institute of Certified Public Accountants ("AICPA"). The examination standard the Board is adopting has been designed to align with the requirements of SEC Rule 17a-5. The examination standard includes specific procedures for auditors performing examinations of certain statements required in a compliance report prepared by brokers and dealers as required under SEC Rule 17a-5. In the Board's view, this approach is consistent with the objectives of SEC oversight and is warranted in view of the importance of brokers' and dealers' compliance with the financial responsibility rules and to the protection of investors. In developing the standard, the Board has emphasized coordination with the financial statement audit and audit procedures performed on supplemental information. This approach should enhance overall audit effectiveness and also help avoid unnecessary duplication of work.

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[63] The examination standard and the SEC Release use the term "financial responsibility rules" to refer to 17 CFR § 240.15c3-1 ("SEC Rule 15c3-1" or the "net capital rule"); 17 CFR § 240.15c3-3 ("SEC Rule 15c3-3"); and 17 CFR § 240.17a-13 ("SEC Rule 17a-13"); and any rule of the designated examining authority ("DEA") of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer (an "account statement rule"). See the SEC Release at 8-9.

[64] See paragraph (g)(2)(i) of SEC Rule 17a-5.

[65] See generally the SEC Release at 206-209.

The following discussion provides background regarding the attestation standards, including significant comments received on the proposed standards and changes made to the standards.

SEC Rule 17a-5 and Related Changes

SEC Rule 17a-5 requires a broker's or dealer's compliance report to include the following statements by the broker or dealer as to whether:[66]

a. The Internal Control Over Compliance of the broker or dealer was effective during the most recent fiscal year;

b. The Internal Control Over Compliance of the broker or dealer was effective as of the end of the most recent fiscal year;

c. The broker or dealer was in compliance with the net capital rule and 17 CFR § 240.15c3-3(e) (the "reserve requirements rule") as of the end of the most recent fiscal year; and

d. The information the broker or dealer used to state whether it was in compliance with the net capital rule and the reserve requirements rule was derived from the books and records of the broker or dealer.

As noted above, SEC Rule 17a-5 also requires the broker or dealer to engage an independent public accountant registered with the PCAOB to examine, and independently report on, certain statements made by a broker or dealer in the compliance report. Neither the SEC Rule nor the examination standard require the auditor to opine on the broker's or dealer's process for

[66] See paragraph (d)(3)(i)(A) of SEC Rule 17a-5. SEC Rule 17a-5 also requires the compliance report to contain a statement as to whether the broker or dealer has established and maintained Internal Control Over Compliance. However, the auditor is not required by SEC Rule 17a-5 to examine and report on that statement.

arriving at the conclusions in the statements made in the compliance report.[67] Thus, the auditor need not opine on the evaluation procedures that a broker or dealer may have performed in order make the statements in the compliance report.

As amended by the Commission, SEC Rule 17a-5 includes modifications from the SEC's proposed amendments,[68] including changes that are reflected in the examination standard. Amendments made to SEC Rule 17a-5 included narrowing the scope of the compliance assertion;[69] eliminating the concepts of "material non-compliance" and "compliance in all material respects;" and requiring the auditor to opine on Internal Control Over Compliance as of the end of the fiscal year, as well as during the fiscal year.[70]

The Commission's narrowing of the scope of the compliance assertion and changes to the evaluation of Internal Control Over Compliance affected the scope of the examination procedures required to be performed by the auditor and the auditor's report, and therefore resulted in conforming changes to the final examination standard. These and other modifications to the examination standard are discussed further below.

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[67] See the SEC Release at 38 and the second note to paragraph 5 of the examination standard.

[68] See SEC Exchange Act Release No. 34-64676, Broker-Dealer Reports (June 15, 2011), 76 Federal Register 37572 (June 27, 2011) ("SEC Proposing Release").

[69] These standards use the term "assertion" to refer to the broker's or dealer's statements that are covered by the examination and review. In the examination standard, the term "assertion" also distinguishes the portion of the statements in the broker's or dealer's compliance report that are covered by the examination.

[70] See paragraph (d)(3)(ii) of SEC Rule 17a-5, which states that the term "Internal Control Over Compliance" means internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with §§ 240.15c3-1, 240.15c3-3, 240.17a-13, or any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer will be prevented or detected on a timely basis.

Changes to the Examination Standard to Align with SEC Rule 17a-5

The proposed examination standard was designed specifically for the examination of the compliance report required by the proposed amendments to SEC Rule 17a-5. As noted earlier, the examination standard reflects conforming changes based on the Commission's revision of its amendments to SEC Rule 17a-5 in the following areas: narrowing the scope of the compliance assertion; eliminating the concepts of "material non-compliance" and "compliance in all material respects;" and requiring the auditor to opine on Internal Control Over Compliance as of the end of the fiscal year, as well as during the fiscal year.

Changes to the Scope of the Compliance Assertion

The SEC's Adopting Release states:

> [T]he final rule [SEC Rule 17a-5] requires a statement as to whether the broker-dealer was in compliance with Rule 15c3-1 and paragraph (e) of Rule 15c3-3 as of the end of the most recent fiscal year and, if applicable, a description of any instances of non-compliance with these rules as of the fiscal year end. This is a modification from the proposed assertion that the broker-dealer is in compliance with the financial responsibility rules in all material respects and proposed description of any material non-compliance with the financial responsibility rules. Thus, the final rule reflects two changes from the proposal: (1) elimination of the concepts of "material non-compliance" and "compliance in all material respects" for the purposes of reporting in the compliance report; and (2) a narrowing of these statements and requirements from compliance with all of the financial

responsibility rules to compliance with Rule 15c3-1 and paragraph (e) of Rule 15c3-3.[71]

The narrowing of the scope of the broker's or dealer's assertion to include only compliance with the net capital rule and reserve requirements rule resulted in several changes to the performance and reporting requirements in the examination standard. As the final rule limits the broker's or dealer's assertion regarding compliance to SEC Rule 15c3-1 and paragraph (e) of SEC Rule 15c3-3, the examination standard requires tests of compliance tailored to compliance with the net capital rule and the reserve requirements rule.

Because the broker's or dealer's assertion relates to compliance with the net capital rule rather than compliance "in all material respects," the concept of material non-compliance has been removed from the provisions of the examination standard regarding testing compliance. Also, the auditor cannot opine that a broker's or dealer's assertion that it is in compliance with the net capital rule and reserve requirements rule is fairly stated, in all material respects, if one or more instances of non-compliance with either the net capital rule or reserve requirements rule exist as of the end of the most recent fiscal year.

Materiality Considerations

As discussed previously, the SEC's elimination of the concepts of "material non-compliance" and "compliance in all material respects" from the provisions of SEC Rule 17a-5 related to asserting compliance has been carried over to the examination standard, which no longer refers to "material non-compliance" or the "risk of material non-compliance." However, most of the procedures set forth in the proposal for assessing the risks of material non-compliance have been retained in paragraph 9 of the examination standard as planning

[71] See the SEC Release at 32.

procedures because they remain relevant for determining the necessary nature, timing, and extent of procedures to be performed in the examination.

Also, consistent with SEC Rule 17a-5, the examination standard retains the concept of a Material Weakness in Internal Control Over Compliance, and the requirements regarding performing procedures to determine whether Material Weaknesses exist in Internal Control Over Compliance.

The concept of materiality also remains relevant when evaluating whether the information the broker or dealer used to assert compliance with the net capital rule and reserve requirements rule is derived from the broker's or dealer's books and records, is fairly stated, in all material respects.

The Board received a number of comments on the proposed examination standard that are no longer applicable given the narrowing of the scope of the compliance assertion. These comments included requests for additional guidance related to the determination of material non-compliance and requests for specific examples regarding the consideration of qualitative and quantitative factors in the context of each of the rules included in the compliance assertion, as well as matters within each of those rules that the PCAOB considers to be most significant to compliance.

Evaluating Internal Control Over Compliance During the Fiscal Year and as of the End of the Fiscal Year

The SEC Release states that SEC Rule 17a-5 requires that the compliance report contain, among other things, statements as to whether (1) the broker or dealer has established and maintained Internal Control Over Compliance, (2) the Internal Control Over Compliance of the broker or dealer was effective during the most recent fiscal year, and (3) the Internal Control

Over Compliance of the broker or dealer was effective as of the end of the most recent fiscal year.[72]

To align with SEC Rule 17a-5, the examination standard requires the auditor to express an opinion regarding whether the specified assertions made by the broker or dealer in its compliance report are fairly stated, in all material respects, including whether the broker's or dealer's Internal Control Over Compliance was effective during and as of the end of the most recent fiscal year. This change from the proposed SEC Rule 17a-5 resulted in conforming changes to the examination standard relating to the requirements for testing controls and the scope of the examination report. For example, the examination standard addresses the effect of changes in controls on the auditor's testing.

Further, Appendix A to the examination standard defines certain terms used in the examination standard, including "Internal Control Over Compliance," "Deficiency in Internal Control Over Compliance," and "Material Weakness." The definitions of these terms in the examination standard are consistent with the definitions of these terms in SEC Rule 17a-5.

Performing the Examination Engagement (Paragraphs 6 – 33 of Attestation Standard No. 1)

General Requirements (Paragraphs 6 – 7 of Attestation Standard No. 1)

The examination standard retains the general requirements as proposed. These requirements are consistent with AT sec. 101, Attest Engagements. Briefly, paragraph 6 of the examination standard sets forth general requirements for an auditor performing an engagement pursuant to the examination standard. Paragraph 6 requires that an auditor: have adequate technical proficiency in attestation engagements; obtain an understanding of the financial responsibility rules and other rules and regulations that are relevant to the broker's or dealer's

[72] See the SEC Release at 29–30.

assertions; determine the auditor's compliance with independence and ethics requirements;[73] and exercise due professional care.

Some commenters stated that the general requirements in the examination engagement were sufficiently clear as proposed. One commenter recommended that the examination standard specify the level of understanding of the financial responsibility rules that auditors are expected to have. The commenter also recommended deleting the reference to "other rules and regulations that are relevant to the broker's or dealer's assertions," asserting that the requirement is too broad to allow auditors to identify suitable criteria and express an opinion on management's assertion. Additionally, that commenter recommended that the examination standard specify how the auditor's understanding of the financial responsibility rules should be documented.

The requirement for the auditor to obtain an understanding of the financial responsibility rules is similar to an existing requirement in AT sec. 101, which includes a requirement for the engagement to be performed by an auditor "having adequate knowledge of the subject matter."[74] In addition, understanding the requirements in other rules and regulations is important to enable the auditor to form conclusions on the broker's or dealer's assertions, as well as aiding the auditor's own compliance with the requirements in the examination standard and SEC Rule 17a-5. For example, paragraph (h) of SEC Rule 17a-5 requires a broker or dealer to provide notification to the Commission and other securities regulators when the auditor notifies the broker or dealer that the auditor has determined that the broker or dealer is not in compliance

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[73] Determining the auditor's compliance with independence and ethics requirements includes determining that the auditor complied with relevant requirements of the PCAOB and the SEC. Paragraph (f)(1) of SEC Rule 17a-5 requires the auditor to be independent in accordance with 17 CFR § 210.2-01.

[74] See AT sec. 101.21.

with SEC Rule 15c3-1 as required by SEC Rule 17a-11, Notification Provisions for Brokers and Dealers. In addition to the financial responsibility rules, it is of course important that the auditor understands the requirements of SEC Rule 17a-5, including the notification requirements when an instance of non-compliance is identified. As such, the requirement was retained substantially as proposed.

With respect to documentation, the attestation engagements are subject to the requirements of Auditing Standard No. 3, Audit Documentation, which applies to engagements conducted pursuant to the standards of the PCAOB. Auditing Standard No. 3 states that as audit documentation is the written record that provides the support for the representations in the auditor's report, it should demonstrate that the engagement complied with the standards of the PCAOB.[75] Further, as there are potentially a variety of ways for the auditor to document their understanding of the financial responsibility rules and other rules and regulations, the examination standard does not prescribe any specific manner to do so. A note has been added to paragraph 6 of the examination standard to remind auditors of their responsibility to comply with Auditing Standard No. 3.

The proposed examination standard included a footnote which stated that "due professional care" referred to in that paragraph was the same term in paragraph .40 of AT sec. 101. One commenter stated that while the commenter did not disagree with the meaning of "due professional care," referencing AT sec. 101 from the examination standard may be confusing, especially as AT sec. 101 would not be applicable to engagements in which the examination standard is applicable. In the examination standard, a note has been added to state that due professional care imposes a responsibility on each engagement team member to comply with the

[75] See paragraph 4 of Auditing Standard No. 3.

examination standard and that the exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report. A footnote to that note states that the auditor's responsibility to exercise due professional care is consistent with the description in paragraphs .40–.41 of AT sec. 101.

