ANNUAL REPORT ON THE INTERIM INSPECTION PROGRAM RELATED TO AUDITS OF BROKERS AND DEALERS

(PCAOB Release No. 2018-003 – August 20, 2018)

PCAOB
Public Company Accounting Oversight Board

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Background

The Public Company Accounting Oversight Board (the "PCAOB" or the "Board") is issuing this annual report on the interim inspection program[1] related to audits of brokers and dealers[2] registered with the Securities and Exchange Commission (the "SEC" or "Commission") under Section 15 of the Securities Exchange Act of 1934 ("Exchange Act"). Under the interim inspection program, the Board conducts inspections of registered public accounting firms[3] in connection with their performance of audit and attestation engagements, their issuance of reports on these engagements, and related matters involving broker-dealers, to assess audit firm compliance with the professional standards, rules of the Commission and the Board, and the Sarbanes-Oxley Act of 2002.

The Board cautions against extrapolating from the results presented in this report to broader conclusions. The firms inspected and the audit and attestation engagements for broker-dealers covered by the inspections are not necessarily representative of the population of firms or of audit or attestation engagements of broker-dealers. Further, the populations of firms and broker-dealers are not homogeneous. Therefore, the independence findings and audit, attestation, and other deficiencies discussed in this report are not necessarily representative of the full population of firms or of all audit and attestation engagements of broker-dealers.

Inspections of Firms During 2017

During 2017, the PCAOB inspected 75 firms that audited broker-dealers. These inspections covered portions of 116 audits and the related attestation engagements of broker-dealers that had financial statement periods ended on June 30, 2016, through June 30, 2017.

The firms inspected during 2017, and the audit and attestation engagements covered during the inspections, were generally selected based on characteristics of the firms and the broker-dealers taking into consideration the risks related to those characteristics.[4] In addition, a portion of the firms and engagements were selected randomly.

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Audit and attestation deficiencies that exceeded a certain level of significance were communicated to the firms in writing. The deficiencies identified during 2017 that Inspections staff determined were important to convey based on their nature, severity, or frequency, are described in this report. Independence findings that were communicated to the firms in writing are described in this report.

Independence Findings[5]

Inspections staff identified independence findings in 4 of 48, or eight percent, of the audits covered by the inspections in 2017, compared to 11 of 115, or 10 percent of the audits covered by the inspections in 2016. For 2017, the selection of independence as a focus area was risk-based, taking into consideration the characteristics of the audit firm, as compared to 2016 when independence was a focus area for all inspections. Three of the four audits with independence findings in 2017, and all 11 audits with independence findings in 2016, were performed by firms that did not audit issuers.[6]

In the 2017 inspections, the independence impairments in three of these four audits were based on the audit firms having performed bookkeeping or other services related to the broker-dealer's accounting records, or having prepared, or assisted in the preparation of, the broker-dealer's financial statements, supplemental information, or exemption report. In the other audit, Inspections staff observed that the firm's independence was impaired because of an indemnification clause in the firm's engagement letter that stated that the broker-dealer would indemnify the firm from any and all claims of the broker-dealer and third parties when there was knowing misrepresentation or concealment of information by the broker-dealer's management, regardless as to the nature of the claim, including the negligence of any party.[7]

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Audit, Attestation, and Other Deficiencies[8]

The following tables present a summary of the audit, attestation, and other deficiencies in the order they are discussed in detail in this section of the report, as well as information regarding the inspections performed during 2016:[9]

Audit and Other Deficiencies	Table	2017			2016
		Number of Audits with Deficiencies	Number of Applicable Audits[10]	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies[11]
Audit Deficiencies Related to the Financial Statements					
Revenue	1	73	112	65%	66%
Assessing and Responding to Risks of Material Misstatement Due to Fraud	2	16	25	64%	57%
Financial Statement Presentation and Disclosures	3	38	116	33%	39%
Related Party Relationships and Transactions	4	21	66	32%	33%
Fair Value Measurements	5	7	25	28%	24%
Receivables and Payables	6	11	35	31%	25%
Audit Deficiencies Related to the Supporting Schedules					
Net Capital Rule[12]	7	28	78	36%	27%
Customer Protection Rule[13]	8	14	29	48%	52%
Other Deficiencies Related to the Audit					
Auditor's Reporting on the Financial Statements and Supporting Schedules	9	12	116	10%	13%
Audit Documentation	10	15	116	13%	28%
Engagement Quality Review	11	55	93	59%	57%
Evaluation of Control Deficiencies	-	8	116	7%	N/A
Deficiencies in Independence Communications to the Audit Committee (or equivalent)[14]					
Independence Communications to the Audit Committee (or equivalent)	-	14	48	29%	19%

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Attestation and Other Deficiencies	Table	2017			2016
		Number of Attestation Engagements with Deficiencies	Number of Applicable Attestation Engagements	Percentage of Attestation Engagements with Deficiencies	Percentage of Attestation Engagements with Deficiencies
Attestation Deficiencies					
Examination Procedures	12	19	27	70%	70%
Review Procedures	13	28	87	32%	28%
Other Deficiencies Related to Examination Engagements					
Examination Report	-	2	27	7%	10%
Examination Documentation	-	2	27	7%	5%
Engagement Quality Review	-	4	20	20%	20%
Other Deficiencies Related to Review Engagements					
Review Report	-	11	87	13%	14%
Review Documentation	-	5	87	6%	21%
Engagement Quality Review	-	14	54	26%	26%

Audit Deficiencies Related to the Financial Statements

Audit deficiencies are failures by firms to perform, or sufficiently perform, certain required audit procedures and do not necessarily indicate that the broker-dealer's financial statements or supporting schedules are materially misstated. Conclusions regarding these situations are often not possible for Inspections staff to reach based only on the information available from the auditors.

Auditing Revenue

Inspections staff identified audit deficiencies related to auditing revenue in 73 of 112, or 65 percent, of the applicable audits covered by the inspections, compared to 66 percent of audits with deficiencies identified in 2016. In 50 of the 73 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 1 below:

Table 1

Deficiencies Related to Auditing Revenue	Number of Audits with Deficiencies of the 112 Applicable Audits
Risk assessment procedures	26
Extent of testing	38
Substantive analytical procedures	10
Auditing information produced by service organizations	10
Auditing information produced by the broker-dealer	15
Other procedures to test revenue	60

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Risk Assessment Procedures

In 26 audits, Inspections staff observed that the firms did not perform, or sufficiently perform, risk assessment procedures for revenue required by AS 2110, *Identifying and Assessing Risks of Material Misstatement*, which contributed to deficiencies in these firms' revenue testing procedures, such as those discussed below. For example, in certain of these audits, Inspections staff observed that the firms did not: (a) obtain a sufficient understanding of the broker-dealer and its environment, including its key products and sources of revenue;[15] (b) obtain a sufficient understanding of aspects of the broker-dealer's internal control over financial reporting, including controls at the broker-dealer's service organization(s), such as (i) understanding how transactions are processed and the controls related to the transactions being initiated, authorized, processed, recorded, and reported; (ii) understanding management's risk assessment process; or (iii) evaluating the design of the controls intended to address significant risks, including the presumed fraud risk involving improper revenue recognition, and determining whether the controls have been implemented;[16] or (c) identify and assess the risks of material misstatement at the financial statement level and the assertion level over material classes of revenue transactions.[17]

Extent of Testing

In 38 audits, Inspections staff observed that the extent of the firms' testing was insufficient pursuant to AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, for material classes of revenue transactions. For example, Inspections staff observed instances where firms: (a) did not perform any procedures to test material classes of revenue transactions; (b) did not test, or sufficiently test, controls to support the firms' reliance on controls to reduce their substantive testing;[18] (c) did not appropriately design and perform sampling procedures to test revenue transactions in accordance with AS 2315, *Audit Sampling,* because: (i) the firms did not adequately consider the relationship of the sample to the relevant audit objective, tolerable misstatement, allowable risk of incorrect acceptance, or the characteristics of the population, resulting in an insufficient sample size; or (ii) the sample items were not selected in a manner that provided a sample that was representative of the population tested (for example, firms limited their sample selections to certain time periods); or (d) limited testing to key items, or all items above a certain amount, such as a firm established threshold, which covered only a portion of revenue, and the firm performed no procedures to test the remaining portion of revenue that was material.[19]

Substantive Analytical Procedures

In 10 audits, Inspections staff observed that firms performed substantive analytical procedures that did not provide the necessary level of assurance required by AS 2305, *Substantive Analytical Procedures*, because the firms did not: (a) develop any expectation when performing analytical procedures intended to be substantive in nature; (b) develop expectations that were sufficiently precise to identify misstatements (for example, developing only an assumption that certain fees would decline from the prior

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year); (c) establish that there was a plausible and predictable relationship between the current year and prior year revenue balances (for example, testing fees by comparing total fees for the current and prior year and not considering the existence of changes that may affect the plausibility and predictability of this relationship); (d) evaluate the reliability of the data from which the firms' expectations were developed (for example, failure to test the completeness and accuracy of data produced by the broker-dealer that was used in developing the firm's expectation); (e) determine an amount of difference from the expectation that could be accepted without further investigation; (f) corroborate management's explanations for significant unexpected differences; or (g) sufficiently test controls, when the necessary level of assurance from the analytical procedures was determined based on reliance on controls.

Auditing Information Produced by Service Organizations

In 10 audits, Inspections staff observed that, in auditing revenue, firms did not obtain sufficient appropriate audit evidence about the accuracy and completeness of information used in audit procedures that was produced by a broker-dealer's service organization required by AS 2601, *Consideration of an Entity's Use of a Service Organization*.

In four of the 10 audits, firms obtained a service auditor's report and relied on controls at the service organization but did not sufficiently evaluate the service auditor's report or consider whether the service auditor's report provided sufficient appropriate audit evidence about the design and operating effectiveness of the controls being relied upon. For example, the firms did not: (a) test, or sufficiently test the operating effectiveness of necessary user organization controls at the broker-dealer specified in the service auditor's report;[20] (b) evaluate whether the scope of the service auditor's report included testing the design and operating effectiveness of controls over the information used by the firm as audit evidence (for example, perform sufficient procedures to determine if the service auditor's report included operating effectiveness testing and results for controls over trading gains and losses or commissions revenue calculated by the service organization, or controls over accuracy and completeness of information produced by the service organization);[21] or (c) evaluate whether the services provided by sub-service organizations were relevant to the audit and, if so, obtain audit evidence about the effectiveness of necessary controls at sub-service organizations specified in the service auditor's report.[22]

In six of the 10 audits**,** firms did not obtain audit evidence about controls that addressed the accuracy and completeness of information produced by service organizations, or perform other procedures to test the accuracy and completeness of this information, when that information was used in substantive procedures (for example, inputs used to calculate revenue such as the number of trades or rates).[23]

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Auditing Information Produced by the Broker-Dealer

In 15 audits, Inspections staff observed that in auditing revenue firms did not test the accuracy and completeness of the information produced by the broker-dealer that was used as audit evidence.[24] Examples of such information included system generated reports, trade blotters, order tickets, invoices, and spreadsheets prepared by broker-dealer personnel.