The Board did not receive other significant comments on the general requirements of the proposed examination standard. As such, the general requirements are being adopted substantially as proposed.

Relationship Between the Examination Engagement and the Audit of the Financial Statements and Audit Procedures Performed on Supplemental Information (Paragraph 8 of Attestation Standard No. 1)

By its terms, SEC Rule 17a-5 requires the financial statement audit and the compliance examination to be performed by the same auditor.[76] Accordingly, the examination standard includes a requirement for the auditor to coordinate the examination engagement with the audit of the financial statements and the audit procedures performed on supplemental information. The emphasis on appropriately coordinating the examination engagement with the audit of the financial statements and the audit procedures performed on supplemental information should promote overall audit effectiveness and avoid redundancy in the auditor's work.

For example, the examination standard includes a requirement for the auditor to take into account evidence from the audit of the financial statements in planning and performing procedures for the examination engagement and in evaluating the results of the procedures performed in the examination. This enables the auditor to plan, perform, and evaluate the results of the examination engagement concurrent with the audit of the financial statements because the

[76] See paragraph (g) of SEC Rule 17a-5.

examination standard is structured similarly to, and contains many of the same concepts included in, auditing standards related to the auditor's assessment of and response to risk.[77]

The proposing release requested comments on other ways the Board could promote coordination of the examination engagement with the audit of the financial statements and the audit procedures performed on supplemental information. Commenters generally stated that requirements regarding the coordination of the examination engagement with the audit of the financial statements were appropriate.

One commenter stated that the Board should require the auditor of the financial statements to perform the examination engagement and issue the examination report. As noted previously, SEC Rule 17a-5 includes this requirement.[78] Thus, the attestation standards do not include specific requirements for performing the examination or review if the auditor did not audit the financial statements.

Another commenter stated that it is inappropriate to require that the auditor plan and perform the work to meet the objectives of both the examination engagement and the financial statement audit, and that the auditor's obligation under the examination standard is to meet the objectives of the examination engagement. The language in the standard was retained as proposed. The auditor should plan and perform the work to meet the objectives of both the examination engagement as well as the financial statement audit. Existing auditing standards require the auditor to properly plan and perform the financial statement audit.[79] Since the objectives are not identical, the auditor must plan and perform the work to achieve the objectives

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[77] See generally, Auditing Standards Nos. 8–15.

[78] See paragraph (g) of SEC Rule 17a-5.

[79] See Auditing Standard No. 9, Audit Planning.

of both engagements. Further, the examination standard does require the auditor to take into account the evidence obtained and the results of procedures performed during the audit of the financial statements and the audit procedures performed on the supplemental information in planning and performing procedures for the examination engagement and in evaluating the results of the procedures performed in the examination engagement.

Consideration of Fraud (Paragraph 10 of Attestation Standard No. 1)

The auditor's consideration of fraud is an important part of the examination engagement. Fraud risks particularly relevant to a broker's or dealer's non-compliance with the financial responsibility rules include the risk of misappropriation of customer funds or securities held for customers and intentional manipulation of the books and records to conceal material misappropriations or other non-compliance. The SEC Release notes that the amendments to SEC Rule 17a-5, which include requiring the examination and review engagements, are designed to provide additional safeguards with respect to broker and dealer custody of customer securities and funds.[80]

Paragraph 10 of the examination standard includes a requirement for the auditor to assess the risk of fraud, and specifically refers to the risk of misappropriation of customer assets, which is relevant to compliance with the net capital rule and the reserve requirements rule, as well as the broker's or dealer's Internal Control Over Compliance.

The requirement to coordinate the examination engagement with the audit of the financial statements and audit procedures performed on supplemental information is also important for the proper assessment of fraud risk in the examination engagement. The auditor's assessment of fraud risk in the examination engagement will be informed to a substantial degree by the

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[80] See the SEC Release at 206.

procedures performed and the fraud risk assessments in the audit of the financial statements and audit procedures performed on supplemental information. Many of the fraud risk factors identified in the financial statement audit regarding (1) incentives or pressures to misappropriate assets or commit fraudulent financial reporting, and (2) attitudes and rationalizations that justify such fraudulent actions,[81] are relevant when identifying and assessing risks of misappropriation of customer assets or intentional manipulation of the books and records to conceal misappropriation of customer assets or non-compliance with the financial responsibility rules. Also, weaknesses in controls regarding safeguarding of assets or stock records can result in opportunities for misappropriation of customer assets or non-compliance. In addition, the evaluation of misstatements for indications of fraud or matters identified during the audit that might affect the assessment of fraud risks in the audit of the financial statements also might affect the assessment of fraud risks in the examination engagement.[82]

Paragraph 9.d. of the examination standard includes a requirement for the auditor to assess the risks associated with related parties, including related parties that are investment advisors or entities with which the broker or dealer has a custodial or clearing relationship, that are relevant to compliance and controls over compliance. Given the nature of the transactions with related parties that are investment advisors or entities with which the broker or dealer has a custodial or clearing relationship, they are particularly relevant to the auditor's consideration of the risks associated with related parties in the examination engagement and in considering both the broker's or dealer's assertions related to Internal Control Over Compliance, as well as to the

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[81] See paragraphs 65–66 of Auditing Standard No. 12, Identifying and Assessing Risks of Material Misstatement, and paragraph 85 of AU sec. 316, Consideration of Fraud in a Financial Statement Audit.

[82] See paragraphs 19–22, 28–29 and Appendix C of Auditing Standard No. 14, Evaluating Audit Results.

broker's or dealer's assertion related to compliance with the net capital rule and the reserve requirements rule.

Likewise, paragraph 9.j. of the examination standard includes a requirement for the auditor to obtain an understanding of the nature and frequency of customer complaints that are relevant to compliance with the financial responsibility rules, which can provide evidence relevant to the assessment of fraud risks, especially if there is a high incidence of customer complaints, thematic issues in the complaints that indicate the potential for misappropriation of customer assets, or specific allegations of fraud or misfeasance by the broker's or dealer's customers.

Other paragraphs in the examination standard address the auditor's responsibilities for responding to fraud risks. For example, paragraph 22 of the examination standard retains an important requirement from the proposed examination standard for the auditor to perform compliance tests that are responsive to risks, including fraud risks. Also, paragraph 23 of the examination standard retains from the proposal the requirement for the auditor to perform procedures to obtain evidence about the existence of customer funds or securities held for customers. This is an important responsibility in an audit of a broker or dealer that has access to customer assets. It affects compliance with the net capital rule and the reserve requirements rule, and it has the potential to result in contingent liability to the broker or dealer that requires recognition or disclosure in the financial statements.

Because the examination standard requires the auditor to perform tests that are responsive to fraud risks, the nature, timing, and extent of procedures to obtain evidence about the existence of assets held for customers should be commensurate with the risk of misappropriation of customer assets. Determining the necessary procedures involves considering relevant risk

factors, including, but not limited to, the amount of cash and securities held for customers and the results of testing and evaluation of the relevant controls. Examples of procedures that provide evidence about the existence of customer assets include (1) counting customer securities or observing and testing the broker's or dealer's procedures for physical inspection and (2) confirming customer security positions directly with depositories and clearing organizations. Procedures performed in the audit of the financial statements and the audit procedures performed on supplemental information to test the existence of assets held for customers also provide relevant evidence in the examination engagement.

The Board requested comment regarding whether specific requirements should be added to either of the proposed attestation standards to further enhance protection of customer assets. One commenter stated that generally the attestation standards are adequate to enhance protection of customer assets. Another commenter stated that the principles in the examination standard for performing compliance tests are sufficiently clear.

One commenter recommended that the Board clarify the extent and timing of procedures included as examples in paragraph 26 of the proposed examination standard regarding procedures that provide evidence about the existence of customer assets. The examination standard requires the auditor to perform procedures to obtain evidence of customer funds or securities held for customers, but the standard does not prescribe specific procedures for the auditor to perform to obtain such evidence. The procedures included in the note to paragraph 23 of the examination standard are examples of procedures that the auditor might perform to obtain such evidence. The necessary extent and timing of those procedures depends on, among other things, the complexity of the operations of the broker's or dealer's business, the nature of carrying

and clearing arrangements, and the design and effectiveness of controls related to the existence assertion. As such, the examination standard has not been changed to reflect this comment.

Testing Controls over Compliance (Paragraphs 11 – 20 of Attestation Standard No. 1)

SEC Rule 17a-5 requires the broker's or dealer's compliance report to include an assertion regarding the effectiveness of Internal Control Over Compliance during the most recent fiscal year and as of the end of the fiscal year.[83] Accordingly, the examination standard requires the auditor to obtain evidence about the design and operating effectiveness of relevant controls over compliance throughout the fiscal year and as of the end of the fiscal year.

The examination standard requires the auditor to test those controls that are important to the auditor's conclusion about whether the broker or dealer maintained effective Internal Control Over Compliance for each financial responsibility rule during the fiscal year and as of the end of the fiscal year. The examination standard also requires the auditor to obtain evidence that the controls over compliance selected for testing are designed effectively and operated effectively during the fiscal year and as of the fiscal year end.[84]

As the broker's or dealer's assertion regarding Internal Control Over Compliance relates to each financial responsibility rule individually, the auditor should obtain evidence about the effectiveness of the selected controls for each financial responsibility rule. However, when testing controls over compliance, the auditor's objective is not to support an opinion about the

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[83] See paragraphs (d)(3)(i)(A)(2) and (3) of SEC Rule 17a-5, which requires the broker or dealer to assert on the effectiveness of its Internal Control Over Compliance with the financial responsibility rules throughout the fiscal year and as of the end of the most recent fiscal year.

[84] See paragraphs (d)(3)(i)(A)(2) and (3) of SEC Rule 17a-5, which requires the broker or dealer to assert on the effectiveness of its Internal Control Over Compliance throughout the fiscal year and as of the broker's or dealer's fiscal year end. See also paragraphs (d)(3)(i)(B) and (C) of SEC Rule 17a-5, which require the broker or dealer to describe each material weakness in Internal Control Over Compliance and any instance of non-compliance with the net capital rule or reserve requirements rule.

effectiveness of each individual control, rather, the objective is to form an opinion about whether the broker's or dealer's assertions regarding Internal Control Over Compliance are fairly stated, in all material respects. This allows the auditor to focus his or her effort on the controls that are important to each of the financial responsibility rules and to vary the level of evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.

One commenter recommended that the examination standard include guidance regarding the identification of controls important to the auditor's conclusion about whether the broker or dealer maintained effective internal controls over compliance for each financial responsibility rule. As the financial responsibility rules outline the requirements necessary to be in compliance, the auditor can identify the controls for testing by understanding the controls the broker or dealer has implemented to assure compliance with the respective requirements.

Additionally, the examination standard identifies certain factors that affect the risk associated with a control. One factor included in paragraph 13 is the broker's or dealer's history of instances of non-compliance with the financial responsibilities rules that the control is intended to prevent or detect. A recent history of non-compliance generally indicates higher risk associated with the control. Factors that affect the risk associated with a control include, but are not limited to, those described in paragraph 13 of the examination standard.

Another factor included in paragraph 13 includes the extent of use of part-time personnel. Some commenters stated that they did not agree that the use of part-time personnel is a factor that affects the risk associated with a control. Those commenters stated that this risk factor is incorporated in another risk factor regarding the competence of the personnel who perform the control or monitor its performance. One commenter stated that, in their opinion, it would be

more appropriate to evaluate the competence and objectivity of personnel executing the controls and their knowledge of the financial responsibility rules.

In considering these comments, the Board took into account the SEC's June 2007 compliance alert,[85] which noted that SEC examinations found that many part-time financial and operational principals did not actually supervise or create and maintain various books and records. In light of risks illustrated in the SEC compliance alert, the use of part-time personnel has been retained in the examination standard as a risk factor for the auditor to consider when testing internal controls over compliance. The auditor's understanding of the role and responsibilities of the part-time personnel is important to evaluating the associated risks.

Paragraphs 14–18 of the examination standard provide requirements for the auditor to test the design and operating effectiveness of the selected controls over compliance. These requirements for testing design and operating effectiveness of controls over compliance are analogous to the requirements for testing controls in Auditing Standard No. 13, The Auditor's Responses to the Risks of Material Misstatement.

Under the examination standard, the auditor should obtain evidence about the effectiveness of controls each year. Similar to testing controls in a financial statement audit, the examination standard provides factors for the auditor to take into account if the auditor plans to use evidence obtained in prior years in determining the extent of testing in the current year.