Other Procedures to Test Revenue

In 60 audits, Inspections staff observed that firms did not perform sufficient procedures to test the relevant assertions, as required by AS 2301. For example, firms did not: (a) evaluate whether the terms of the underlying contractual arrangements were appropriately considered in revenue recognition; (b) evaluate whether the revenue recognition criteria under ASC Topic 605, *Revenue Recognition*, were satisfied (for example, verifying that the broker-dealer completed all services required pursuant to an agreement with a customer and that the services were completed within the reporting period in which the revenue was recognized or verifying the transaction amount upon which fee revenue was based); (c) test the accuracy and completeness of inputs used in the calculation of revenue such as (i) rates, quantities, and prices of securities purchased and sold used to calculate commission revenue, (ii) assets under management, average net asset value, and purchase and sale values of customer investment transactions used to calculate fees; or (iii) quantities and prices of securities purchased and sold used to calculate trading gains and losses; (d) perform procedures to test the completeness of revenue; or (e) evaluate the effect on the financial statements of recognizing commission revenue based on settlement date rather than trade date, as required under ASC Topic 940, *Financial Services – Broker and Dealers.*

<u>Assessing and Responding to Risks of Material Misstatement Due to Fraud</u>

Inspections staff identified audit deficiencies related to assessing and responding to risks of material misstatement due to fraud in 16 of 25, or 64 percent, of the applicable audits covered by the inspections, compared to 57 percent of audits with deficiencies identified in 2016. In three of the 16 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 2 below:

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Table 2

Deficiencies Related to Assessing and Responding to Risks of Material Misstatement Due to Fraud	Number of Audits with Deficiencies of the 25 Applicable Audits
Identification and assessment of the risks of material misstatement due to fraud	6
Responses to the assessed risks of material misstatement due to fraud – management override	6
Responses to fraud risk related to improper revenue recognition	7

Identification and Assessment of the Risks of Material Misstatement Due to Fraud

In six audits, Inspections staff observed that firms did not, or did not sufficiently, identify and assess the risks of material misstatement due to fraud in accordance with AS 2110. For example, in four of the six audits, Inspections staff observed that the firms did not identify improper revenue recognition as a fraud risk, and the audit documentation did not demonstrate, and there was no other persuasive evidence, that the firms overcame the presumption that improper revenue recognition is a fraud risk.[25] In another audit, Inspections staff observed that the firm performed inquiries with the Chief Executive Officer only and did not perform inquiries with others within the broker-dealer who were reasonably expected to be knowledgeable about potential fraud risks.[26]

Responses to the Assessed Risks of Material Misstatement Due to Fraud – Management Override

In six audits, Inspections staff observed that firms did not perform sufficient procedures to address the risk of management override of controls, as required by AS 2401. For example, Inspections staff observed that firms did not perform, or did not sufficiently perform, one or more of the procedures such as: (a) determining whether the controls over journal entries and other adjustments were suitably designed and placed in operation;[27] (b) testing journal entries to address management override of controls; (c) considering the characteristics of fraudulent entries or adjustments in selecting journal entries to test;[28] or (d) testing, or sufficiently testing, all journal entries that had identified fraud characteristics.[29]

Responses to Fraud Risk Related to Improper Revenue Recognition

In seven audits, Inspections staff observed that firms did not perform sufficient audit procedures to specifically address assessed fraud risks related to improper revenue recognition because the firms' responses to an identified fraud risk did not include tests of details required by AS 2301.[30]

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Auditing Financial Statement Presentation and Disclosures

Inspections staff identified audit deficiencies related to auditing financial statement presentation and disclosures in 38 of 116, or 33 percent, of the applicable audits covered by the inspections, compared to 39 percent of audits with deficiencies identified in 2016. In 13 of the 38 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 3 below:

Table 3

Deficiencies Related to Auditing Financial Statement Presentation and Disclosures	Number of Audits with Deficiencies of the 116 Applicable Audits
Identifying and evaluating omitted, incomplete, or inaccurate disclosures	26
Evaluating fair value disclosures	4
Evaluating going concern disclosures	6
Evaluating financial statement presentation	16

Identifying and Evaluating Omitted, Incomplete, or Inaccurate Disclosures

In 26 audits, Inspections staff observed instances in which firms did not perform sufficient procedures required by AS 2810, *Evaluating Audit Results*, to identify and evaluate disclosures in the financial statements that were omitted, or appeared incomplete or inaccurate, in order to determine whether the broker-dealer's financial statements contained the information essential for fair presentation.

In 16 of the 26 audits, firms did not identify and evaluate instances pertaining to related party relationships and transactions that were necessary to understand related party relationships and the effects of related party transactions on the financial statements. For example, in one audit, Inspections staff observed that the firm did not identify and evaluate apparent misstatements in the related party disclosures in the broker-dealer's financial statements, specifically, the omission of necessary information about fees paid to a related party and the misidentification in the disclosures of the related party recipient of certain fees paid by the broker-dealer.

In nine of the 26 audits, firms did not identify and evaluate the apparent omission from the broker-dealer's financial statements of the broker-dealer's revenue recognition policy for material classes of revenue transactions in consideration of the requirements of ASC Topic 235, *Notes to Financial Statements* (for example, the omission of a policy for investment advisory fees or commissions).

In two of the 26 audits, Inspections staff observed that firms did not identify and evaluate disclosures that contained potential factual errors. In both situations, the broker-dealers' financial statement disclosures asserted regulatory exemptions for which the firms had obtained contrary information, but the firms did not perform

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procedures to address whether the disclosures were inaccurate, and if so, the effect on the financial statements. In one audit, the broker-dealer disclosed that it was exempt from registration with the SEC related to the clearance and settlement of transactions in foreign securities between its customers and its foreign parent, when in fact the broker-dealer was registered with the SEC. In the other audit, the broker-dealer disclosed that it was exempt from Rule 15c3-3, but did not disclose that it had responsibilities for safeguarding funds and securities in connection with transactions on behalf of U.S. institutional investors for which the broker-dealer's non-registered foreign affiliates transacted pursuant to Rule 15a-6.[31]

Evaluating Fair Value Disclosures

In four audits, Inspections staff observed that firms did not evaluate, or sufficiently evaluate, whether the broker-dealer's fair value disclosures were in accordance with ASC Topic 820, *Fair Value Measurement*. In all four audits, the firms did not evaluate, or sufficiently evaluate, whether the classification of securities disclosed as Level 1 or Level 2 was appropriate based on the inputs used by the broker-dealer to measure fair value. In addition, in two of these audits, firms did not sufficiently evaluate the disclosures of the nature and characteristics of the securities. In one audit, the broker-dealer's financial statements described a material portion of asset-backed securities as corporate obligations and, in the other audit, the broker-dealer's financial statements described a material portion of municipal and corporate bonds as U.S. government and agency securities. The firms did not identify these apparent misstatements and evaluate their effects on the financial statements.

Evaluating Going Concern Disclosures

In six audits, Inspections staff observed that firms did not perform sufficient procedures related to the adequacy of a broker-dealer's disclosures concerning its ability to continue as a going concern for a reasonable period of time required by AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*. For example, in five of these audits, Inspections staff observed that in situations in which the broker-dealer and the firm concluded that substantial doubt was alleviated by management's plans, the firm failed to identify and evaluate the effect on the financial statements of the omission of the following disclosures required by generally accepted accounting principles ("GAAP"): (a) the principal conditions or events that raised substantial doubt about the broker-dealer's ability to continue as a going concern (before consideration of management's plans); (b) management's evaluation of the significance of those conditions or events in relation to the broker-dealer's ability to meet its obligations; or (c) management's plans that alleviated substantial doubt about the broker-dealer's ability to continue as a going concern.[32] In addition, in each of these audits, the firms did not sufficiently evaluate management plans to alleviate substantial doubt (for example, in two audits, the firm did not perform procedures to evaluate whether management's plans to obtain additional financing could be effectively implemented).

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Evaluating Financial Statement Presentation

In 16 audits, Inspections staff observed that firms did not perform sufficient procedures required by AS 2810 regarding whether the broker-dealer's financial statements were presented fairly, in all material respects, in conformity with GAAP.[33] For example, Inspections staff observed that firms did not: (a) identify that the broker-dealer had incorrectly presented items on its cash flow statements, such as reporting the purchases and sales of investments as cash flows from investing activities rather than as cash flows from operating activities;[34] (b) identify that the broker-dealer incorrectly presented investment banking revenue, which comprised the majority of total revenue, as brokerage commissions; (c) identify that the broker-dealer incorrectly presented an asset for notes received for a contribution to equity without substantial evidence of the ability and intent of the contributing entity to pay within a reasonably short period of time;[35] (d) sufficiently evaluate whether net presentation was appropriate (for example, a firm did not evaluate the appropriateness of netting clearance and execution fees against revenue);[36] (e) evaluate whether a return of capital distributions was presented appropriately as dividend income on the statement of income rather than as a credit to investment cost;[37] or (f) evaluate whether the broker-dealer's presentation of rent and utility expenses as commission expenses in the statement of operations was appropriate.[38]

In four of the 16 audits, Inspections staff observed that the firms did not perform sufficient procedures to address instances where the broker-dealer's financial statements were inconsistent with the requirements of Part II or IIA to SEC Form X-17A-5 (the Financial and Operational Single Report, commonly referred to as the "FOCUS" report) because the broker-dealer presented multiple significant categories of revenue as a single line item on the statement of income.[39]

Auditing Related Party Relationships and Transactions

Related parties often play a significant role in the operations of broker-dealers, including, for example, through direct participation in the activities of the broker-dealers by principals or affiliates under shared service agreements. AS 2410, *Related Parties*, requires auditors to obtain sufficient appropriate audit evidence to determine whether a broker-dealer's related parties and relationships and transactions with related parties have been properly identified, accounted for, and disclosed in its financial statements.

Inspections staff identified audit deficiencies related to auditing related party relationships and transactions in 21 of 66, or 32 percent, of the applicable audits covered by the inspections, compared to 33 percent of audits with deficiencies identified in 2016. In five of the 21 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 4 below:

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Table 4

Deficiencies Related to Auditing Related Party Relationships and Transactions	Number of Audits with Deficiencies of the 66 Applicable Audits
Risk assessment procedures	3
Responding to risks of material misstatement	19
Evaluating the broker-dealer's identification of related parties and relationships and transactions with related parties	4

Risk Assessment Procedures

In three audits, Inspections staff observed that firms failed to perform sufficient risk assessment procedures over related party relationships and transactions. For example, in one audit, the firm did not perform procedures to identify and assess the risks of material misstatement at the financial statement and assertion level. In another audit, the firm did not perform sufficient risk assessment procedures because the firm did not obtain an understanding of the broker-dealer's process for: (a) identifying related parties and relationships and transactions with related parties; (b) authorizing and approving transactions with related parties; and (c) accounting for and disclosing relationships and transactions with related parties in the financial statements.[40] In addition, this firm failed to perform required inquiries of management and others regarding related party relationships and transactions.[41]

Responding to Risks of Material Misstatement

In 19 audits, Inspections staff observed that firms did not design and perform procedures in a manner that addressed the risks of material misstatement.[42] For example, in one audit, the firm assessed the overall risk of material misstatement for the valuation or allocation and presentation and disclosure assertions for material related party transactions and receivables at the maximum, but limited its procedures to reviewing a list of the receivables as of year end and inquiring of management about the nature and collectability of the amounts. In other audits, Inspections staff observed that firms did not sufficiently test the controls, including information technology ("IT") controls, relied upon in its audit procedures;[43] or test the accuracy and completeness of information produced by the broker-dealer (for example, reports and spreadsheets that were used as audit evidence to test related party expenses that were based on allocations between the broker-dealer and its parent or affiliates).[44]

In 11 of the 19 audits, Inspections staff observed deficiencies in the procedures performed over related party revenues and expenses that were based on allocations between the broker-dealer and its parent or affiliates. For example, Inspections staff observed that in certain audits, firms did not test material allocated amounts, the basis for the allocations, or the computations of the allocated amounts. In other audits, firms did not sufficiently test the basis for the allocations or the computations of the allocated

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amounts because their procedures were limited to reading the allocation agreement, performing inquiries of management, and tracing the amounts disclosed in the financial statements to general ledger accounts, without testing whether the allocated amounts were in accordance with the terms of the allocation agreement. In two of these audits, firms did not appropriately design and perform substantive analytical procedures to test allocated amounts in accordance with AS 2305. In one of these audits, the firm did not appropriately design and perform sampling procedures to test transactions with related parties consistent with AS 2315 because the firm's sample size was insufficient and the samples selected were not representative of the total population of allocated expenses. In addition, this firm did not perform sufficient procedures to test allocated expenses charged to the broker-dealer by its parent that were disclosed by the broker-dealer as being arm's length and at market because the firm limited its procedures to agreeing the markup amount to information provided by the parent's transfer pricing group without further testing.[45]

Evaluating the Broker-Dealer's Identification of Related Parties and Relationships and Transactions with Related Parties

In four audits, Inspections staff observed that firms failed to evaluate whether the broker-dealer properly identified related parties and relationships and transactions with related parties.[46] If the auditor identifies information that indicates that related parties or relationships or transactions with related parties previously undisclosed to the auditor might exist, the auditor should perform the procedures necessary to determine whether previously undisclosed relationships or transactions with related parties exist and these procedures should extend beyond inquiry of management.[47] For example, in one audit, Inspections staff observed that the firm did not evaluate information that appeared to indicate that the broker-dealer did not properly identify its related party relationships and transactions. Specifically, the firm performed procedures to test allocated expenses related to salary and business expenses of a member of the broker-dealer's management that were paid by the parent but not identified and disclosed by the broker-dealer as related party transactions. However, the firm failed to identify that these allocated expenses were transactions with related parties and evaluate whether it would be required to be disclosed in the financial statements.

Auditing Fair Value Measurements

Inspections staff identified audit deficiencies related to auditing fair value measurements in 7 of 25, or 28 percent, of the applicable audits covered by the inspections, compared to 24 percent of audits with deficiencies identified in 2016. In two of the seven audits with deficiencies in 2017, Inspections staff identified deficiencies in both of the categories set forth in Table 5 below:

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Table 5

Deficiencies Related to Auditing Fair Value Measurements	Number of Audits with Deficiencies of the 25 Applicable Audits
Understanding the broker-dealer's process for determining fair value measurements	2
Testing fair value measurements	7

Understanding the Broker-Dealer's Process for Determining Fair Value Measurements

In two audits, Inspections staff observed that firms did not obtain, or sufficiently obtain, an understanding of the broker-dealer's process for determining fair value of securities based on inputs other than those from quoted prices in active markets to develop an audit approach in accordance with AS 2502, *Auditing Fair Value Measurements and Disclosures*.[48] Specifically, the firms did not obtain an understanding of the methods and assumptions used by the broker-dealer's external pricing sources to determine the fair value of securities.

Testing Fair Value Measurements

In seven audits, Inspections staff observed that firms did not perform, or sufficiently perform, procedures to test the fair value of securities. For example, in four of the seven audits, the firms limited their procedures to tracing the total value of securities to the general ledger, a clearing broker statement, or a confirmation response from a custodian, but did not perform substantive testing of the fair value of securities (for example, testing management's significant assumptions, the valuation model, and the underlying data, developing independent fair value estimates for corroborative purposes, or reviewing subsequent events and transactions).[49] In one audit, the firm did not sufficiently evaluate the reasonableness of significant assumptions used by the broker-dealer to value its securities that were based on unobservable inputs. In another audit, the firm used a specialist to develop independent fair value estimates to corroborate the fair value of the broker-dealer's securities, but did not determine whether the prices obtained were independent of the external pricing source used by the broker-dealer to value its securities.

<u>Auditing Receivables and Payables</u>

Inspections staff identified audit deficiencies related to auditing receivables and payables in 11 of 35, or 31 percent, of the applicable audits covered by the inspections, compared to 25 percent of audits with deficiencies identified in 2016. In seven of the 11 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 6 below:

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Table 6

Deficiencies Related to Auditing Receivables and Payables	Number of Audits with Deficiencies of the 35 Applicable Audits
Risk assessment procedures	5
Extent or timing of testing	7
Confirmation procedures	3
Auditing information produced by the broker-dealer	2
Other procedures to test receivables and payables	3

Risk Assessment Procedures

In five audits, Inspections staff observed that firms did not perform, or sufficiently perform, risk assessment procedures for receivables and payables required by AS 2110, which contributed to deficiencies in these firms' testing procedures, such as those discussed below. For example, in two audits, the firms did not evaluate the design of the controls intended to address significant risks and determine whether those controls were implemented.[50] In another two audits, the firms did not identify and assess the risks of material misstatement at the assertion level, or at both the financial statement and assertion level, which resulted in the firms not evaluating the types of potential misstatements that could occur related to material payables to customers.[51]

Extent or Timing of Testing

In seven audits, Inspections staff observed that the extent or timing of testing was insufficient for a receivable or payable account balance, including receivables from customers or payables to customers, pursuant to AS 2301. For example, firms: (a) did not perform any procedures to test a material payable to customers balance; (b) limited testing to key items, or all items above a certain amount, such as a firm established threshold, which covered only a portion of the payable account balance, and the firms did not perform, or sufficiently perform, procedures to test the remaining portion of the account balance that was material;[52] (c) did not adequately consider the relationship of the sample to the relevant audit objective, tolerable misstatement, allowable risk of incorrect acceptance, and the characteristics of the population, pursuant to AS 2315, resulting in an insufficient sample size; or (d) did not perform procedures to provide a reasonable basis for extending audit conclusions from an interim date to year end (for example, confirmation procedures were performed as of an interim date and the firm performed no procedures at year end).[53]

Confirmation Procedures

In three audits, Inspections staff observed that firms did not perform sufficient confirmation procedures required by AS 2310, *The Confirmation Process*, for receivables and payables. For example, in one audit, the firm did not perform sufficient

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procedures to design the confirmation request because it did not consider whether the individuals to whom the confirmations were directed were knowledgeable about the information to be confirmed. Further, this firm did not maintain control over the confirmation process because it relied on broker-dealer personnel to insert customer statements into firm envelopes containing the confirmation request and place the envelopes in the mail. In another audit, the firm selected customer receivable and payable balances for confirmation procedures, but did not test the completeness of the populations from which the selections were made because it did not reconcile the populations to the broker-dealer's reported receivable and payable balances.

Auditing Information Produced by the Broker-Dealer

In two audits, Inspections staff observed that firms did not perform sufficient procedures to test payables to customers because the firms did not test the accuracy and completeness of the information produced by the broker-dealer that was used as audit evidence.[54] Examples of such information included system generated reports prepared by broker-dealer personnel.

Other Procedures to Test Receivables and Payables

In three audits, Inspections staff observed other deficiencies related to the testing of receivables and payables. In two audits, the firms did not perform sufficient procedures because they did not test the accuracy and completeness of information underlying the calculation of the receivables or payables balance, such as assets under management and commission rates. In the other audit, the firm limited its procedures to comparing customer trade information between two reports produced by the broker-dealer and did not perform any testing of the information that generated the payable balance.

Audit Deficiencies Related to the Supporting Schedules

The supporting schedules broker-dealers are required to include in their filings with the SEC relate to their compliance with certain SEC rules regarding maintaining minimum net capital and customer protection. AS 2701, *Auditing Supplemental Information Accompanying Audited Financial Statements*, requires auditors to obtain sufficient appropriate audit evidence to express an opinion on whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole.

<u>Net Capital Rule</u>

Inspections staff observed deficiencies in the testing of the information in the supporting schedule related to the Net Capital Rule in 28 of 78, or 36 percent, of the applicable audits covered by the inspections, compared to 27 percent of audits with deficiencies identified in 2016. In 10 of the 28 audits with deficiencies in 2017,

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Inspections staff observed deficiencies in more than one of the categories set forth in Table 7 below:

Table 7

Deficiencies Related to the Net Capital Rule	Number of Audits with Deficiencies of the 78 Applicable Audits
Minimum net capital requirements	5
Adjustments to net worth	5
Allowable assets	14
Haircuts	2
Operational charges and other deductions	11
Other procedures	4

Minimum Net Capital Requirements

In four audits, Inspections staff observed that firms did not test, or sufficiently test, whether the broker-dealer's required minimum net capital reported in the supporting schedule was determined by the broker-dealer in accordance with Rule 15c3-1(a)(2). In another audit, Inspections staff observed that the firm did not evaluate whether securities purchased qualified for exclusion from aggregate indebtedness, and therefore, did not sufficiently evaluate whether the calculated minimum net capital reported in the supporting schedule was in accordance with Rule 15c3-1(a)(1).