One commenter recommended that paragraph 16 of the proposed examination standard, which stated "[a]s the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases," be replaced with paragraph 18 of Auditing Standard No. 13, which states that [t]he auditor should obtain more persuasive audit evidence. . . ." The

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[85] See Compliance Alert, June 2007, available at http://www.sec.gov/about /offices/ocie/complialert.htm.

suggested revision is consistent with the intent of the requirement, so it has been included in paragraph 12 of the examination standard. This change will focus the auditor on the persuasiveness of audit evidence, rather than quantity, and avoid unnecessary differences between the examination standard and the auditing standards. Similar changes are reflected in paragraphs 22 and 24 of the examination standard.

Paragraphs 19 and 20 of the examination standard describe the auditor's use of evidence obtained in past examination engagements and using tests of controls that are modified during the year. One commenter suggested that as changes to controls occur throughout the period, the examination standard should require the auditor to determine with management what types of changes could materially affect control effectiveness. That commenter stated that the auditor should then test and evaluate management's documentation of the changes to controls and perform procedures to test the broker's or dealer's implementation of that change. SEC Rule 17a-5 requires that the broker or dealer assert that its controls were effective during the most recent fiscal year. As stated in the examination standard, to evaluate controls over compliance throughout the period, the auditor should obtain evidence regarding the design effectiveness of the selected controls before and after the change. Further, the examination standard also requires that, if a broker or dealer makes changes to its policies and procedures or key personnel during the fiscal year, the auditor should obtain an understanding of the reason for the change and obtain evidence regarding the design and operating effectiveness of the superseded and new controls before and after the change.

One commenter stated that the phrase within paragraph 20 of the proposed examination standard which stated, "whether each control is operating as designed" might be confusing and recommended revising the paragraph to state "each control selected for testing." The suggested

revision is consistent with the intent of the requirement, so it has been included in paragraph 16 of the examination standard.

Performing Compliance Tests (Paragraphs 21 – 24 of Attestation Standard No. 1)

Paragraphs 21–24 set forth requirements for performing tests of compliance with the net capital rule and reserve requirements rule.

With respect to compliance tests, the auditor's objective is to form a conclusion about whether the broker's or dealer's assertion regarding compliance with the net capital rule and the reserve requirements rule is fairly stated, in all material respects. To satisfy this objective, the examination standard requires the auditor to perform procedures that are sufficient to support the auditor's conclusions regarding whether the broker or dealer was in compliance with the net capital rule and reserve requirements rule as of the end of its most recent fiscal year.

The examination standard requires the auditor to perform specific procedures on the schedules the broker or dealer used to determine compliance with the net capital rule and the reserve requirements rule as of the end of its fiscal year, including:

a. Evaluating whether the amounts in the schedule were determined in accordance with the net capital rule or reserve requirements rule, as applicable;

b. Testing the accuracy and completeness of the information in the schedule;

c. Determining whether the broker or dealer maintained the required level of net capital in accordance with the net capital rule;

d. Determining whether the broker or dealer maintained a special reserve bank account for the exclusive benefit of customers and deposited funds in at least the required amount in accordance with the reserve requirements rule;

e. Determining whether the information in the schedule was derived from the books and records of the broker or dealer; and

f. Determining whether the broker or dealer made the notifications, if any, required by the net capital rule and reserve requirements rule as of the end of the most recent fiscal year.

Paragraph 21.e. of the examination standard requires the auditor to perform procedures to determine whether the information used to assert compliance with the net capital rule and the reserve requirements rule was derived from the broker's or dealer's books and records. Proper coordination of these procedures with the audit of the financial statements and audit procedures performed on supplemental information should allow the auditor to avoid redundancy in the auditor's work and increase the effectiveness of the procedures performed. For example, Auditing Standard No. 17, Auditing Supplemental Information Accompanying Audited Financial Statements, includes a requirement for the auditor to determine that the supplemental information reconciles to the underlying accounting and other records or to the financial statements themselves, as applicable. Such supplemental information includes the supporting schedules that brokers or dealers are required to include in their financial reports pursuant to SEC Rule 17a-5.[86]

To test compliance pursuant to paragraph 21, the auditor will need to design his or her procedures to test the provisions of the net capital rule and reserve requirements rule that have a bearing on the broker's or dealer's compliance with that rule. For example, the current requirements in the net capital rule generally include:

a. The requirement to maintain minimum net capital and tentative net capital, as

[86] See paragraph (d)(2) of SEC Rule 17a-5.

applicable, at all times.[87]

b. The requirement for certain brokers or dealers not to let a specified amount of certain accounts it carries exceed a specified threshold for more than five business days.[88]

c. The requirement for brokers or dealers carrying accounts of listed options specialists not to let the amount of certain deductions required under Appendix A of the net capital rule to exceed a specified threshold for more than three business days.[89]

d. The notification requirement relating to paragraph (c)(2)(x)(C) of the net capital rule.[90]

e. The requirement for brokers or dealers carrying accounts of listed options specialists to liquidate accounts when a liquidating deficit exists which includes a notice requirement.[91]

f. The requirement that the total of outstanding principal amounts of satisfactory subordination agreements cannot exceed 70% of the broker's or dealer's debt-equity total for a period in excess of 90 days.[92]

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[87] See paragraph (a) of 17 CFR § 240.15c3-1.

[88] See paragraph (a)(6)(v) of 17 CFR § 240.15c3-1.

[89] See paragraph (c)(2)(x)(C) of 17 CFR § 240.15c3-1.

[90] See paragraph (c)(2)(x)(C)(1) of 17 CFR § 240.15c3-1.

[91] See paragraph (c)(2)(x)(D) of 17 CFR § 240.15c3-1.

[92] See paragraph (d) of 17 CFR § 240.15c3-1.

g. The notification requirements relating to withdrawals of equity capital.[93]

h. The limitations on withdrawal of equity capital.[94]

i. The requirements regarding temporary restrictions on net capital withdrawals.[95]

Other provisions of the rule also may apply depending on the particular activities or elections of the broker or dealer. Auditors should look to the requirements of the individual rules in order to test compliance.[96]

The requirements for testing compliance with the net capital rule and the reserve requirements rule should facilitate the coordination of the examination engagement and the audit procedures performed on supplemental information. The compliance procedures, if properly planned and performed, should provide substantial evidence to satisfy the requirements of Auditing Standard No. 17.

As discussed earlier, in view of the amendments to SEC Rule 17a-5 adopted by the Commission, the examination standard was revised to more closely align the auditor's performance requirements with the scope of the compliance assertion in SEC Rule 17a-5. It is appropriate to include specific procedures the auditor should perform on the schedules the broker or dealer used to determine compliance with the net capital rule and the reserve requirements rule as of the end of its fiscal year.

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[93] See paragraph (e)(1) of 17 CFR § 240.15c3-1.

[94] See paragraph (e)(2) of 17 CFR § 240.15c3-1.

[95] See paragraph (e)(3) of 17 CFR § 240.15c3-1.

[96] See paragraph 6.b. of the examination standard, which requires the auditor to obtain an understanding of the financial responsibility rules and other rules and regulations that are relevant to the broker's or dealer's assertions.

In addition to those procedures that the auditor would perform on the broker's or dealer's schedules when planning and performing compliance tests, the auditor should take into account the evidence obtained from procedures performed as part of the audit of the financial statements and the audit procedures performed on supplemental information. For example, certain audit procedures performed to test the valuation and classification of the broker's or dealer's investments as of the end of the fiscal year may provide relevant evidence regarding the broker's or dealer's compliance with the net capital rule. Further, when testing the broker's or dealer's cash and cash equivalents, certain audit procedures may provide evidence regarding the existence of special reserve bank accounts for the exclusive benefit of customers, as well as evidence about the deposits to, and withdrawals from, those bank accounts. Such evidence may be relevant to the broker's or dealer's compliance with the reserve requirements rule. However, as the objectives of the audit and the examination engagement are not the same, the auditor must plan and perform the work to meet the objectives of both engagements.

Evaluating the Results of the Examination Procedures (Paragraphs 25 – 29 of Attestation Standard No. 1)

Paragraph 25 of the examination standard states that in forming an opinion on whether the assertions made by the broker or dealer in the compliance report are fairly stated, in all material respects, the auditor should evaluate all evidence obtained, regardless of whether the evidence corroborates or contradicts the broker's or dealer's assertions. Paragraph 26 of the examination standard provides that the auditor should evaluate: (1) identified instances of non-compliance[97] with the net capital rule and reserve requirements rule, to determine whether any

[97] In evaluating the results of compliance testing, an error in a broker's or dealer's computation used to determine compliance with a provision of the net capital rule or reserve requirements rule is not an instance of non-compliance if, after giving consideration to the effect of the error, the broker or dealer still met the requirements of that provision, e.g., maintained at least the required minimum level or net capital or at least the minimum level on deposit in the

instances of non-compliance existed as of the end of the most recent fiscal year; (2) identified instances in which the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived from the broker's or dealer's books and records to determine whether they are material, individually or in combination; and (3) identified Deficiencies in Internal Control Over Compliance to determine whether the deficiencies, individually or in combination, are Material Weaknesses. Identified instances of non-compliance might be an indication of a Deficiency in Internal Control Over Compliance.

The auditor's evaluation of the materiality of instances in which the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived from the broker's or dealer's books and records is based on relevant quantitative and qualitative factors, including, in particular, the importance of the information not derived from the books and records to the broker's or dealer's compliance with the corresponding requirement in the net capital rule or the reserve requirements rule. For example, when a broker or dealer asserts that the information used to state whether it was in compliance with the net capital rule was derived from its books and records, and the auditor identifies an amount not derived from a broker's or dealer's books and records, the broker or dealer may still be able to support its assertion that it maintained the required net capital using information that was derived from the books and records of the broker or dealer. However, such an instance might be an indication of a Deficiency in Internal Control Over Compliance.

Paragraph 28 of the examination standard applies when the auditor has not obtained sufficient appropriate evidence about an assertion or has substantial doubt about an assertion.

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special reserve account. However, such an instance might be an indication of a Deficiency in Internal Control Over Compliance that requires evaluation pursuant to this standard.

Pursuant to paragraph 28, the auditor in those situations is required to perform additional procedures to address the matter. Performing the examination with due professional care requires an auditor conducting an examination to take appropriate actions when becoming aware of non-compliance or Material Weaknesses not included in the broker's or dealer's assertions or when substantial doubt remains. This requirement is similar to the requirement in paragraph 35 of Auditing Standard No. 14, which states that if the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion or has substantial doubt about a relevant assertion, the auditor should perform procedures to obtain further audit evidence to address the matter.

Obtaining a Representation Letter (Paragraphs 32 – 33 of Attestation Standard No. 1)

The examination standard includes a requirement for the auditor to obtain written representations from management of the broker or dealer. The failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the examination engagement. See Reporting on the Examination Engagement below for further discussion regarding scope limitations.

Overall, commenters were supportive of the requirement for the auditor to obtain representations from management and stated that obtaining representations from management is a necessary part of the auditor's ability to support the auditor's opinion. One commenter recommended that the auditor obtain a written representation from the broker or dealer that acknowledges the broker's or dealer's responsibility for the assertions in the compliance report. This recommendation has been incorporated into paragraph 32.b. of the examination standard.

Commenters suggested additional representations that the auditor should obtain from management during an examination engagement, including representations regarding management's responsibility for compliance with the financial responsibility rules, that

management has performed an evaluation of compliance, that management did not use the auditor's procedures performed during the audit of the financial statements or procedures performed on supplemental information as part of the basis for management's assertions and that management has disclosed to the auditor all known instances of non-compliance and fraud. While many of these additional representations might be appropriate based on the facts and circumstances of the examination engagement, the examination standard was not modified to include them as they are either duplicative of management's assertions or not necessary to meet the requirements of the standard. However, the examination standard does not preclude the auditor from obtaining additional representations from management in situations in which the auditor believes additional representations are appropriate.

Communication Requirements (Paragraphs 34 – 35 of Attestation Standard No. 1)

The examination standard requires the auditor to communicate certain matters to management and the audit committee. These requirements reflect changes from the proposed communication requirements to conform to SEC Rule 17a-5. In addition, rather than defining the term "audit committee," the examination standard states that the term "audit committee" has the same definition as that in Auditing Standard No. 16, Communication with Audit Committees.

One commenter stated that communication requirements in the proposed examination standard are sufficient. Another commenter requested that the Board clarify the meaning of "identified" as used in paragraph 36 of the proposed examination standard. That commenter questioned whether an "identified" instance of non-compliance referred to the moment the auditor becomes aware of its existence or only after the auditor concludes it represented a significant deficiency. The language in the standard was retained as proposed. In the context of the examination standard, the term "identified instance of non-compliance" is meant to clarify

that the communication requirement applies to instances of non-compliance identified by the auditor.[98] A note has been included to paragraph 35 of the examination standard reminding auditors of their obligation to comply with the requirements of paragraph (h) of SEC Rule 17a-5.

Reporting on the Examination Engagement (Paragraphs 36 – 38 of Attestation Standard No. 1)

The examination standard requires the auditor to issue a single report that expresses an opinion on whether the assertions made by a broker or dealer in a compliance report are fairly stated, in all material respects, when expressing an unqualified opinion. Paragraph 36 of the standard includes basic report elements, while paragraph 37 includes an illustrative report.

The reporting requirements in the examination standard have been revised to align with the compliance report that is required by SEC Rule 17a-5. This includes reporting on the broker's or dealer's assertions regarding the effectiveness of Internal Control Over Compliance during and as of the end of the most recent fiscal year, compliance with the net capital rule and the reserve requirements rule, and whether the information used to assert compliance with those rules was derived from the broker's or dealer's books and records.

Legal Determinations, Discussion of Inherent Limitation of the Examination, Discussion of Interpretations of Rules and Regulations, and Restrictions on the Use of the Examination Report

One commenter stated that the report clearly communicates the auditor's responsibilities. Other commenters suggested that the examination standard should address additional reporting matters, such as including a caveat about legal determinations, discussion of inherent limitations of the examination, discussion of interpretations of rules and regulations, and restrictions on the use of the examination report.

Legal Determinations

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[98] See also the discussion of the notification requirements in the SEC Release at 101–107.

Some commenters stated that the auditor's examination report should be modified to include language indicating that the auditor's examination does not provide for a legal determination of a broker's or dealers compliance with financial responsibility rules. When the auditor is engaged to perform an examination, it is necessary for the auditor to read and make judgments regarding the application of the regulatory requirements, as applicable to the engagement. The auditor's report issued pursuant to the examination standard does not provide a legal determination, nor does it purport to provide a legal determination, of a broker's or dealer's compliance with the net capital rule or the reserve requirements rule. However, such a report may be useful to legal counsel or others in making such determinations. In the context of an examination, the auditor expresses an opinion on whether the assertions made by a broker or dealer in a compliance report are fairly stated, in all material respects. Accordingly, the Board did not add the suggested language to the examination standard.

Inherent Limitations of the Examination

Some commenters stated that the examination report should be revised to include language discussing the inherent limitations of the examination, similar to language contained in other PCAOB auditing standards. Those commenters recommended including a statement similar to the statement contained in the audit report on internal control over financial reporting, which states that because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements.[99]

The examination standard does not prescribe reporting language regarding the inherent limitations of the examination. Such language might be confusing to users who interpret such a

[99] Paragraph 85.j. of Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.

statement as a limitation on the opinion expressed in the auditor's examination report, rather than the nature of internal controls over compliance. Also, an inherent limitation statement about internal control over financial reporting, which is management's responsibility and the subject of the audit, is different from a limitation statement about the auditor's examination itself.

Interpretations of Rules and Regulations

Several commenters stated that evaluating a broker's or dealer's compliance with regulatory requirements may be based upon interpretations of regulations or rules established by the Commission and/or DEAs. Commenters recommended that the examination standard permit the inclusion of a statement within the examination report stating the description and the source of interpretations made by the brokers and dealer's management. After considering these comments, a footnote has been added to paragraph 36.h. of the examination standard. The statement in the footnote is consistent with the existing requirements of paragraph .59 of AT sec. 601, Compliance Attestation, which allows the auditor to include a paragraph stating the description and the source of interpretations made by the entity's management immediately after the scope paragraph of the auditor's report. The following is an example of such a paragraph:

> We have been informed that, under X Broker's interpretation of [identify the compliance requirement, e.g. SEC Rule 15c3-1], [explain the source and nature of the relevant interpretation].

One commenter recommended that the auditor's examination report should include a statement that the assertions are the responsibility of the broker or dealer. The examination standard does not include this language because the first sentence in the auditor's examination report clarifies that the assertions are the responsibility of the broker or dealer.

Restriction of Use of the Examination Report

The proposed examination standard did not include provisions for restricting the use of the examination report to specified parties. Some commenters stated that audit firms previously have often restricted the use of reports required by SEC Rule 17a-5 to the board of directors, management, the Commission, and other regulatory agencies that rely on SEC Rule 17a-5. Some commenters stated that a restriction on the use of an auditor's examination or review report is appropriate, given that general users of these reports may not have a sufficient understanding of the subject matter to which they relate, such as the financial responsibility rules.

SEC Rule 17a-5 specifies the required reports, assertions, and the compliance requirements related to these engagements. The reports pursuant to this rule are generally filed only with the Commission, the broker's or dealer's DEA, and the Securities Investor Protection Corporation ("SIPC"). Accordingly, these criteria are suitable and available for purposes of these engagements.

As the reporting criteria have been established by the Commission and those reporting criteria are publicly available, including language restricting the auditor's examination report in the examination standard is unnecessary. As such, no additional language is included in the examination standard.

Examination Report Date (Paragraph 38 of Attestation Standard No. 1)

Under paragraph 38 of the examination standard, the auditor should date the examination report no earlier than the date on which the auditor obtains sufficient appropriate evidence to support his or her opinion. Because of the coordination between the examination engagement, the audit of the financial statements and the audit procedures performed on supplemental information, the date of the examination report should not be earlier than the date of the auditor's report on the financial statements and supplemental information. The Board did not receive

comments on the proposed dating of the report. As such, these requirements are adopted as proposed.

Examination Report Modifications (Appendix C of Attestation Standard No. 1)

The examination standard includes an appendix ("Appendix C") that builds on existing concepts described in AT sec. 101 regarding report modifications and adapts them as appropriate to the requirements of the examination engagement.

Under the examination standard, if one or more instances of non-compliance with the net capital rule or the reserve requirements rule exist as of the end of the most recent fiscal year, one or more Material Weaknesses in Internal Control Over Compliance exist during or as of the end of the most recent fiscal year, or the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the books and records of the broker or dealer, the auditor must express an adverse opinion directly on the subject matter of the respective assertions, rather than on the assertions themselves, unless there is a restriction on the scope of the examination engagement.[100] For example, if the broker or dealer is not in compliance with the net capital rule, the auditor's report would include an adverse opinion on compliance and would identify the instance of non-compliance regardless of whether it was described in the broker's or dealer's compliance report.

This requirement is different from AT sec. 101, which states that "[r]eservations about the subject matter . . . can result in either a qualified or an adverse opinion, depending on the materiality of the departure from the criteria against which the subject matter . . . was

[100] The requirement to express an adverse opinion applies regardless of whether the instance of non-compliance, material weakness, or other matters preventing an unqualified opinion were identified by management or the auditor.

evaluated."[101] Qualified opinions are not appropriate because any instance of non-compliance as of the end of the fiscal year, any Material Weakness in Internal Control Over Compliance during or as of the end of the fiscal year, or any instance in which the information used to assert compliance with the net capital rule and the reserve requirements rule was not derived, in all material respects, from the broker's or dealer's books and records, is by definition material and, as such, must result in an adverse opinion.

The examination standard describes specific matters that the auditor should include in the examination report when expressing an adverse opinion. For example, when expressing an adverse opinion because one or more Material Weaknesses exist, the auditor's examination report must include a statement that one or more Material Weaknesses have been identified and an identification of the description of the Material Weaknesses in the compliance report.

The requirement to express an adverse opinion applies only to the subject matter for the respective assertion. It does not require an adverse opinion on the subject matter of all assertions in every instance. For example, if a Material Weakness was identified during the year but not at year end, and there were no instances of non-compliance or instances in which the information used to assert compliance with the net capital rule and the reserve requirements rule was not derived, in all material respects, from the broker's or dealer's books and records, the examination report should include an adverse opinion on Internal Control Over Compliance during the year and an unqualified opinion on the other three assertions.

Several commenters recommended that the examination standard include examples of modified examination reports. Appendix C to the examination standard describes examination

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[101] See AT sec. 101.76.

report modifications. Additional report examples may be considered, if guidance is issued in the future.

Further, paragraph C6 of the examination standard states that, when the auditor plans to disclaim an opinion and the limited procedures performed by the auditor caused the auditor to make certain conclusions, the auditor's report also must include the matters described in paragraph C3 of the examination standard. Those conclusions include that: (1) one or more instances of non-compliance with the net capital rule or the reserve requirements rule existed as of the end of the fiscal year, (2) one or more Material Weaknesses existed during or as of the end of the most recent fiscal year, or (3) the information used to assert compliance with the net capital rule or the reserve requirements rule was not derived, in all material respects, from the books and records of the broker or dealer.

The examination standard states that the auditor may issue a report disclaiming an opinion on the assertions made by a broker or dealer in a compliance report as soon as the auditor concludes that a scope limitation will prevent the auditor from obtaining the reasonable assurance necessary to express an opinion. The auditor is not required to perform any additional work before issuing a disclaimer when the auditor concludes that he or she will not be able to obtain sufficient evidence to express an opinion.

In addition, unlike AT sec. 101, if the auditor concludes that he or she cannot express an opinion because there has been a limitation on the scope of the examination engagement, under the examination standard, the auditor should communicate on a timely basis, in writing, to management and the audit committee that the examination engagement cannot be satisfactorily completed.

Some commenters stated that when the auditor expresses an adverse opinion, the auditor should report directly on the subject matter for all assertions, rather than the respective assertion necessitating the adverse opinion. As discussed, the examination standard aligns with the requirements of SEC Rule 17a-5, which requires the auditor to report on the respective management assertion.

Under the examination standard, if the broker's or dealer's compliance report contains other information in addition to the statements and descriptions, if applicable, required by SEC Rule 17a-5,[102] the auditor should disclaim an opinion on the other information. For example, if the broker's or dealer's compliance report states that an identified Material Weakness no longer exists because controls have been implemented after the end of the fiscal year that address the Material Weakness, the auditor should disclaim an opinion on this information.

One commenter recommended that the examination standard address instances when there is a misstatement of fact in management's assertion, particularly when management's assertion is improperly presented. SEC Rule 17a-5 establishes the assertions brokers and dealers are required to make regarding compliance with the financial responsibility rules. The auditor's responsibility is to express an opinion on management's assertions. SEC Rule 17a-5 specifically describes the content of the statements to be made by the broker or dealer.[103] Further, a misstatement of fact by the broker or dealer in its assertion would likely result in an adverse opinion on one or more of the broker's or dealer's assertions. As the examination standard provides requirements relating to adverse opinions, no further changes were made based on this comment. Furthermore, as stated in the proposing release, if the auditor believes that additional

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[102] See paragraphs (d)(3) and (g)(2) of SEC Rule 17a-5.

[103] See paragraph (d)(3) of SEC Rule 17a-5.

information in the compliance report contains a material misstatement of fact, the auditor should discuss the matter with management of the broker or dealer. If, after discussing the matter with management, the auditor concludes that a material misstatement of fact remains, the auditor should notify management and the audit committee of the auditor's views concerning the information.

Appendix B. Considerations for Brokers and Dealers with Multiple Divisions or Branches

When a broker or dealer conducts its operations through multiple divisions and branch offices, the examination standard includes, in Appendix B, a requirement for the auditor to determine the extent to which examination procedures should be performed at selected divisions or branches to obtain sufficient appropriate evidence to support the conclusions expressed in the auditor's examination report. This includes determining the divisions or branches at which to perform examination procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual divisions or branches. The same requirements were included in the body of the proposed examination standard.

One commenter recommended certain additional factors that should be taken into account when determining the extent of the examination procedures to be performed at divisions or branches, including judgments about materiality of the division or branch and the similarity of operations over compliance for different divisions or branches. These factors were considered during the development of the examination standard. The requirement in the examination standard for the auditor to take into account the degree to which the financial responsibility rules relate to activities at the division or branch level is broader than judgments based solely on the materiality of a specific division. Adding another factor regarding materiality within paragraph 13 of the examination standard might limit an auditor's consideration of the procedures to be

performed to only quantitative factors rather than risks related to non-compliance. As such, this factor has not been included in the examination standard.

One commenter recommended including the similarity of operations over compliance for different divisions or branches as a factor within the examination standard. Similar to the discussion in the preceding paragraph, the requirement in the examination standard for the auditor to take into account the degree to which the financial responsibility rules relate to activities at the division or branch level includes considerations regarding the similarity of operations over compliance for different divisions or branches. Including this factor within paragraph 13 of the examination standard might limit the auditor's consideration of the procedures to be performed to identify differences between different divisions or branches, rather than assessing the risk that different divisions or branches with similar operations over compliance might have instances of non-compliance.