Adjustments to Net Worth

In five audits, Inspections staff observed that firms did not test, or sufficiently test, the completeness and accuracy of the adjustments to net worth that the broker-dealer reported in the supporting schedule. For example, in two audits, the firms did not test, or sufficiently test, whether the amounts of subordinated loans that were reported by the broker-dealer as additions to net worth met the requirements of Rule 15c3-1.[55] In another audit, the firm was aware that the broker-dealer had obligations for services rendered to the broker-dealer that were assumed by a broker-dealer's owner, but did not test whether the broker-dealer should have reported an adjustment to net worth for these obligations in accordance with Rule 15c3-1.[56]

Allowable Assets

In 14 audits, Inspections staff observed that firms did not perform sufficient procedures to test the broker-dealer's classification of allowable assets and assets not readily convertible into cash ("non-allowable assets") reported in its supporting schedule. For example, in six audits, firms limited their procedures to tracing reported amounts, such as receivables from clearing broker-dealers and customers, and commissions receivable, to the FOCUS report, trial balance, general ledger, spreadsheets prepared by the broker-dealer, or the financial statements, but did not

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evaluate whether the reported assets were classified appropriately in accordance with Rule 15c3-1. In two audits, the firms did not test the aging of commissions receivables to determine whether the amounts reported as allowable assets met the requirements of Rule 15c3-1.[57] In addition, in two other audits, the firms did not perform sufficient procedures to evaluate whether the broker-dealer offsetting commissions receivables, classified as allowable assets on its supporting schedule, against commissions payables was in accordance with Rule 15c3-1.[58]

Haircuts

In two audits, Inspections staff observed that firms did not perform, or sufficiently perform, procedures to evaluate whether the appropriate haircuts[59] were applied by the broker-dealer to reported securities positions, including evaluating the relevant characteristics of the securities positions (for example, maturity dates) or whether undue concentration charges were necessary in accordance with Rule 15c3-1.[60]

Operational Charges and Other Deductions

In 11 audits, Inspections staff observed that firms did not test, or sufficiently test, the completeness and accuracy of the amounts of operational charges and other deductions reported by the broker-dealer on its supporting schedule,[61] such as failed foreign security transactions[62] related to the broker-dealer's chaperoning activities pursuant to Rule 15a-6, stock loan or stock borrow deficits,[63] and excess deductible amounts related to fidelity bond coverage.[64]

Other Procedures

In four audits, Inspections staff observed other deficiencies related to net capital. For example, in two audits, the firms did not obtain written representations from management.[65] Further, in two of the four audits, the firms did not obtain an understanding of the methods of preparing the supplemental information and evaluate the appropriateness of those methods.[66] In addition, in another audit, the firm did not evaluate the marketability of certain securities to determine whether the securities reported as marketable securities in the net capital computation met the requirements of Rule 15c3-1.[67]

<u>Customer Protection Rule</u>

Inspections staff observed deficiencies in the testing of the information in the supporting schedules[68] related to the Customer Protection Rule in 14 of 29, or 48 percent, of the applicable audits covered by the inspections, compared to 52 percent of audits with deficiencies identified in 2016. In six of the 14 audits with deficiencies in 2017, Inspections staff observed deficiencies in more than one of the categories set forth in Table 8 below:

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Table 8

Deficiencies Related to the Customer Protection Rule	Number of Audits with Deficiencies of the 29 Applicable Audits
Customer and broker-dealer debits or credits	12
Possession or control requirements	7
Other procedures	2

Customer and Broker-Dealer Debits or Credits

In 12 audits, Inspections staff observed that firms did not test, or sufficiently test, the completeness and accuracy of debits or credits included in the customer and PAB account reserve computations reported by the broker-dealer on the supporting schedules.[69] In seven audits, the firms used as audit evidence information produced by the broker-dealer, or the broker-dealer's service organization, without obtaining sufficient appropriate audit evidence about the accuracy and completeness of the reported amounts (for example, firms did not perform, or sufficiently perform, procedures to test the accuracy and completeness of the underlying information produced by the broker-dealer in their testing of the reported amounts in the supporting schedules).[70] In two audits, the firms did not test, or sufficiently test, whether the broker-dealer appropriately allocated debits and credits reported in the customer reserve computation in accordance with Rule 15c3-3.[71]

Possession or Control Requirements

In seven audits, Inspections staff observed that firms did not perform sufficient procedures to test the information related to the broker-dealer's possession or control requirements as reported on the supporting schedule.[72] For example, in four audits, the broker-dealer reported no items or amounts on its possession or control schedule and the firms limited their procedures to inquiry, tracing the supporting schedule to the FOCUS reports, or obtaining an understanding of the methods used by the broker-dealer to prepare the supporting schedule. However, the firms did not evaluate whether fully-paid and excess margin securities were held by the broker-dealers at control locations or whether deficits existed at year end that were required to be reported on the supporting schedule. In two audits, the firms failed to identify misstatements in the schedule because the broker-dealers did not report the number of items and amounts of the securities held in locations that did not comply with the requirements for possession or control pursuant to Rule 15c3-3.[73]

Other Procedures

In two audits, Inspections staff observed deficiencies in other procedures performed on the supporting schedules related to compliance with Rule 15c3-3. In one audit, the firm obtained a bank confirmation for a cash balance held in deposit in a special reserve bank account[74] as of an interim date and did not perform procedures to

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test the amount held on deposit reported on the supporting schedule as of the balance sheet date. In another audit, the firm did not obtain written representations from management.[75]

Other Deficiencies Related to the Audit

Other deficiencies are failures by firms to perform, or sufficiently perform, certain procedures required by PCAOB standards that are part of the performance of the audit.

Auditor's Reporting on the Financial Statements and Supporting Schedules

Inspections staff identified deficiencies related to the auditor's reporting on the financial statements and supporting schedules in 12 of 116, or 10 percent, of the applicable audits covered by the inspections, compared to 13 percent of audits with deficiencies identified in 2016. These deficiencies were identified in the categories set forth in Table 9 below:

Table 9

Deficiencies Related to Auditor's Reporting on the Financial Statements and Supporting Schedules	Number of Audits with Deficiencies of the 116 Applicable Audits
Inaccurate auditor's report	9
Dating of the auditor's report	3

Inaccurate Auditor's Report

In nine audits, Inspections staff observed that the auditor's report on the supplemental information did not include, or include properly, one or more of the elements required by AS 2701.[76] For example, firms: (a) did not identify the supplemental information either by a descriptive title or by reference to the page number and document where the supplemental information was located; (b) did not include a statement that the supplemental information was the responsibility of management; (c) did not include a statement that the supplemental information was subjected to audit procedures performed in conjunction with the audit of the broker-dealer's financial statements; (d) did not include a statement that the audit procedures performed included determining whether the supplemental information reconciled to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental information; (e) did not include a statement that in forming its opinion, the firm evaluated whether the supplemental information, including its form and content, complied, in all material respects, with the specified regulatory requirements; or (f) referenced the incorrect regulatory requirement with which the supplemental information was to comply.

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Further, in one of the nine audits, the auditor's report on the financial statements did not include the required title and a statement that the audit was conducted in accordance with the standards of the PCAOB.[77] In another audit, the auditor's report did not identify and include an opinion on all of the broker-dealer's financial statements, including the statements of income, changes in member's equity, and cash flows.[78]

Dating of the Auditor's Report

In three audits, Inspections staff observed that the auditor's report was dated prior to the date on which the auditor concluded that it had obtained sufficient, appropriate evidence.[79] For example, firms reached conclusions regarding matters necessary to support their auditor's opinion after the date of the auditor's report, such as in one instance in which the engagement partner completed his review of the audit engagement after the date of the auditor's report.

Audit Documentation

Inspections staff identified deficiencies related to audit documentation in 15 of 116, or 13 percent, of the applicable audits covered by the inspections, compared to 28 percent of audits with deficiencies identified in 2016. In three of the 15 audits with deficiencies, Inspections staff identified deficiencies in more than one of the categories set forth in Table 10 below:

Table 10

Deficiencies Related to Audit Documentation	Number of Audits with Deficiencies of the 116 Applicable Audits
Engagement completion document	4
Documentation of significant findings or issues	8
Other audit documentation matters	6

Engagement Completion Document

In four audits, Inspections staff observed that firms did not complete an engagement completion document required by AS 1215, *Audit Documentation*.[80] In three of these audits, the firms also did not complete an engagement completion document in the related review engagements (see Other Deficiencies Related to Review Engagements below). All four of these audits were performed by firms that did not audit issuers.

Documentation of Significant Findings or Issues

In eight audits, Inspections staff observed that firms prepared an engagement completion document, but did not include one or more relevant required items, such as significant findings or issues, including the results of auditing procedures performed in

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response to significant risks, including fraud risks, or the identification of significant deficiencies in internal control over financial reporting.[81]

Other Audit Documentation Matters

In six audits, Inspections staff observed deficiencies related to other audit documentation matters. In four of the six audits, the firms did not assemble a complete and final set of audit documentation within 45 days after the report release date, which is the date the auditor grants permission for the use of the auditor's report in connection with the issuance of a broker-dealer's financial statements.[82] In three of the six audits**,** the firms added documentation to the audit file after the report release date but did not document the date the information was added, the name of the person who prepared the additional documentation, or the reasons for adding it.[83]

Engagement Quality Review

Inspections staff identified deficiencies related to the engagement quality review in 55 of 93, or 59 percent, of the applicable audits covered by the inspections, compared to 57 percent of audits with deficiencies identified in 2016. In one of the 55 audits with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 11 below:

Table 11

Deficiencies Related to Engagement Quality Review	Number of Audits with Deficiencies of the 93 Applicable Audits
Performance of an engagement quality review	5
Insufficient review by the engagement quality reviewer	50
Engagement quality reviewer qualifications	1

Performance of an Engagement Quality Review

In five audits, Inspections staff observed that firms did not have an engagement quality review performed for the audit prior to issuance of the engagement report required by AS 1220, *Engagement Quality Review*.[84] All of these audits were conducted by firms that did not audit issuers. In four of these audits, the firms did not have an engagement quality review performed for the related review attestation engagement (one audit did not have a corresponding attestation engagement because the broker-dealer did not file either a compliance report or an exemption report, see Other Deficiencies Related to Review Engagements below).