Other Comments

Use of the Work of Other Auditors

Some commenters stated that situations could exist in which the auditor that is engaged to perform an examination engagement might use the work of other auditors. Those commenters stated that the examination standard should include a reference to AU sec. 543, Part of Audit Performed by Other Independent Auditors. Other commenters stated that references to the Board's auditing standards were inappropriate within the attestation standards. By its terms, AU sec. 543 applies when one auditor uses the work and reports of another auditor of the financial statements of a component. As this situation does not apply to a compliance examination engagement, the standard does not refer to AU sec. 543. Nonetheless, auditors can use the work of other auditors if such work is performed under their supervision.

Interaction with an Audit of Internal Control Over Financial Reporting

Some commenters stated that additional guidance relating to the relationship between internal control over financial reporting and Internal Control Over Compliance would be beneficial. Those commenters stated that while SEC Proposed Rule 17a-5 is clear that the attestation reports do not extend to internal control over financial reporting, there may be certain controls over financial reporting that could overlap with Internal Control Over Compliance with the financial responsibility rules.

Several commenters stated that the Board should coordinate with the SEC to provide further guidance regarding the relationship between the evaluation of Deficiencies in Internal Control Over Compliance and the evaluation of Material Weaknesses and significant deficiencies in internal control over financial reporting. The SEC Release contains relevant discussion regarding the interaction between Internal Control Over Compliance and internal control over financial reporting.[104]

Attestation Standard No. 2, Review Engagements Regarding Exemption Reports of Brokers and Dealers

As previously described, the review standard has been designed specifically for an auditor's review of statements made by a broker or dealer in an exemption report required by the Commission's amendments to SEC Rule 17a-5.

Briefly, certain brokers and dealers claim exemption from the Commission's requirements contained in SEC Rule 15c3-3, the SEC rule relating to the custody of customer

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[104] See the SEC Release at 38, which notes, among other things, that internal control over financial reporting is focused on the reliability of financial reporting and preparation of financial statements in accordance with generally accepted accounting principles, whereas the compliance report should focus on oversight of net capital, custody arrangements, and protection of customer assets, and, therefore should be focused on compliance with the financial responsibility rules.

funds, pursuant to exemption provisions contained in paragraph (k) of SEC Rule 15c3-3 (the "exemption provisions"). In the exemption report, the broker or dealer identifies (i) the exemption provision of paragraph (k) of SEC Rule 15c3-3 under which the broker or dealer claimed exemption from the SEC's custody requirements (the "identified exemption provisions"), and (ii) states that the broker or dealer met the exemption provisions throughout the most recent fiscal year without exception or, if applicable, states that exceptions to the identified exemption provisions were identified, including a description of any such exceptions and the approximate date on which the exception existed. SEC Rule 17a-5 requires the broker or dealer to engage an independent public accountant registered with the PCAOB to review, and independently report on, the statements in the broker's or dealer's exemption report.

Because brokers and dealers claiming an exemption from SEC Rule 15c3-3 requirements under paragraph (k) of that rule might have access to customer funds, a review engagement focusing on the identification of exceptions to the exemption provisions claimed by brokers and dealers is important to the protection of investors. Notably, a recent PCAOB report on the progress of its interim inspection program of broker and dealer audits noted that in a significant number of audits of brokers and dealers that claimed an exemption from SEC Rule 15c3-3, auditors did not perform sufficient procedures to ascertain that the broker or dealer complied with the conditions of the exemption.[105] The review standard includes specific procedures for auditors performing compliance reviews of a broker's or dealer's assertions in an exemption report with an emphasis on coordination with the auditor's work on the financial statement audit and the audit procedures performed relating to supplemental information. This approach should enhance overall audit effectiveness and also help avoid unnecessary duplication of work.

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[105] See Second Report on the Progress of the Interim Inspection Program Related to Audits of Brokers and Dealers, PCAOB Release No. 2013-006 (August 19, 2013), at 9.

The following discussion provides background regarding the review standard, including significant comments received on the proposed review standard and changes made to the standard.

Overview of SEC Rule 17a-5 and Related Changes

As amended by the Commission, SEC Rule 17a-5 includes modifications from the SEC's proposed amendments, including a number of changes that focus the auditor more directly on the exemption provisions claimed by the broker or dealer and the identification of any exceptions. These modifications resulted in corresponding changes to the review standard. Principally, the changes involve:

- The introduction of certain terms, including "exemption provisions," and "exceptions;"
- Changes to the broker's or dealer's assertions, as set forth in SEC Rule 17a-5, to include more detailed information regarding the exemption provision claimed asserted by the broker or dealer and any exceptions identified; and
- Changes to the auditor's reporting requirements, and the example report, including requirements for auditors to modify their reports in situations in which the broker or dealer fails to disclose an exception in the exemption report.

As noted above, the review standard was designed specifically to implement the auditor's requirements in SEC Rule 17a-5. The review standard establishes requirements that apply when an auditor is engaged to perform an exemption review of the statements made by a broker or dealer in an exemption report prepared pursuant to SEC Rule 17a-5.

Paragraph 2 states that SEC Rule 17a-5 requires a broker's or dealer's exemption report to contain the following statements[106] by the broker or dealer:

a. A statement that identifies the exemption provisions under which the broker or dealer claimed an exemption from SEC Rule 15c3-3;

b. A statement that the broker or dealer (1) met the identified exemption provisions throughout the most recent fiscal year without exception or (2) met the identified exemption provisions throughout the most recent fiscal year except as described in the exemption report; and

c. If applicable, a statement that identifies each exception during the most recent fiscal year in meeting the identified exemption provisions (an "exception") and that briefly describes the nature of each exception and the approximate dates on which the exception existed.

The changes reflected in SEC Rule 17a-5 to include exceptions to the exemption provisions in the exemption report did not result in significant changes to the procedural requirements in the proposed review standard. The review standard, similar to the proposed review standard, requires the auditor to state a conclusion regarding whether, based upon the results of the review procedures, the auditor is aware of any material modifications that should be made to the broker's or dealer's assertions for the assertions to be fairly stated, in all material respects.[107] To state such a conclusion, the auditor must plan and perform the review engagement

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[106] See paragraph (d)(4) of SEC Rule 17a-5.

[107] The review standard largely carries forward the requirement from prior SEC Rule 17a-5 that the independent public accountant engaged by the broker or dealer "must ascertain that the conditions of the exemption were being complied with as of the examination date and that no facts came to the independent public accountant's attention to indicate that the exemption

to obtain appropriate evidence that is sufficient to obtain moderate assurance about whether one or more conditions exist that would cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects.

Moderate Assurance

The requirement that the auditor obtain moderate assurance[108] to support his or her opinion has not been changed from the Board's proposal. The approach taken in the review standard is in contrast to the examination standard, in which the auditor obtains reasonable assurance to support his or her opinion on the broker's or dealer's assertions. In the review engagement contemplated by the review standard, the auditor must obtain moderate assurance regarding the broker's or dealer's assertions.

Review engagements typically involve the performance of inquiries and analytical procedures,[109] and the auditor's conclusions typically are expressed in the report in the form of negative assurance.[110]

The proposing release noted that, in a review engagement covered by the proposed review standard, analytical procedures are not feasible for evaluating compliance with the

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had not been complied with during the period since the last examination." See the SEC Release at 72.

[108] Obtaining moderate assurance in a review engagement is consistent with both existing PCAOB standards and the SEC Release. AT sec. 101.55 describes a review as an attest engagement designed to provide a moderate level of assurance. See the SEC Release at 88, which states that a "moderate level of assurance [is] contemplated by the required review."

[109] AT sec. 101.55 states that "[i]n an attest engagement designed to provide a moderate level of assurance (referred to as a review), the objective is to accumulate sufficient evidence to restrict attestation risk to a moderate level. To accomplish this, the types of procedures performed generally are limited to inquiries and analytical procedures (rather than also including search and verification procedures)."

[110] See AT sec. 101.68.

exemption conditions, as the conditions are based on activities of the broker or dealer rather than on financial statement amounts. Thus, the review standard establishes specific procedural requirements that are commensurate with the responsibility to obtain moderate assurance. This approach is consistent with AT sec 101.55–.56 which states that ". . . there will be circumstances in which inquiry and analytical procedures . . . cannot be performed. . . . In [this] circumstance, the practitioner should perform other procedures that he or she believes can provide him or her with a level of assurance equivalent to that which inquiries and analytical procedures would have provided."

Commenters generally stated that the requirements in the review standard were appropriate for obtaining moderate assurance. Further, some commenters stated that the term "moderate assurance" as used in the review standard is consistent with how the term "moderate assurance" is presently used in practice and with how auditors are currently performing engagements to obtain moderate assurance.

One commenter stated that the review standard could clarify that the auditor plans and performs the review engagement in the context of obtaining a moderate level of assurance. In considering this comment, the Board noted that the objective of the review standard states ". . . the auditor must plan and perform the review engagement to obtain appropriate evidence that is sufficient to obtain moderate assurance. . . ." As such, additional clarification is not necessary.

One commenter stated that an "agreed-upon procedures" engagement would be more appropriate than a review engagement for a broker's or dealer's assertion that it is exempt from SEC Rule 15c3-3. SEC Rule 17a-5 requires a broker or dealer that claimed exemption from the requirements of SEC Rule 15c3-3 to file a report from their independent public accountants that includes the results of a review of the broker's or dealer's assertions. As adopted, the review

standard establishes requirements that are designed specifically to provide auditors with a standard for performing the review required by SEC Rule 17a-5.

Performing the Review Engagement (Paragraphs 5 – 14 of Attestation Standard No. 2)

General Requirements (Paragraphs 5 – 6 of Attestation Standard No. 2)

Paragraphs 5 and 6 of the review standard set forth general requirements for an auditor performing the review standard. The Board did not receive significant comments on the general requirements of the proposed review standard. As such, the general requirements are being adopted largely as proposed.

Paragraph 5 of the review standard requires that an auditor performing a review engagement have adequate technical proficiency in attestation engagements, obtain an understanding of the exemption conditions and other rules and regulations that are relevant to the broker's or dealer's assertion, determine the auditor's compliance with independence and ethics requirements,[111] and exercise due professional care.

The proposed review standard included a footnote which stated that "due professional care" referred to in that paragraph was the same term in paragraph .40 of AT sec. 101. One commenter stated that while they did not disagree with the meaning of "due professional care," they believe that referencing AT sec. 101 from the review standard may be confusing, especially as AT sec. 101 would not be applicable to engagements in which the review standard is applicable. In response, a note has been added to state that due professional care imposes a responsibility on each engagement team member to comply with the review standard and that the

[111] Determining the auditor's compliance with independence and ethics requirements includes determining whether the auditor complied with relevant requirements of the PCAOB and the SEC. Paragraph (f)(1) of SEC Rule 17a-5 requires the auditor to be independent in accordance with 17 CFR § 210.2-01.

exercise of due professional care requires critical review at every level of supervision of the work done and the judgment exercised by those assisting in the engagement, including the preparation of the report. A footnote to that note states that the auditor's responsibility to exercise due professional care is consistent with the description in paragraphs .40–.41 of AT sec. 101.

With respect to documentation, the review engagement is subject to the requirements of Auditing Standard No. 3, which applies to engagements conducted pursuant to the standards of the PCAOB. Auditing Standard No. 3 states that as audit documentation is the written record that provides the support for the representations in the auditor's report, it should demonstrate that the engagement complied with the standards of the PCAOB.[112] A note has been added to paragraph 5 of the review standard to remind auditors of their responsibility to comply with Auditing Standard No. 3.

Review Procedures (Paragraphs 8 – 10 of Attestation Standard No. 2)

The review standard requires the auditor to perform procedures consistent with a review engagement; however, the procedures have been tailored for the exemption report required by SEC Rule 17a-5.

Nature, Timing, and Extent of Procedures (Paragraph 9 of Attestation Standard No. 2)

Under the proposed review standard, the nature, timing, and extent of the review procedures were dependent on certain risk factors and evidence about the broker's or dealer's compliance with the exemption conditions or about the effectiveness of controls over the exemption conditions obtained from the audit of the financial statements and the audit procedures performed on supplemental information. For example, one risk factor is potential non-compliance associated with related parties. Risks associated with related parties that are

[112] See paragraph 4 of Auditing Standard No. 3.

investment advisors or with which the broker or dealer has a custodial or clearing relationship may be especially relevant to the exemption provisions.