Insufficient Review by the Engagement Quality Reviewer

In 50 audits, Inspections staff observed that the engagement quality review performed was not sufficient. For example, through inspection of the documentation

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relating to the engagement quality review performed, the engagement quality reviewer did not, or did not sufficiently: (a) evaluate the engagement team's judgments made about materiality and the effect of those judgments on the engagement strategy; (b) evaluate the engagement team's assessment of, and audit responses to, significant risks identified by the engagement team, including fraud risks, or identify deficiencies when reviewing the engagement team's procedures intended to address significant and fraud risks; (c) evaluate the engagement team's judgments made about the severity and disposition of identified control deficiencies; (d) review the engagement team's evaluation of the firm's independence in relation to the engagement; (e) review the engagement completion document or identify that the engagement completion document did not include the results of auditing procedures intended to address an identified fraud risk; (f) review the financial statements and the related engagement report; or (g) evaluate the engagement team's conclusions related to difficult and contentious matters (for example, the broker-dealer's ability to continue as a going concern).[85]

Engagement Quality Reviewer Qualifications

In one audit, Inspections staff observed that the engagement quality reviewer did not meet the qualifications specified by AS 1220. Specifically, the engagement quality reviewer was not a partner at the firm or individual in an equivalent position[86] and did not appear to possess the level of knowledge and competence related to accounting, auditing, and financial reporting required in order to serve as the engagement partner on the engagement under review,[87] given that the engagement quality reviewer had no experience auditing broker-dealer engagements.

Evaluation of Control Deficiencies

Inspections staff identified deficiencies related to the auditor's evaluation of control deficiencies in the broker-dealer's internal control over financial reporting in an audit of the financial statements in 8 of 116, or seven percent, of the applicable audits covered by the inspections in 2017. In two of the eight audits with deficiencies in 2017, Inspections staff identified deficiencies related to auditors' evaluations pursuant to both AS 2301 and AS 1305, *Communications About Control Deficiencies in an Audit of Financial Statements*.

In three audits, the firms identified control deficiencies affecting IT controls on which the firms intended to rely, but failed to evaluate the effect of the deficiencies on control risk, and where appropriate, revise the control risk assessment and modify the planned substantive procedures.[88]

In five audits, the firms did not perform, or sufficiently perform, procedures to evaluate the severity of identified control deficiencies in the broker-dealer's internal control over financial reporting and determine whether the deficiencies, either individually or in combination with other deficiencies, were significant deficiencies or

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material weaknesses, for purposes of communication to management and the audit committee (or equivalent).[89]

In two audits, the firms failed to evaluate whether a misstatement identified during the audit that exceeded the firm's established materiality levels was indicative of a significant deficiency or material weakness in the broker-dealer's internal control over financial reporting, for purposes of communication to management and the audit committee (or equivalent).[90]

Deficiencies in Independence Communications to the Audit Committee (or equivalent)[91]

Inspections staff identified deficiencies related to independence communications to the audit committee (or equivalent) in 14 of 48, or 29 percent, of the applicable audits covered by the inspections, compared to 19 percent of audits with deficiencies identified in 2016.

In seven audits, the firms failed to make the required annual communications.

In two audits, the firms failed to make the required communications concerning independence prior to accepting an initial engagement, and in two audits, the firms made the required annual communications but incorrectly referenced other regulatory requirements rather than PCAOB Rule 3520, *Auditor Independence*.[92]

In three audits, the firms' independence was impaired because they provided prohibited non-audit services to the broker-dealer or had an indemnification clause in the engagement letter. These firms failed to describe those relationships in writing to the audit committees (or equivalent).

Attestation Deficiencies

Rule 17a-5(d) requires that SEC-registered broker-dealers file annual reports that include, among other things, a compliance report or an exemption report.[93]

Rule 17a-5(d) also generally requires the annual reports to contain reports by an independent public accountant covering the financial report and the compliance report or exemption report.[94] The auditor must, as part of the engagement, undertake, as applicable: (1) to prepare a report based on an examination of certain statements of the broker-dealer in the compliance report; or (2) to prepare a report based on a review of the statements of the broker-dealer in the exemption report. In each case, the examination or review performed by the auditor must be conducted in accordance with PCAOB standards.[95]

The examination, pursuant to AT No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or the review, pursuant to AT No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*, should be coordinated with the audit of the financial statements and the audit procedures

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performed on supplemental information of the broker-dealer.[96]

Attestation deficiencies are failures by firms to perform, or sufficiently perform, certain required attestation procedures and do not necessarily indicate that the broker-dealer's assertions in the compliance or exemption reports are, in any material respect, not fairly stated, that a material weakness existed during, or as of the end of, the fiscal year specified in the assertions in the compliance report, or that the broker-dealer was in violation of the Net Capital Rule or the Reserve Requirements Rule.[97] Conclusions about whether the assertions are fairly stated, material weaknesses existed, or a rule violation occurred are often not possible for Inspections staff to reach based only on the information available from the auditors.

Examination Procedures

Inspections staff identified deficiencies related to the examination procedures in 19 of 27, or 70 percent, of the applicable attestation engagements covered by the inspections, compared to 70 percent of attestation engagements with deficiencies identified in 2016. In 15 of the 19 examinations with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 12 below:

Table 12

Deficiencies Related to Examination Procedures	Number of Examinations with Deficiencies of the 27 Applicable Examinations
Planning the examination	8
Testing controls over compliance	18
Performing compliance tests	13
Evaluation of results	3
Other examination procedures	2

Planning the Examination

In eight examinations, Inspections staff observed that firms did not plan, or sufficiently plan, the examination engagement.[98] For example, in one examination, the firm did not perform any procedure to plan the examination engagement. In seven other examinations, the firms did not: (a) obtain a sufficient understanding of certain of the financial responsibility rules[99] or of the broker-dealer's processes, including relevant controls, regarding compliance with the financial responsibility rules; (b) 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-dealer's internal control over compliance ("ICOC"); or (c) obtain a sufficient understanding of the nature and frequency of customer complaints that were relevant to compliance with the financial responsibility rules because the firm's

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procedures did not provide an understanding of all types of customer complaints received by the broker-dealer.

Testing Controls Over Compliance

In 18 examinations, Inspections staff observed that firms did not test, or sufficiently test, important ICOC with the financial responsibility rules.[100] In one examination, the firm did not test any ICOC related to any of the financial responsibility rules. In another examination, the firm did not test controls over the establishment and maintenance of special reserve bank accounts and the timeliness of deposits made to the special reserve bank accounts. Further, in two examinations, the firms did not test, or sufficiently test, the design and operating effectiveness of IT controls important to the broker-dealer's ICOC.[101] In addition, Inspections staff observed that firms did not test, or sufficiently test: (a) management review controls; (b) ICOC during the year and as of year end; (c) the accuracy and completeness of information upon which ICOC depended; (d) controls related to possession or control; (e) controls related to customer account statements; or (f) controls related to quarterly security counts, as discussed below.

In seven of the 18 examinations, when the firms tested management's review controls, the firms did not obtain a sufficient understanding of the nature and extent of management's review, including understanding and evaluating the expectation and criteria used by management to identify matters for investigation, and the nature and resolution of the investigation procedures performed. For example, in some of these instances, the firms' procedures consisted solely of inspecting documentation of management's sign-off as evidence that the review had occurred or performing direct tests of compliance, without testing the controls.

In six of the 18 examinations, Inspections staff observed deficiencies in the timing and extent of the firms' testing of ICOC during the year and as of year end. For example, Inspections staff observed that: (a) a broker-dealer's important controls selected for testing consisted of a review of the weekly reserve computation,[102] as well as of the monthly reserve computation, but the firm limited its testing to only the monthly review; (b) a firm's testing of the operating effectiveness of a monthly control was limited to only the control's operation at year end, which did not provide evidence that the control was operating effectively during the year; and (c) a firm's testing as of an interim date included a mix of inquiry, observation, inspection, and re-performance procedures to provide the firm with evidence commensurate with risk associated with the control; however, the firm only performed inquiry procedures to extend its conclusions as of interim to year end, which did not provide the firm the same level of evidence commensurate with the risk associated with the control.[103]

In one of the six examinations, Inspections staff observed that the broker-dealer implemented a quarterly control during the current year under examination to address a material weakness identified in the prior year. The firm's testing of the implemented control provided evidence that it was operating effectively during the third and fourth

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quarters of the current year, and as of year end. However, the firm's testing did not provide evidence that the control was operating effectively during the first half of the current year, even though the firm stated in its examination report that the broker-dealer's ICOC was effective during the entire year.

In nine of the 18 examinations, Inspections staff observed that firms did not test, or sufficiently test, the accuracy and completeness of information, produced by either the broker-dealer or the broker-dealer's service organizations, upon which the design and operating effectiveness of ICOC depended. For example, certain firms relied on controls over the accuracy and completeness of reports produced by a service organization that were important to ICOC but neither the firm nor the service auditor tested controls over these reports.[104]

In nine of the 18 examinations, Inspections staff observed that firms did not test, or sufficiently test, controls related to possession or control. For example, in two examinations, the firms did not perform any tests of controls over the broker-dealer's possession or control requirements. In five other examinations, the firms did not test, or sufficiently test, the broker-dealer's controls over maintaining its custodial accounts free of any right, charge, security interest, lien, or claim.[105]

In 12 of the 18 examinations, Inspections staff observed that firms did not test, or sufficiently test, controls over customer account statements.[106] Specifically, these firms did not test, or sufficiently test, controls over all customers receiving account statements either electronically or by mail or controls over the account statements including complete and accurate information.