Evidence about the broker's or dealer's compliance with the exemption provisions or about the effectiveness of controls over the exemption provisions obtained from the audit of the financial statements and the audit procedures performed on supplemental information also affect the nature, timing, and extent of the necessary inquiries and other review procedures. For example, if the broker or dealer claims an exemption under Rule 15c3-3(k)(1), the auditor, among other things, needs to obtain evidence that the broker's or dealer's transactions are limited to those in redeemable securities of investment companies or of interests or participations in an insurance company separate account.[113] Audit procedures regarding the broker's or dealer's

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[113] Paragraph (k)(1) of SEC Rule 15c3-3, states that "the provisions of [Rule 15c3-3] shall not be applicable to a broker or dealer meeting all of the following conditions:

> (i) His dealer transactions (as principal for his own account) are limited to the purchase, sale, and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; except that a broker or dealer transacting business as a sole proprietor may also effect occasional transactions in other securities for his own account with or through another registered broker or dealer;
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> (ii) His transactions as broker (agent) are limited to: (a) The sale and redemption of redeemable securities of registered investment companies or of interests or participations in an insurance company separate account, whether or not registered as an investment company; (b) the solicitation of share accounts for savings and loan associations insured by an instrumentality of the United States; and (c) the sale of securities for the account of a customer to obtain funds for immediate reinvestment in redeemable securities of registered investment companies; and
>
> (iii) He promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.
>
> (iv) Notwithstanding the foregoing, this section shall not apply to any insurance company which is a registered broker [or] dealer, and which otherwise meets all of the conditions in paragraphs (k)(1) (i), (ii), and (iii) of this section, solely by reason of its participation

investment inventory or investment transactions related to the broker's or dealer's trading for its own account, including confirmation of investment inventory with the custodian and testing investment transactions, can provide evidence relevant to the broker's or dealer's compliance with these exemption conditions.

As another example, if the broker or dealer claims exemption under section (k)(1) of Rule 15c3-3, the auditor needs to obtain evidence about whether the broker or dealer promptly transmits all funds and delivers all securities received in connection with his activities as a broker or dealer, and does not otherwise hold funds or securities for, or owe money or securities to, customers.[114] Audit procedures regarding customer trade and transaction activities can provide evidence relevant to these exemption provisions.

Other procedures performed during the audit that are relevant to the broker's or dealer's compliance with the exemption provisions include testing of specially designated cash accounts and reading clearing agreements between the broker or dealer and clearing brokers and dealers in connection with testing trade fee or commission revenues and expenses.[115]

One commenter recommended incorporating the discussion in the proposing release relating to the risk of fraud into the review standard to provide further guidance. The proposing release stated that in considering the risk of fraud relevant to the exemption conditions, the auditor also considers whether the broker or dealer has misrepresented its activities, for example,

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in transactions that are a part of the business of insurance, including the purchasing, selling, or holding of securities for or on behalf of such company's general and separate accounts."

[114] See paragraph (k)(1)(iii) of SEC Rule 15c3-3.

[115] Refer to "Relationship Between the Examination Engagement and the Audit of the Financial Statements and Audit Procedures Performed on Supplemental Information" for further discussion.

the broker or dealer claims to be operating as a non-carrying broker or dealer but, based on other evidence appears to hold customer funds or securities. The Board considered this comment and determined, as it has done in other projects, to include performance requirements in the standard and to provide additional discussion and examples in the release. Therefore, the release discussion regarding the risk of fraud has not been incorporated into the review standard. The request for guidance regarding the risk of fraud may be taken into account if additional guidance is issued.

The Board did not receive extensive comment on these requirements. Two commenters stated that the factors are appropriate. In general, these requirements are being adopted substantially as proposed.

Review Procedures (Paragraph 10 of Attestation Standard No. 2)

Paragraph 10 of the review standard sets forth the required procedures for the review engagement. Specifically, the procedures required by the standard are consistent with a review engagement, including making inquiries of management and relevant personnel of the broker or dealer; reading relevant reports from internal auditors or regulatory correspondence; evaluating evidence from the audit of the financial statements and the audit procedures performed on supplemental information; and performing additional procedures for identified exceptions.

While the review standard requires the auditor to perform procedures consistent with a review engagement, the procedures in the standard have been modified in a number of ways to reflect changes made to SEC Rule 17a-5, including to reflect terms used in SEC Rule 17a-5. The following discussion highlights some of the key aspects of, comments on, and changes made to, the required review procedures.

Commenters generally supported the requirements as proposed. However, one commenter stated the proposed review standard does not clearly describe the procedures or the extent of evidence necessary to obtain moderate assurance. Another commenter stated that the language in paragraph 10.h. of the proposed review standard, "perform other procedures as necessary in the circumstances to obtain moderate assurance," is an overly broad requirement.

As previously discussed, obtaining moderate assurance in a review engagement is consistent with both existing PCAOB standards and the SEC Release. AT sec. 101.55 describes a review as an attest engagement designed to provide a moderate level of assurance. The SEC Release states that a "moderate level of assurance [is] contemplated by the required review."[116] The procedures required by the review standard have been designed to assist the auditor in obtaining moderate assurance in a review engagement. These procedures largely focus on making inquiries and reading information relevant to the broker's or dealer's assertions. In the Board's view, such procedures are consistent with AT sec. 101.56, given that analytical procedures would not provide relevant evidence in light of the broker's or dealer's assertions required by SEC Rule 17a-5. For example, paragraph 10.g. of the review standard states that in performing the review engagement, the auditor should evaluate whether the evidence obtained and the results of the procedures performed in the audit of the financial statements and the audit procedures performed on supplemental information corroborate or contradict information in the broker's or dealer's assertions. Further, paragraph 10.h. of the review standard has been revised to state that in performing the review engagement, the auditor should perform other procedures as necessary in the circumstances to obtain moderate assurance regarding whether a material

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[116] See the SEC Release at 88.

modification should be made to the broker's or dealer's assertions for the assertions to be fairly stated, in all material respects.

One commenter stated that, while the review procedures and the matters affecting their nature, timing, and extent are, for the most part, appropriate for an engagement to obtain a moderate level of assurance, they did have certain specific recommendations, including clarifying the note in paragraph 10.g. of the review standard to explicitly indicate that the examples of procedures are those that may be performed during the audit of the financial statements. The Board considered this comment and agrees that such a revision would clarify that the note is referring to examples of procedures performed during the audit of the financial statements that might provide relevant evidence to the review engagement. As such, the note to paragraph 10.g. of the review standard has been revised.

In addition, if the broker or dealer has sent to or received correspondence from the SEC or the broker's or dealer's DEA that is relevant to compliance with the exemption conditions, the review standard includes a requirement for the auditor to read such correspondence and, when necessary in the circumstances, make inquiries of the regulatory agencies. These procedures can provide the auditor with relevant information about a broker's or dealer's compliance with the exemption provisions. Under the circumstances when a need arises to make inquiries of the regulatory agencies, the Board acknowledges that auditors may need authorization from the broker or dealer before contacting the regulatory authority.

One commenter suggested that the Board provide guidance related to the interaction between auditors and a company's regulatory examiners consistent with the AICPA Audit and Accounting Guide for Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies. The guidance in that publication is

specific to the interaction between the auditor and federal bank examiners, and might differ from the DEAs of the broker or dealer. As such, additional requirements in this area have not been included in the review standard.

Evaluating the Results of the Review Procedures (Paragraphs 11 – 12 of Attestation Standard No. 2)

Under paragraph 11 of the review standard, the auditor should evaluate whether information has come to the auditor's attention that cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects. For example, a broker's or dealer's failure to disclose an exception in the exemption report would cause the assertion not to be fairly stated, in all material respects, which would require modification of the review report. This paragraph has been modified to align with the amendments to SEC Rule 17a-5.

Additionally, the proposed standard required the auditor to perform additional procedures if information came to the auditor's attention that indicated that one or more instances of non-compliance might exist that might cause the broker's or dealer's assertion not to be fairly stated or if the auditor had substantial doubt about the assertion. The review standard has been revised to align with the requirements in SEC Rule 17a-5.

One commenter requested clarification of the relationship between paragraphs 10.h. and 12 of the review standard. Those two requirements address different situations, as discussed below.

As previously noted, paragraph 10.h. of the review standard requires auditors to perform other procedures as necessary in the circumstances to obtain moderate assurance. This applies when the auditor determines the nature, timing, and extent of review procedures to be performed, such as in planning the review.

Paragraph 12 of the review standard applies when information comes to the auditor's attention during the engagement indicating that the broker's or dealer's assertions might not be fairly stated or if the auditor has substantial doubt about the assertion. Pursuant to paragraph 12, the auditor in those situations is required to perform additional procedures to address the matter. Performing the review with due professional care requires an auditor conducting a review to take appropriate actions when becoming aware of exceptions to the exemption provisions not included in the broker's or dealer's assertion or when substantial doubt remains. The phrase "substantial doubt" has the same meaning as the phrase "substantial doubt" in paragraph 35 of Auditing Standard No. 14, which states that if the auditor has not obtained sufficient appropriate audit evidence about a relevant assertion or has substantial doubt about a relevant assertion, the auditor should perform procedures to obtain further audit evidence to address the matter. In the context of a review engagement, these additional procedures could include, but are not limited to, making additional inquiries, reading documents, or performing search and verification procedures, as necessary.[117]

One commenter recommended incorporating the examples in the preceding paragraph, e.g., making additional inquiries, reading documents, or performing search and verification procedures, as necessary, and the discussion in AT sec. 101.56, into the review standard. That discussion and the examples have not been included in the review standard as they are provided to illustrate the nature of procedures that might be appropriate in such circumstances. Including these as examples in the review standard might limit auditors' consideration of additional procedures to only these procedures, when other procedures might be appropriate.

Obtaining a Representation Letter (Paragraphs 13 – 14 of Attestation Standard No. 2)

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[117] See, e.g., AT sec. 101.56.

The review standard includes a requirement for the auditor to obtain written representations from management of the broker or dealer that relate to the review engagement. The purpose of such representations is to provide the auditor with necessary information for, and context regarding, the engagement. The auditor should not rely inappropriately on management's representations.

The review standard also provides that the failure to obtain written representations from management, including management's refusal to furnish them, constitutes a limitation on the scope of the review engagement. If a limitation on the scope of the review engagement exists, the auditor should withdraw from the engagement or should modify the review report.[118] Additionally, the review standard also includes a list of written representations that the auditor should obtain from management.

Commenters stated that obtaining representations from management is a necessary part of the auditor's ability to express an opinion. One commenter recommended that the list of required written representations include a representation from management that acknowledges its responsibility for the assertions in the exemption report. The suggested additional representation has been included in the review standard.

Further, in the review standard, several of the representations were updated to align with the language in SEC Rule 17a-5.

Communication Requirements (Paragraph 15 of Attestation Standard No. 2)

The review standard requires the auditor to communicate to management and to the audit committee any exceptions to the exemption provisions identified by the auditor or information

[118] See paragraph 20 of the review standard for auditor requirements when a scope limitation exists.

that causes the broker's or dealer's assertions about its exemption provisions not to be fairly stated, in all material respects. In addition, rather than defining the term audit committee, the review standard states that the term "audit committee" has the same definition as that in Auditing Standard No. 16.

The Board did not receive significant comments on the communication requirements included in the proposed review standard. However, the communication requirements in the standard have been modified to align closely with SEC Rule 17a-5. Additionally, a note has been added to paragraph 15 of the review standard reminding auditors of their obligation to comply with the requirements of paragraph (h) of SEC Rule 17a-5.[119]

Reporting on the Review Engagement (Paragraphs 16 – 18 of Attestation Standard No. 2)

The review standard includes requirements for the auditor's review report to include certain elements that are important for a reader of the review report to understand regarding the auditor's responsibilities. This includes a statement that the review was conducted in accordance with the standards of the PCAOB and, accordingly, includes inquiries and other required procedures to obtain evidence about the broker's or dealer's compliance with the exemption provisions. These are largely the same elements as in the proposed standard.

The review standard includes an example of the auditor's standard review report when the broker or dealer asserted that it met the identified exemption provisions throughout the most recent fiscal year without exception and an example of the auditor's standard review report when the broker or dealer includes exceptions to the exemption provisions in the exemption report. A change was made to the review results paragraph in the example review report to align the

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[119] See also the discussion of the notification requirements in the SEC Release at 101–107.

reporting language more closely to the corresponding reporting element, which was not modified from the proposed review standard.

Some commenters stated concerns similar to those for the examination report regarding the use of the review report as a legal determination, interpretation of rules and regulations, restrictions on use of the review report, and limitations of an engagement to obtain moderate assurance. When the auditor is engaged to perform a review engagement, it is necessary for the auditor to read and make judgments regarding the application of regulatory requirements, as applicable to the engagement. The review report issued pursuant to the review standard does not provide a legal determination, nor does it purport to provide a legal determination, of a broker's or dealer's compliance exemption provision. However, such a report may be useful to legal counsel or others in making such determinations.