In seven of the 18 examinations, Inspections staff observed that firms did not test, or sufficiently test, controls related to a broker-dealer's compliance with Rule 17a-13. For example, in four of these examinations, the firms did not test, or sufficiently test, controls over the verification of securities subject to the broker-dealer's control or direction, but not in its physical possession, where such securities were not in its physical possession for more than 30 days.[107] In two of these seven examinations, the firms also did not evaluate whether the quarterly security count was made or supervised by appropriate persons because the responsibilities of the individuals that made and supervised the security count also performed or reviewed processes related to reconciliations and trade processing.[108]

Performing Compliance Tests

In 13 examinations, Inspections staff observed deficiencies in the firms' performance of compliance tests to support their conclusions regarding whether the broker-dealer was in compliance with the Net Capital Rule or the Reserve Requirements Rule as of the end of its fiscal year. For example, in seven examinations, the firms did not perform sufficient procedures on the schedules the broker-dealer used to determine compliance, because the firms did not perform, or sufficiently perform, procedures to test the accuracy and completeness of the information produced by the

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broker-dealer, or the broker-dealer's service organizations, used by the broker-dealer to prepare its schedules.[109]

In seven of the 13 examinations, the firms did not evaluate, or sufficiently evaluate, whether the amounts in the schedules were determined in accordance with the Net Capital Rule or Reserve Requirements Rule, as applicable. For example, in two examinations, the firms did not test, or sufficiently test, whether the broker-dealer appropriately allocated debits and credits reported in the customer reserve computation in accordance with Rule 15c3-3.[110] In another examination, the firm did not evaluate whether a receivable from a customer, which included partly secured accounts, was appropriately included as an allowable asset in the net capital computation in accordance with Rule 15c3-1.[111]

Inspections staff also observed in two of the 13 examinations that firms' procedures were deficient concerning whether the broker-dealer maintained a special reserve bank account for the exclusive benefit of its customers in accordance with the requirements of the Customer Protection Rule[112] because these firms did not test whether the broker-dealer obtained the required written notification from the bank.[113]

Evaluation of Results

In three examinations, Inspections staff observed that firms identified deficiencies in ICOC and did not evaluate, or sufficiently evaluate, whether individually or in combination with other deficiencies, there was a material weakness in ICOC.[114] For example, in one examination, the broker-dealer reported a material weakness in ICOC with its possession or control requirements because it did not maintain no lien acknowledgement letters for certain funds.[115] The firm failed to obtain sufficient audit evidence to support that the reported material weakness was limited to those certain funds because the firm did not test controls that addressed whether other locations met the requirements of Rule 15c3-3(c) to be considered good control locations. In addition, the firm identified a control deficiency related to one of these other locations when it was determined not to be a good control location for a portion of the year because the broker-dealer did not maintain a no lien acknowledgment letter. The firm failed to sufficiently evaluate the severity of this control deficiency, and whether it also constituted a material weakness, when evaluated in combination with other control deficiencies.

Other Examination Procedures

In two examinations, Inspections staff observed that the firms did not obtain written representations from management of the broker-dealer.[116]

Review Procedures

Inspections staff identified deficiencies related to review procedures in 28 of 87, or 32 percent, of the applicable attestation engagements covered by the inspections,

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compared to 28 percent of attestation engagements with deficiencies identified in 2016. In five of the 28 reviews with deficiencies in 2017, Inspections staff identified deficiencies in more than one of the categories set forth in Table 13 below:

Table 13

Deficiencies Related to Review Procedures	Number of Reviews with Deficiencies of the 87 Applicable Reviews
Gaining an understanding of exemption conditions	2
Making required inquiries and performing other review procedures	25
Evaluation of results	5
Other required review procedures	1

Gaining an Understanding of Exemption Conditions

In two reviews, Inspections staff observed that firms did not gain an understanding of the broker-dealer's exemption conditions and other rules and regulations that were relevant to the broker-dealer's exemption asserted in the exemption report.[117] For example, the firms did not obtain an understanding of the provisions of Rule 17a-5 and the Customer Protection Rule, which were relevant to the broker-dealer's assertions and necessary to properly perform the review.

Making Required Inquiries and Performing Other Review Procedures

In 25 reviews, Inspections staff observed that the firms' inquiries and other review procedures were insufficient.

In 19 of the 25 reviews, the firms did not perform all required inquiries,[118] including those which involve obtaining an understanding of management's controls and monitoring activities in place to comply with the claimed exemption provisions.

In five of the 25 reviews, the firms did not evaluate, or sufficiently 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 corroborated or contradicted the broker-dealer's assertions regarding compliance with the exemption provisions.[119] For example, in one review, the firm obtained information as part of the financial statement audit confirmation procedures and inquiry with the broker-dealer that a zero balance checking account was being used by the broker-dealer as a Special Account for the Exclusive Benefit of Customers.[120] The firm did not evaluate whether the evidence obtained and the results of the procedures performed related to the checking account corroborated or contradicted the broker-dealer's assertions regarding compliance with the exemption it claimed. In another review, the broker-dealer stated in its exemption report that it claimed an exemption from Rule 15c3-3 and met the identified exemption provision without exception. The broker-dealer's FOCUS report disclosed that it carried securities

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accounts for customers in its vault, at other broker-dealers, and at a depository institution, and the results of the firm's procedures indicated that the broker-dealer acted as a self-clearing broker. However, the firm failed to evaluate that information that appeared to contradict the broker-dealer's assertion that it claimed and met the identified exemption provision from Rule 15c3-3 without exception.

In three of the 25 reviews, the firms did not perform other procedures necessary to assess whether a material modification was necessary for the broker-dealer's assertions to be fairly stated, in all material respects.[121] For example, in one of these reviews, the firm performed additional procedures in response to exceptions identified by the broker-dealer in the exemption report whereby the broker-dealer failed to promptly transmit customer checks for the purchase of annuity contracts. The firm selected a sample of two checks from the broker-dealer's check log and identified that one of the checks was not promptly transmitted by the broker-dealer to the insurance carrier, as the transmittal was more than seven business days after receipt from the customer.[122] The broker-dealer did not report this check as an exception. The firm did not perform procedures in response to the identified exception or determine whether additional procedures were necessary to test for unreported exceptions.

Evaluation of Results

In five reviews, Inspections staff observed instances where the firms' evaluations of the results of its review procedures were insufficient. For example, in three reviews, in which the broker-dealer stated in the exemption report that it met the identified exemption provisions of Rule 15c3-3(k)(2)(i), firms were aware that the broker-dealer did not maintain the required Special Account and did not modify its review report. In one review, the firm performed procedures over exceptions related to annuity checks that the broker-dealer identified in its exemption report as exceptions to Rule 15c3-3(k)(2)(ii). Although annuity checks are generally applicable to the Rule 15c3-3(k)(2)(i) exemption, the firm did not further evaluate this matter in order to determine whether a modification to its review report was necessary. In another review, the firm was aware that the nature of the exceptions to the identified exemption provision related to customer checks and customer securities that were not promptly transmitted based on its review procedures. However, the firm failed to evaluate that information in reaching its conclusion on the accuracy of the broker-dealer's assertion in the exemption report that identified and described each exception as being only related to customer checks.

Other Required Review Procedures

In one review, Inspections staff observed that the firm did not obtain the written representations from management of the broker-dealer required by AT No. 2.[123]

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Other Deficiencies Related to Examination Engagements

Other deficiencies related to examination engagements are failures by firms to perform, or sufficiently perform, certain procedures required by PCAOB standards that are part of the performance of an examination engagement.

Examination Report

Inspections staff identified deficiencies related to the examination report in 2 of 27, or seven percent, of the applicable examinations covered by the inspections, compared to 10 percent of examinations with deficiencies identified in 2016. In one examination, the firm's examination report inaccurately described the broker-dealer's responsibility to send customer account statements as being pursuant to Rule 17a-13. In the other examination, the firm's examination report omitted the word "independent" from the report title.[124]

Examination Documentation

Inspections staff identified deficiencies related to examination engagement documentation in 2 of 27, or seven percent, of the applicable examinations covered by the inspections, compared to five percent of examinations with deficiencies identified in 2016. In these examinations, Inspections staff observed that the firms did not complete an engagement completion document for the examination or include required documentation related to the examination in the engagement completion document prepared in connection with the corresponding audit.[125]

Engagement Quality Review in an Examination Engagement

Inspections staff identified deficiencies related to the engagement quality review for examination engagements in 4 of 20, or 20 percent, of the applicable examinations covered by the inspections, compared to 20 percent of examinations with engagement quality review deficiencies identified in 2016.

In four examinations, Inspections staff observed that the engagement quality reviewer failed to identify that the engagement team did not perform examination procedures necessary in the circumstances of the examination engagement.[126] For example, in one examination, it appeared to Inspections staff that the engagement quality reviewer's concurring approval of issuance was provided despite the fact that the engagement team performed no examination procedures for the examination engagement, did not complete an engagement completion document for the examination engagement, and did not correctly prepare the engagement report. In another examination, it appeared to Inspections staff that the engagement quality reviewer's concurring approval of issuance was provided despite the fact that the engagement team failed to sufficiently evaluate the severity of a deficiency in ICOC and whether it also constituted a material weakness when evaluated in combination with the reported material weakness.

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Other Deficiencies Related to Review Engagements

Other deficiencies related to review engagements are failures by firms to perform, or sufficiently perform, certain procedures required by PCAOB standards that are part of the performance of a review engagement.

<u>Review Report</u>

Inspections staff identified deficiencies related to the review report in 11 of 87, or 13 percent, of the applicable reviews covered by the inspections, compared to 14 percent of reviews with deficiencies identified in 2016. For example, these review reports either: (a) inaccurately stated that the broker-dealer's exemption report asserted that it met the identified exemption provision without exception when the broker-dealer's exemption report contained no such statement; (b) were dated prior to the date on which the firm had completed the review procedures; (c) identified a different exemption(s) than the exemption(s) the broker-dealer operated under and specified in its exemption report; or (d) incorrectly made reference to the broker-dealer's assertions included within the FOCUS report, which was not an exemption report.[127]

<u>Review Documentation</u>

Inspections staff identified deficiencies related to review engagement documentation in 5 of 87, or six percent, of the applicable reviews covered by the inspections, compared to 21 percent of reviews with deficiencies identified in 2016. In three of the five reviews, Inspections staff observed that firms did not complete an engagement completion document for the review or for the corresponding audit.[128] These reviews were performed by firms that did not audit issuers. In one of the five reviews, the firm did not assemble a complete and final set of audit documentation within 45 days after the report release date.[129]

<u>Engagement Quality Review in a Review Engagement</u>

Inspections staff identified deficiencies related to the engagement quality review for review engagements in 14 of 54, or 26 percent, of the applicable reviews covered by the inspections, compared to 26 percent of reviews with engagement quality review deficiencies identified in 2016.

In four reviews, Inspections staff observed that firms did not have an engagement quality review performed for the review engagement. In another 10 reviews, Inspections staff observed that the engagement quality reviewer did not sufficiently perform a review, including instances in which the engagement quality reviewer failed to detect one or more errors in the engagement report or failed to identify the absence of an engagement completion document.[130]

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Firms and Broker-Dealers Inspected During 2017 on a Random Basis

During 2017, certain firms inspected, and audits and attestation engagements covered by the inspections, were selected on a random basis. The random selections were made after the selection of firms and broker-dealers that were based on certain risk characteristics. The focus areas for these inspections were selected individually based on risk factors, including past inspection experience.