Modifications of the Report (Paragraphs 19 – 20 of Attestation Standard No. 2)

The review standard requires that if one or more of the broker's or dealer's assertions are not fairly stated, in all material respects, the auditor must modify the review report to describe the reasons why the assertions are not fairly stated, in all material respects. If the broker's or dealer's assertion is not fairly stated because of one of more omitted exceptions, the auditor's review report should disclose each omitted exception.

Paragraph 20 of the review standard sets forth circumstances involving scope limitations. Under the review standard, if the auditor cannot perform the procedures required by the review standard or other procedures that the auditor deems necessary in the circumstances, the review is incomplete because of the scope limitation. An incomplete review is not a sufficient basis for stating a conclusion regarding the broker's or dealer's assertions. In the case of a scope limitation, the auditor should withdraw from the engagement or should modify the review report to:

a. Describe the scope limitation and any review procedures deemed necessary by the auditor that have been omitted and the reason for their omission;

b. State that the auditor does not express any form of assurance on the broker's or dealer's assertions; and, if applicable,

c. Describe the circumstances which cause one or more of the broker's or dealer's assertions not to be fairly stated, in all material respects.

One commenter stated that auditors should use judgment in drafting an appropriate modification to the review report. Other commenters stated that the attestation standards should contain examples of report modifications. The standard sets forth the necessary reporting elements for modified reports. Additional report examples may be considered if guidance is issued in the future.

One commenter questioned the appropriateness of the requirement in paragraph 20 of the proposed review standard for the auditor to describe the omitted procedures and the reason for their omission. The commenter stated that as the reason for the omission of the review procedures is required in the description of the scope limitation itself, describing the omitted review procedures might overshadow the scope limitation. The commenter recommended that it would be more appropriate to generally describe the effect of the scope limitation on the engagement, without providing a list of omitted procedures that may have been considered necessary. Including in the review report a description of the scope limitation, the omitted procedures, and the reason for their omission are important elements of a modified review report given the nature of the procedures and the specificity of the exemption provisions. The discussion of the omitted procedures generally would provide the reader with additional

information beyond the description of the scope limitation. As such, this recommendation has not been incorporated into the review standard.

The same commenter also recommended that the review standard address the auditor's responsibility as it relates to report modifications when management's assertion is improperly presented or contains additional information. That commenter suggested that, in such circumstances, an explanatory paragraph should be included in the auditor's report. Paragraph 19 of the review standard requires the auditor to modify the review report to describe the reasons the assertions are not fairly stated, in all material respects, if one or more of the broker's or dealer's assertions are not fairly stated. This would include circumstances in which management's assertion is improperly presented, and other PCAOB standards address additional information.[120]

Amendments

Auditing Standard No. 3

The Board is adopting certain amendments to Auditing Standard No. 3, Audit Documentation, to clarify that its requirements apply to examination engagements and review engagements. Auditing Standard No. 3 establishes general requirements for documentation the auditor should prepare and retain in connection with engagements conducted pursuant to standards of the PCAOB, including the attestation standards of the PCAOB. The Board is amending Auditing Standard No. 3 to help auditors properly apply the relevant requirements in Auditing Standard No. 3 to attestation engagements, including the attestation engagements covered by the attestation standards. For example, paragraph 6 of Auditing Standard No. 3 includes a requirement for the auditor to document procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions. An amendment

[120] See, e.g., AU sec. 550, Other Information in Documents Containing Audited Financial Statements.

to footnote 2 of paragraph 6 clarifies that, with respect to an engagement conducted pursuant to the attestation standards of the PCAOB, the relevant assertions are the assertions expressed by management or the responsible party regarding the subject matter of the attestation engagement.

In addition, paragraph 12 of Auditing Standard No. 3 includes requirements regarding significant findings or issues and provides certain examples of significant findings or issues. Further, paragraph 13 of Auditing Standard No. 3 requires the auditor to identify all significant findings or issues in an engagement completion document.

The Board did not receive comments requiring revision to the amendments to Auditing Standard No. 3. As such, the amendments are adopted largely as proposed.

Auditing Standard No. 7

The Board is adopting certain amendments to Auditing Standard No. 7, Engagement Quality Review, to extend the requirements for an engagement quality review and concurring approval of issuance for the examination engagements and review engagements of brokers and dealers covered by these attestation standards. The proposal also included amendments that set forth certain procedures to be applied in an engagement quality review of the examination and review under these attestation standards.

Commenters expressed a range of views. Some commenters generally supported the engagement quality review requirement for these attestation engagements as well as the required procedures. One commenter did not support requiring an engagement quality review for either an examination engagement or a review. Other commenters did not support engagement quality reviews for review engagements. Some commenters stated that additional guidance is necessary to implement the proposed amendments.

Other commenters stated that as the audit and attestation standards have been separate bodies of literature, audit and attest standards should be kept separate. Those comments stated that to promote compliance with PCAOB standards, they believe that the Board should continue to maintain this structure. They also believe that the use of an amendment to adopt such significant changes in the literature may not sufficiently take into account a broader consideration of the affected engagements. For those firms that do not audit brokers or dealers, such changes also may go unnoticed.

The Board considered the comments received regarding the amendments to Auditing Standard No. 7 and is adopting the amendments as proposed for both a compliance examination and a compliance review.

Given the importance of the attestation engagements to investor protection and the high level of deficiencies observed by PCAOB inspection staff in areas that would be covered by the attestation engagements,[121] the Board believes that engagement quality reviews can enhance the consistency of compliance with the SEC's rule. An effective engagement quality review can increase the likelihood of identifying significant engagement deficiencies before the examination or review report is issued. Additionally, the Board took note of the fact that, in a February 2011 AICPA Peer Review Alert, the AICPA designated audits of carrying brokers or dealers as a

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[121] See PCAOB Release 2013-006, which reports that PCAOB inspection staff identified auditing deficiencies in 57 of the 60 audits of brokers and dealers selected for inspection and that deficiencies in compliance with audit requirements for brokers and dealers under the Exchange Act that were among the most frequently noted by PCAOB inspection staff included deficiencies in audit procedures related to net capital and customer reserve supporting schedules, compliance with the conditions of the exemption claimed by the broker or dealer, and the accountant's supplemental report on material inadequacies. See PCAOB Release 2013-006, Executive Summary, at ii.

"must select" for peer review, recognizing the significant public interest in audits of such firms.[122]

Also, the emphasis in the attestation engagements regarding the coordination of the attestation engagement with the financial statement audit should reduce the audit effort required to complete the engagement quality review. To emphasize the coordination of the attestation engagement with the financial statement audit in performing an engagement quality review, the proposed amendment to paragraph 18A of Auditing Standard No. 7 was modified to reflect that to evaluate significant judgments made by the engagement team and the related conclusions reached in forming the overall conclusion on the attestation engagement and in preparing the engagement report, the engagement quality review should take into account the procedures performed in the engagement quality review of the financial statement audit. The knowledge that the engagement quality reviewer gains from the engagement quality review of the audit and the specific steps in paragraph 18A should enable the engagement quality reviewer to identify whether there are any significant engagement deficiencies, or any indications of potential significant engagement deficiencies that warrant further investigation.

Other Areas of Comment

The Board requested comment from interested parties on all aspects of the proposal. Several commenters included additional recommendations that have not yet been discussed. Those suggestions are discussed below.

Scalability of the Attestation Standards

The Board requested comment regarding whether the proposed attestation standards are tailored appropriately for examinations and reviews related to compliance and exemption reports

[122] See AICPA Peer Review Alert 11-01 (February 2011).

of brokers and dealers. Commenters who responded to the question generally agreed that the proposed attestation standards are tailored appropriately for examinations and reviews related to compliance and exemption reports of brokers and dealers. One commenter stated that they generally support the proposals and noted that the proposed standards had been clearly aligned with the SEC's proposed rule amendments.

The Board also requested comment regarding whether the proposed attestation standards were appropriately scalable based on the size and complexity of the broker or dealer. Some commenters stated that the standards are proportionate and appropriately scalable based on the size and complexity of the broker or dealer, noting that paragraphs 11 and 12 of Attestation Standard No. 1 are particularly helpful. Some commenters recommended that the Board provide additional guidance, including specific examples, regarding the application of scalability to these examination engagements. Other commenters expressed concern that without such guidance, application of the audit scalability concept could vary greatly across the audit profession. The requests for guidance may be taken into account if additional staff guidance is issued.

Commodity Futures Trading Commission Rules

One commenter stated that for brokers and dealers that are also registered as a Futures Commission Merchant with the Commodity Futures Trading Commission ("CFTC"), it will be necessary for the PCAOB to recognize and address the requirements related to CFTC Rule 1.16 for the auditor to report on compliance therewith. The Commission stated in the SEC Release that its staff "is in discussions with the CFTC staff concerning ways to align the reporting and audit requirements for dually registered broker-dealers/Futures Commissions Merchants with the goal of coordinating these requirements."[123]

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[123] See the SEC Release at 8.

Independence

Several commenters recommended that the discussion in the proposing release stating that auditors of non-issuer brokers and dealers are not subject to PCAOB Rules 3521 through Rule 3526 be included in the attestation standards. On February 28, 2012, the Board proposed amendments to require that registered firms that audit brokers and dealers comply with certain of the Board's professional practice standards including the Board's Rules relating to independence.[124]The Board will consider relevant comments applicable to the Board's independence rules in connection with adopting final amendments.

Period of the Examination and Review

Some commenters stated that brokers and dealers should be allowed to assert compliance with the financial responsibility rules if it can identify deficiencies, implement effective controls, and test their operating effectiveness prior to year-end, and if the auditor also can adequately test the operating effectiveness of the remediated controls. SEC Rule 17a-5 requires the broker or dealer to assert that Internal Control Over Compliance was effective during the most recent fiscal year and as of the end of the most recent fiscal year. While this would require a broker or dealer to identify in its report Material Weaknesses in internal control that occurred during the most recent fiscal year, if those Material Weaknesses are remediated, it would allow the broker or dealer to assert that Internal Control Over Compliance was effective as of the end of the most recent fiscal year.

Some commenters requested clarification about the time period for the assertion regarding exemption from the requirements of SEC Rule 15c3-3 and indicate that they believe a

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[124] See Proposed Amendments to Conform PCAOB Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications, PCAOB Release No. 2012-002 (February 28, 2012).

point-in-time assertion would be sufficient. SEC Rule 17a-5 requires the broker or dealer to assert that it met, or met with exception, the identified exemption provisions in paragraph (k) of SEC Rule 15c3-3 throughout the most recent fiscal year end. The review standard has been updated to reflect this time period.

Providing Additional Guidance and Including Examples from the Proposing Release in the Examination Standard

Several commenters recommended incorporating the additional discussion and examples included in the proposing release into the standard. The examples are not included in the attestation standards. Those examples were illustrative and did not impose requirements or define engagement requirements. Additional report examples may be considered, if guidance is issued in the future.

Other Considerations

Agreed-Upon Procedures Engagements

SEC Rule 17a-5 largely carries forward the requirement that the broker or dealer file with SIPC a supplemental report that includes an accountant's report on applying agreed-upon procedures based on the performance of the procedures outlined in SEC Rule 17a-5.[125]

These attestation standards do not affect the requirements for those agreed-upon procedures engagements. Auditors should continue to look to AT sec. 101, AT sec. 201, Agreed-Upon Procedures, and AT sec. 601,[126] for the requirements applicable to those engagements.

Relationship to the Interim Attestation Standards

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[125] See paragraph (e)(4)(ii) of SEC Rule 17a-5.

[126] See paragraphs .16–.29 of AT sec. 601.

In general terms, the requirements in the examination standard are consistent with the requirements of AT sec. 101 and AT sec. 601. However, when an auditor performs an engagement pursuant to the examination standard, AT sec. 101 and AT sec. 601 would not apply. For this reason, the examination standard includes, for example, a section on general requirements that are consistent with those in AT sec. 101.

The examination standard focuses specifically on performing an examination of the statements made by a broker or dealer in a compliance report and allows auditors to perform such engagements without looking to multiple attestation standards. In addition, the emphasis in the examination standard on appropriately coordinating the examination engagement with the audit of the financial statements and supplemental information should avoid unnecessary redundancy in the auditor's work.

Economic Considerations, including Audits of Emerging Growth Companies

Economic Considerations

As noted above, in developing the attestation standards, the Board's objective was to consider the SEC's amendments to SEC Rule 17a-5 and evaluate whether its standards were appropriate for the SEC's requirements for examinations of compliance reports and reviews of exemption reports.

As part of its process, the Board also considered the SEC's economic analysis related to its amendments to SEC Rule 17a-5. The SEC's analysis considers the economic effects, including the benefits and costs, of the new examinations of compliance reports and reviews of exemption reports that are now required by the SEC to be filed by registered brokers and dealers

pursuant to SEC Rule 17a-5 and includes considerations relating to efficiency, competition, and capital formation.[127]

The SEC's economic analysis considered the Board's proposed attestation standards. As described in the SEC Release, after considering the views of commenters relating to anticipated costs, including with respect to the Board's proposed attestation standards, the SEC concluded that, while the total costs associated with the new compliance and review requirements would depend on the final PCAOB standards for attestation engagements, "as the PCAOB's proposed standards were tailored to the proposed amendments, nothing in those standards causes the Commission to change its estimates of the costs associated with these requirements, or to question that the benefits will justify the costs."[128] The Board notes that, as adopted, the new attestation standards are aligned with SEC Rule 17a-5, and most of the differences between the proposed standards and the attestation standards, as adopted, result from changes to conform to the SEC's final amendments to SEC Rule 17a-5.

In addition to considering the SEC's requirements and economic analysis, the Board also took into account other related economic considerations as discussed below.

Economic Baseline

The SEC made the determination to require brokers and dealers to include in their annual reports either a compliance report that is examined by an auditor or an exemption report that is reviewed by an auditor.

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[127] See the SEC Release, which discusses costs and benefits of the requirements for examined compliance reports and reviewed exemption reports at 226-245.

[128] See the SEC Release at 241.

Therefore, the SEC Release contains a discussion of the economic baseline in its economic analysis. Aspects of the SEC's discussion of the baseline that are relevant to the attestation standards include:

- Before the SEC's amendments, Rule 17a-5 required that the audit under GAAS include a "review" of the broker's or dealer's accounting system, internal accounting control, and procedures for safeguarding securities.[129] The scope of the auditor's work was required to be sufficient to provide reasonable assurance that any material inadequacies[130] existing as of the date of the examination would be disclosed.
- Before the SEC's amendments, if the broker or dealer was exempt from the reserve requirements rule, the auditor was required to ascertain that the conditions of the exemption were being complied with as of the examination date and that no facts came to the auditor's attention to indicate that the exemption had not been complied with during the period since the last examination.

Under the SEC's amendments, audits of brokers and dealers are now required to be conducted in accordance with PCAOB standards, the material inadequacy report has been

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[129] See the SEC Release at 70.

[130] Prior to the SEC's amendments, paragraph (g)(3) of Rule 17a-5 described a "material inadequacy" in a broker's or dealer's accounting system, internal accounting controls, procedures for safeguarding securities, and practices and procedures to include "any condition which has contributed substantially to or, if appropriate corrective action is not taken, could reasonably be expected to: (i) inhibit a broker-dealer from promptly completing securities transactions or promptly discharging its responsibilities to customers, other broker-dealers or creditors; (ii) result in material financial loss; (iii) result in material misstatements of the broker-dealer's financial statements; or (iv) result in violations of the Commission's recordkeeping or financial responsibility rules to an extent that could reasonably be expected to result in the conditions described in [(i) through (iii)] above." See the SEC Release at 70, footnote 287.

replaced with an examination of the compliance report, and the requirement to ascertain compliance with the exemption conditions has been replaced with a review of the exemption report.

Consideration of Alternatives and Additional Considerations

In general, the Board sought to evaluate whether its attestation standards were appropriate for performing and reporting on the newly required examinations and reviews. The SEC is a key user of the new reports, which serve to facilitate the SEC's compliance oversight function. Accordingly, the Board's standards for those engagements needed to reflect a compliance focus and needed to be aligned with the requirements in SEC Rule 17a-5.

The Board considered two principal alternatives: (1) issuing guidance on applying existing PCAOB attestation standards to the new examination and review engagements, or (2) developing standards tailored to the requirements of SEC Rule 17a-5. In considering the first alternative, the Board observed that auditors performing examinations of compliance reports would need to look to a patchwork of requirements in existing attestation standards, including AT sec. 101 and AT sec. 601, and apply them to the new examination of the compliance report and review of the exemption report. This could lead to more inconsistencies in compliance with the SEC's rule as compared to a tailored standard that sets forth the necessary procedures for complying with the SEC's rule.

The Board preliminarily determined that a broker and dealer specific approach to examining compliance reports and reviewing exemption reports that is tailored to the SEC's rule would promote consistent audit practices and compliance with the SEC's rule because auditors could more readily determine the procedures necessary to meet the requirements for reasonable assurance in the examination and moderate assurance in the review. The greater clarity also can

help facilitate more efficient use of audit resources, which can help mitigate the associated costs. Since the Board's initial proposal, the high level of auditing deficiencies observed by PCAOB inspections of audits of brokers and dealers under pre-existing standards have underscored the Board's initial concerns about the need for standards that facilitate more consistent compliance with the SEC's rule.[131]

In developing the new standards, the Board took into account economic considerations, including taking note of commenters' views on the proposed attestation standards. The Board's approach is intended to focus and streamline the auditor's work in order to promote overall audit effectiveness and avoid duplicative procedures. The Board sought to ease the transition to the new standards and help lessen the effect of associated costs by:

- Building on principles and concepts in existing attestation standards, such as the general requirements in AT sec. 101, and the risk-based principles for testing controls as set forth in Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements, and Auditing Standard No. 13, The Auditor's Responses to the Risks of Material Misstatement;

[131] See PCAOB Release 2013-006, which reports that PCAOB inspection staff identified auditing deficiencies in 57 of the 60 audits of brokers and dealers selected for inspection and that deficiencies in compliance with audit requirements for brokers and dealers under the Exchange Act that were among the most frequently noted by PCAOB inspection staff included deficiencies in audit procedures related to net capital and customer reserve supporting schedules, compliance with the conditions of the exemption claimed by the broker or dealer, and the accountant's supplemental report on material inadequacies. See PCAOB Release 2013-006, Executive Summary, at ii.

- Focusing the auditor's attention on the most important matters related to the objective of the examination or review, as applicable, including addressing the risk of misappropriation of customer assets;
- Requiring coordination of the attestation standards with the audit of the financial statements and audit procedures on the supplemental information, to enhance the effectiveness of the coordinated work and avoid unnecessary duplication of work;[132] and
- Establishing risk-based approaches for the examination and review that are scalable – that is, the required audit effort is commensurate with the broker's or dealer's size and complexity[133] – and that facilitate consistent compliance with SEC Rule 17a-5.

The Board also considered commenters' views. Commenters on the Board's proposed attestation standards generally agreed that the proposed standards were appropriately tailored for the SEC's proposed amendments to Rule 17a-5. Notably, when the attestation standards were proposed, the PCAOB requested comment on whether the standards were appropriately scalable based on the size and complexity of the broker or dealer. Some commenters specifically agreed

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[132] By its terms, SEC Rule 17a-5 requires the financial statement audit and the compliance examination or review to be performed by the same auditor. See paragraph (g) of SEC Rule 17a-5.

[133] This view is also analogous to the SEC's view for preparation of the compliance report discussed in the SEC Release. In the SEC Release, the SEC observed that the controls necessary for a carrying broker or dealer that engages in limited custodial activities generally should be less complex than the controls necessary for a carrying broker or dealer that engages in more extensive custodial activities, so a carrying broker or dealer with limited custodial activities should have to expend less effort to make the statements in the compliance report regarding Internal Control Over Compliance. See the SEC Release at 229. Similarly, the necessary audit effort related to test controls should be less for brokers and dealers with limited custodial activities.

that the standards are scalable, and no commenters asserted that the standards are not scalable. Additionally, several comments on the proposed standards were no longer relevant because of changes the SEC made when it adopted the amendments.

Some commenters on the proposed standards expressed concerns about costs associated with extending the requirements for engagement quality reviews to encompass the attestation engagements covered by these standards. In light of the importance of the attestation engagements to investor protection and the high level of deficiencies observed by PCAOB inspection staff in areas that would be covered by the attestation engagements, the Board believes that engagement quality reviews can enhance the consistency of compliance with the SEC's rule. An effective engagement quality review can increase the likelihood of identifying significant engagement deficiencies before the examination report or review report is issued. Additionally, the Board took note of the fact that, in a February 2011 AICPA Peer Review Alert, the AICPA designated audits of carrying brokers or dealers as a "must select" for peer review, recognizing the significant public interest in audits of such firms.[134]

Regarding the incremental costs of engagement quality reviews, because engagement quality reviews are required for audits of financial statements under PCAOB standards, the requirements for auditors to coordinate their audits of the financial statements and attestation engagements should facilitate the engagement quality review of the attestation engagement and help mitigate incremental costs. Furthermore, the Board anticipates that incremental costs for an engagement quality review of an attest engagement will vary with the nature of the attest engagement. For example, the required effort for an engagement quality review of a review engagement generally would be less than for an examination engagement, and the required effort

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[134] See AICPA Peer Review Alert 11-01 (February 2011).

for an examination of a smaller, less complex broker or dealer generally would be less than for a larger, more complex broker or dealer.

Applicability to Audits of Emerging Growth Companies

The Board is adopting the attestation standards pursuant to its authority under the Sarbanes-Oxley Act.[135]

Before rules adopted by the Board can take effect, they must be approved by the SEC. Pursuant to Section 107(b)(3) of Sarbanes-Oxley Act, the SEC shall approve a proposed rule if it finds that the rule is "consistent with the requirements of [the] Act and the securities laws, or is necessary or appropriate in the public interest or for the protection of investors."

Additionally, Section 104 of the Jumpstart Our Business Startups Act ("JOBS Act")[136] amended Sarbanes-Oxley Act to provide that any additional rules adopted by the PCAOB after April 5, 2012 do not apply to audits of emerging growth companies ("EGCs")[137] unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation".[138]

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[135] Pub. L. 107-204, 116 Stat. 745 (2002). Under Section 101 of the Sarbanes-Oxley Act, the mission of the PCAOB is to oversee the audit of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. Section 103 of the Sarbanes-Oxley Act authorizes the Board to adopt auditing standards for use by registered public accounting firms in the preparation and issuance of audit reports "as required by [the] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors."

[136] Pub. L. No. 112-106, 126 Stat. 306 (2012).

[137] Section 3(a)(80) of the Exchange Act defines the term "emerging growth company."

As previously discussed, the attestation standards will apply solely in connection with audits of registered brokers and dealers pursuant to SEC Rule 17a-5. PCAOB staff has discussed the applicability of the JOBS Act to this rulemaking with the SEC staff. The PCAOB is not aware of any EGCs that are also registered brokers or dealers.[139] Moreover, the reporting regimes for registered brokers and dealers under SEC Rule 17a-5 are separate and distinct from those for companies subject to reporting requirements pursuant to Section 13 and 15 of the Exchange Act or for a Securities Act registration statement. The Board defers to the SEC on the applicability of the JOBS Act to this rulemaking and stands ready to assist the SEC with any additional analysis that may become necessary.

Effective Date

The attestation standards will be effective, subject to approval by the SEC, for examination engagements and review engagements for fiscal years ending on or after June 1, 2014. This effective date coincides with the effective date for the corresponding amendments to SEC Rule 17a-5.[140]

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

The proposed rules discussed in this release are related to the proposed rules discussed in SEC Release No. 34-70843 (the "proposed rules relating to Auditing Standard No. 17"). Because the PCAOB has requested that the Commission determine that the proposed rules

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[138] See Section 103(a)(3)(C) of the Sarbanes-Oxley Act (15 U.S.C. §7213(a)(3)), as amended by Section 104 of the JOBS Act, Pub. L. No. 112-106 (2012).

[139] PCAOB staff has reviewed the reported industry classifications in the most recent filings of those companies and read SEC filings of self-identified EGCs as necessary to ascertain whether any EGCs were brokers or dealers. For those companies for which audited financial statements were available and based on information included in the most recent audited financial statements filed as of May 15, 2013, PCAOB staff has observed that none of the EGCs is a broker or dealer.

[140] See the SEC Release at 2.

relating to Auditing Standard No. 17 apply to audits of emerging growth companies, the Commission has determined to extend to [insert date 90 days from the date of publication in the Federal Register] the date by which the Commission should take action on those proposed rules. Pursuant to Section 19(b)(2)(A)(ii) of the Exchange Act, and based on its determination that an extension of the period set forth in Section 19(b)(2)(A)(i) of the Exchange Act is appropriate, the Commission has also determined to extend to [insert date 90 days from the date of publication in the Federal Register] the date by which the Commission should take action on the proposed rules discussed in this release.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Sarbanes-Oxley Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB-2013-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number PCAOB-2013-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all

comments on the Commission's Internet website (http://www.sec.gov/rules/pcaob.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without charge; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. PCAOB-2013-01 and should be submitted on or before [insert 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill
Deputy Secretary

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