Specifically, seven audits and the related attestation engagements performed by seven firms were selected randomly from the population of firms and broker-dealer audits. Six of the seven firms had been selected for inspection in previous years. For three of these seven, auditor independence was an area covered in the inspection and Inspections staff did not identify any independence findings. For these seven, Inspections staff identified deficiencies in 86 percent, 38 percent, 100 percent (only one examination engagement), and 17 percent of audits, areas, examination engagement, and review engagements, respectively.

Further, for five firms where one or more of the firms' audits were covered by the 2017 inspections, one additional audit and related review engagement was selected on a random basis from the population of broker-dealer engagements that had not previously been inspected under the interim inspection program. Independence was not a focus area for these selections. Inspections staff identified deficiencies in 60 percent and 8 percent of audits and areas, respectively, which were lower than the deficiency percentages identified for those audits selected for inspection on a risk basis at these same five firms. There were no deficiencies identified in the review engagements.

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Appendix A

Summary of Results of Inspections of Audits and Attestation Engagements Performed in Accordance with PCAOB Standards Under the Interim Inspection Program

Since inception of the interim inspection program through December 31, 2017, the Board has performed 409 inspections of 310 firms that conducted audits of broker-dealers.[131] The 409 inspections covered portions of 630 audits, of which 351 were required to be performed in accordance with PCAOB standards and 279 were required to be performed in accordance with generally accepted auditing standards, and 347[132] attestation engagements that were required to be performed in accordance with PCAOB standards. The 630 audits and the 347 attestation engagements had financial statement periods ended December 31, 2010 through June 30, 2017 and June 30, 2014 through June 30, 2017, respectively.

The following tables summarize the independence findings and audit, attestation, and other deficiencies identified from inspections of audits and attestation engagements performed in accordance with PCAOB standards under the interim inspection program through December 31, 2017:

Comparative Summary of Findings and Deficiencies

Inspection Year	Percentage of Audits with Independence Findings	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies[133]	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
2017[134]	8%	76%	32%	70%	40%
2016	10%	83%	36%	70%	43%
2015[135]	7%	78%	35%	77%	49%

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Comparison of Audit and Other Deficiencies Related to the Audit

Deficiencies	Percentage of Applicable Audits with Deficiencies		
	2017	2016	2015
Revenue	65%	66%	71%
Assessing and Responding to Risks of Material Misstatement Due to Fraud	64%	57%	44%
Financial Statement Presentation and Disclosures	33%	39%	38%
Related Party Relationships and Transactions	32%	33%	32%
Fair Value Measurements	28%	24%	44%
Receivables and Payables	31%	25%	23%
Net Capital Rule	36%	27%	29%
Customer Protection Rule	48%	52%	52%
Auditor's Reporting on the Financial Statements and Supporting Schedules	10%	13%	8%
Audit Documentation	13%	28%	27%
Engagement Quality Review	59%	57%	58%
Evaluation of Control Deficiencies	7%	N/A	N/A
Independence Communications to the Audit Committee (or equivalent)	29%	19%	10%

Comparison of Attestation and Other Deficiencies Related to the Attestation Engagement

Deficiencies	Percentage of Applicable Attestation Engagements with Deficiencies		
	2017	2016	2015
Examination Procedures	70%	70%	77%
Review Procedures	32%	28%	34%
Examination Report	7%	10%	13%
Examination Documentation	7%	5%	17%
Examination Engagement Quality Review	20%	20%	50%
Review Report	13%	14%	16%
Review Documentation	6%	21%	17%
Review Engagement Quality Review	26%	26%	35%

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The following tables[136] present a comparative summary of audit and attestation engagements with deficiencies by certain firm characteristics:

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

	Percentage of Audits with Audit and Other Deficiencies			Percentage of Areas with Audit and Other Deficiencies		
	2017	2016	2015	2017	2016	2015
Firms that audited broker-dealers that filed compliance reports	66%	70%	64%	24%	22%	25%
Firms that only audited broker-dealers that filed exemption reports	85%	97%	95%	39%	51%	47%

	Percentage of Examinations with Attestation and Other Deficiencies			Percentage of Reviews with Attestation and Other Deficiencies		
	2017	2016	2015	2017	2016	2015
Firms that audited broker-dealers that filed compliance reports	70%	70%	77%	17%	25%	26%
Firms that only audited broker-dealers that filed exemption reports	N/A	N/A	N/A	52%	54%	63%

In 2017, Inspections staff identified a high percentage of audits, areas, and attestation engagements with deficiencies across firms covered by the inspections but noted that deficiencies were significantly higher at firms that only audited broker-dealers that filed exemption reports. The 2017 results are consistent with 2016.

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

	Percentage of Audits with Audit and Other Deficiencies			Percentage of Areas with Audit and Other Deficiencies		
	2017	2016	2015	2017	2016	2015
Firms That Also Audited Issuers:						
Broker-dealers that filed a compliance report	83%	74%	79%	33%	22%	25%
Broker-dealers that filed an exemption report	65%	75%	62%	25%	25%	23%
Firms That Did Not Audit Issuers:						
Broker-dealers that filed a compliance report	100%	100%	100%	43%	70%	71%
Broker-dealers that filed an exemption report	95%	100%	95%	44%	60%	51%

	Percentage of Attestations with Attestation and Other Deficiencies		
	2017	2016	2015
Firms That Also Audited Issuers:			
Broker-dealers that filed a compliance report	71%	68%	71%
Broker-dealers that filed an exemption report	32%	28%	32%
Firms That Did Not Audit Issuers:			
Broker-dealers that filed a compliance report	67%	100%	100%
Broker-dealers that filed an exemption report	64%	66%	71%

In 2017, Inspections staff identified a high percentage of audits, areas, and attestation engagements with deficiencies across firms covered by the inspections but noted that deficiencies were generally higher at firms that did not audit issuers. The 2017 results are consistent with 2016.

In addition, Inspections staff identified that the percentage of attestation and other deficiencies was higher for examinations of broker-dealers that filed a compliance report compared to reviews of broker-dealers that filed an exemption report at both firms that also audited issuers and those that did not.

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Firms Inspected More than Once

There were seven firms inspected during 2017 that were also inspected during 2016 and 2015. The following tables present a comparative summary of deficiencies for these firms by year:

Deficiencies for Firms Inspected in 2017, 2016, and 2015

Inspection Year	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
2017	61%	17%	65%	17%
2016	60%	11%	57%	21%
2015	48%	10%	46%	24%

Inspections staff has identified that the percentage of audits, areas, and examination engagements with deficiencies for firms inspected in all three years increased in 2017 compared to 2016 and 2015. The percentage of review engagements with deficiencies decreased in 2017 compared to 2016 and 2015. The individual firm results were varied across these seven firms.

There were an additional 11 firms that were inspected twice during 2015 through 2017, of which seven firms also audited issuers. For the seven firms that also audited issuers, Inspections staff noted that the percentage of audits and examination engagements with deficiencies was lower in the subsequent inspections when compared to the initial inspections under PCAOB standards; while the percentage of areas and review engagements with deficiencies was higher. Inspections staff also noted that for the four firms that did not audit issuers, the percentage of audits, areas, and review engagements with deficiencies was lower in the subsequent inspections when compared to the initial inspections under PCAOB standards.

The following table shows a comparative summary of the percentage of audits, areas, examinations, and reviews with deficiencies for the seven firms that also audited issuers and the four firms that did not audit issuers that were inspected twice during 2015 through 2017:

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Deficiencies for Firms Inspected Twice During 2015 through 2017

Inspection Year	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
Firms That Also Audited Issuers:				
Subsequent inspections	73%	31%	50%	22%
Initial inspections under PCAOB standards	80%	23%	100%	0%
Firms That Did Not Audit Issuers:				
Subsequent inspections	80%	52%	100%	25%
Initial inspections under PCAOB standards	100%	64%	N/A	75%

The remainder of this appendix presents cumulative audit, attestation, and other deficiencies from inspections of audits and attestation engagements performed in accordance with PCAOB standards stratified by certain firm or broker-dealer characteristics.

Number of Broker-Dealer Audits per Firm

Number of Broker-Dealer Audits per Firm	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
1	91%	55%	100%	69%
2 to 20	94%	46%	91%	58%
21 to 50	70%	30%	100%	23%
51 to 100	82%	36%	100%	30%
More than 100	57%	13%	56%	23%

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

Firms	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
Also audited issuers	71%	25%	70%	31%
Did not audit issuers	97%	54%	90%	67%

Percentage of Audits with Audit, Attestation, and Other Deficiencies Stratified by whether the Broker-Dealer Claimed or Did Not Claim Exemption from Rule 15c3-3

Broker-Dealer	Percentage of Audits with Audit and Other Deficiencies	Percentage of Areas with Audit and Other Deficiencies	Percentage of Examinations with Attestation and Other Deficiencies	Percentage of Reviews with Attestation and Other Deficiencies
Did not claim exemption	80%	30%	73%	40%[137]
Claimed exemption	79%	36%	N/A	44%

The following tables present a comparison of audit and other deficiencies related to the audit regarding the inspections performed during 2017 and 2016 for broker-dealers that did or did not claim exemption from Rule 15c3-3:

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Comparison of Audit and Other Deficiencies Related to the Audit – Broker-Dealers That Did Not Claim Exemption

Audit and Other Deficiencies	2017			2016
	Number of Audits with Deficiencies	Number of Applicable Audits	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Revenue	20	28	71%	57%
Assessing and Responding to Risks of Material Misstatement Due to Fraud	4	8	50%	38%
Financial Statement Presentation and Disclosures	5	28	18%	19%
Related Party Relationships and Transactions	4	16	25%	7%
Fair Value Measurements	1	10	10%	0%
Receivables and Payables	10	18	56%	11%
Net Capital Rule	8	17	47%	19%
Customer Protection Rule	14	28	50%	48%
Auditor's Reporting on the Financial Statements and Supporting Schedules	1	28	4%	14%
Audit Documentation	4	28	14%	14%
Engagement Quality Review	11	24	46%	33%
Evaluation of Control Deficiencies	6	28	21%	N/A
Independence Communications to the Audit Committee (or equivalent)	2	5	40%	14%

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Comparison of Audit and Other Deficiencies Related to the Audit – Broker-Dealers That Claimed Exemption

Audit and Other Deficiencies	2017			2016
	Number of Audits with Deficiencies	Number of Applicable Audits	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Revenue	53	84	63%	68%
Assessing and Responding to Risks of Material Misstatement Due to Fraud	12	17	71%	65%
Financial Statement Presentation and Disclosures	33	88	38%	44%
Related Party Relationships and Transactions	17	50	34%	38%
Fair Value Measurements	6	15	40%	40%
Receivables and Payables	1	17	6%	30%
Net Capital Rule	20	61	33%	29%
Customer Protection Rule	0	1	0%	75%
Auditor's Reporting on the Financial Statements and Supporting Schedules	11	88	13%	13%
Audit Documentation	11	88	13%	31%
Engagement Quality Review	44	69	64%	63%
Evaluation of Control Deficiencies	2	88	2%	N/A
Independence Communications to the Audit Committee (or equivalent)	12	43	28%	20%

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Percentage of Audits with Audit and Other Deficiencies Stratified by Reported Actual Net Capital by Broker-Dealers

Reported Actual Net Capital	Number of Broker-Dealers	Percentage of Audits with Audit and Other Deficiencies		
		2017	2016	2015
Less than $100,000	40	79%	87%	83%
$100,000 to $2,000,000	129	79%	90%	94%
$2,000,001 to $15,000,000	96	71%	78%	69%
$15,000,001 to $100,000,000	54	75%	75%	68%
Greater than $100 million	32	77%	83%	43%

Percentage of Attestations with Attestation and Other Deficiencies Stratified by Reported Actual Net Capital by Broker-Dealers

Reported Actual Net Capital	Number of Broker-Dealers	Percentage of Attestations with Attestation and Other Deficiencies		
		2017	2016	2015
Less than $100,000	38	39%	73%	60%
$100,000 to $2,000,000	127	57%	46%	71%
$2,000,001 to $15,000,000	96	50%	33%	43%
$15,000,001 to $100,000,000	54	25%	40%	45%
Greater than $100 million	32	46%	67%	43%

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Percentage of Audits with Audit and Other Deficiencies Stratified by Reported Revenues by Broker-Dealers

Reported Revenues	Number of Broker-Dealers	Percentage of Audits with Audit and Other Deficiencies		
		2017	2016	2015
Less than $1,000,000	66	70%	88%	80%
$1,000,000 to $5,000,000	71	80%	94%	96%
$5,000,001 to $15,000,000	66	78%	100%	83%
$15,000,001 to $50,000,000	56	87%	77%	63%
$50,000,001 to $125,000,000	34	80%	73%	69%
$125,000,001 to $500,000,000	43	63%	72%	56%
Greater than $500 million	15	80%	50%	67%

Percentage of Attestations with Attestation and Other Deficiencies Stratified by Reported Revenues by Broker-Dealers

Reported Revenues	Number of Broker-Dealers	Percentage of Attestations with Attestation and Other Deficiencies		
		2017	2016	2015
Less than $1,000,000	64	38%	50%	71%
$1,000,000 to $5,000,000	71	56%	56%	68%
$5,000,001 to $15,000,000	64	47%	50%	55%
$15,000,001 to $50,000,000	56	60%	41%	53%
$50,000,001 to $125,000,000	34	70%	45%	46%
$125,000,001 to $500,000,000	43	25%	39%	33%
Greater than $500 million	15	40%	75%	33%

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Percentage of Audits with Audit and Other Deficiencies Stratified by Reported Assets by Broker-Dealers

Reported Assets	Number of Broker-Dealers	Percentage of Audits with Audit and Other Deficiencies		
		2017	2016	2015
Less than $250,000	39	72%	88%	80%
$250,000 to $1,000,000	48	82%	100%	100%
$1,000,001 to $5,000,000	79	76%	85%	87%
$5,000,001 to $15,000,000	51	65%	90%	90%
$15,000,001 to $50,000,000	45	83%	75%	57%
$50,000,001 to $500,000,000	54	81%	78%	60%
Greater than $500 million	35	75%	64%	67%

Percentage of Attestations with Attestation and Other Deficiencies Stratified by Reported Assets by Broker-Dealers

Reported Assets	Number of Broker-Dealers	Percentage of Attestations with Attestation and Other Deficiencies		
		2017	2016	2015
Less than $250,000	37	41%	56%	50%
$250,000 to $1,000,000	48	47%	63%	93%
$1,000,001 to $5,000,000	77	50%	44%	60%
$5,000,001 to $15,000,000	51	55%	30%	57%
$15,000,001 to $50,000,000	45	42%	42%	38%
$50,000,001 to $500,000,000	54	50%	39%	40%
Greater than $500 million	35	42%	64%	50%

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Appendix B

Information Regarding Firms That Performed Audit and Attestation Engagements and the Selection of Firms and Audit and Attestation Engagements for Inspections During 2017 and Since Inception of the Interim Inspection Program

Firms that Performed Audit and Attestation Engagements

For fiscal periods ended during the period from July 1, 2016 through June 30, 2017, there were 475 firms that issued audit reports on the financial statements and other information required by Rule 17a-5 of broker-dealers that were filed with the SEC. Many of the firms performed audits for as few as one broker-dealer, while several firms performed audits for more than 100 broker-dealers.

Number of Broker-Dealer Audits per Firm	Number of Firms[138]	Percentage of Firms
1	157	33%
2 to 20	280	59%
21 to 50	24	5%
51 to 100	9	2%
More than 100	5	1%
Total	475	100%

There were 3,829 broker-dealers that filed audited annual financial statements with the SEC for fiscal years ended during the period from July 1, 2016 through June 30, 2017. The following table expands on the information above to provide further information on which firms also audited issuers and the number of their broker-dealer audits:[139]

Number of Broker-Dealer Audits per Firm	Also Audited Issuers		Did Not Audit Issuers	
	Number of Firms	Number of Broker-Dealers	Number of Firms	Number of Broker-Dealers
1	51	51	106	106
2 to 20	118	696	162	810
21 to 50	12	382	12	382
51 to 100	4	322	5	347
More than 100	4	599	1	134
Total	189	2,050	286	1,779

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Selection of Firms and Audit and Attestation Engagements During 2017

The firms inspected during 2017, and the audit and attestation engagements covered during the inspections, were generally selected based on characteristics of the firms and the broker-dealers taking into consideration the risks related to those characteristics. The firm characteristics included, among others, the number of broker-dealer audits performed, whether the firm also issued audit reports for issuers, previous inspection results, history of the firm or firm personnel in auditing broker-dealers, and existence of disciplinary actions against the firm or engagement partner by the SEC, PCAOB, or other regulatory authorities. The selection of the firms' broker-dealer engagements was based on various characteristics, including among others, financial metrics, whether the broker-dealer filed a compliance report with the SEC, whether the broker-dealer was a subsidiary of an issuer and its significance to the issuer's consolidated financial statements, changes in auditors and certain circumstances related to the changes, existence of disciplinary actions against the broker-dealer by the SEC, FINRA, or other regulatory authorities, and the engagement partner's workload, experience in auditing broker-dealers, and previous inspection results.

The following tables present the number of firms inspected and the number of audits covered by the inspections by the number of broker-dealer audits per firm as determined at the time of the inspection, whether or not the firms also audited issuers, and whether the firms audited broker-dealers that filed a compliance report or only audited broker-dealers that filed an exemption report:

Number of Broker-Dealer Audits per Firm	Number of Firms Inspected	Number of Audits Covered
1	9	9
2 to 20	46	47
21 to 50	12	18
51 to 100	4	8
More than 100	4	34
Total	75	116

Firms	Number of Firms Inspected	Number of Audits Covered
Also audited issuers	49	90
Did not audit issuers	26	26
Total	75	116

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Firms	Number of Firms Inspected	Number of Audits Covered
Audited broker-dealers that filed compliance reports	20	56
Only audited broker-dealers that filed exemption reports	54	59
Total[140]	74	115

At the time of the inspections, 49 of the 75 firms also audited issuers. Of these 49, four firms selected for inspection audited more than 100 issuers and 45 firms selected for inspection audited 100 or fewer issuers. The remaining 26 firms did not audit issuers and were not subject to inspection other than under the interim inspection program.

The following tables present the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers that filed either a compliance report or an exemption report, stratified by the type of report filed and whether the broker-dealer did or did not claim exemption from Rule 15c3-3:

Broker-Dealer Filed	Number of Attestations[141]	Range of Minimum Net Capital Requirements	Range of Actual Net Capital Reported at Fiscal Year End[142]
Compliance report	27	$250,000 - $1,200,000,000	$300,000 - $8,000,000,000
Exemption report	87[143]	$5,000 - $82,000,000	$6,000 - $200,000,000

Broker-Dealer	Number of Audits	Range of Minimum Net Capital Requirements	Range of Actual Net Capital Reported at Fiscal Year End
Did not claim exemption	28[144]	$250,000 - $1,200,000,000	$300,000 - $8,000,000,000
Claimed exemption	88	$5,000 - $82,000,000	$6,000 - $200,000,000

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Selection of Firms and Audit and Attestation Engagements Since Inception

The following tables present the number of firms inspected, the number of audits covered by the inspections, and the number of attestation engagements covered by the inspections by the number of broker-dealer audits per firm as determined at the time of the inspection, whether or not the firms also audited issuers, and whether the firms audited broker-dealers that filed a compliance report or only audited broker-dealers that filed an exemption report since the inception of the interim inspection program:

Number of Broker-Dealer Audits per Firm	Number of Firms Inspected	Number of Audits	Number of Examinations	Number of Reviews
1	59	60[145]	3	29
2 to 20	211	250	22	121
21 to 50	30	100	5	35
51 to 100	14	45	4	23
More than 100	7	175	43	62
Total	310[146]	630	77	270

Firms	Number of Firms Inspected	Number of Audits	Number of Examinations	Number of Reviews
Also audited issuers	126	400	67	172
Did not audit issuers	184	230	10	98
Total	310	630	77	270

The following table presents the number of firms inspected during 2017, 2016, 2015 and five firms inspected during 2014, the number of audits covered by the inspections, and the number of attestation engagements covered by the inspections by whether the firms audited broker-dealers that filed compliance reports or only audited broker-dealers that filed exemption reports:

Firms	Number of Firms Inspected	Number of Audits	Number of Examinations	Number of Reviews
Audited broker-dealers that filed compliance reports	46	176	77	99
Only audited broker-dealers that filed exemption reports	158	173	N/A	171
Total[147]	202[148]	349	77	270

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The following tables present the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers that filed either a compliance report or an exemption report, stratified by the type of report filed and whether the broker-dealer did or did not claim exemption from Rule 15c3-3, as applicable since the inception of the interim inspection program:

Broker-Dealer Filed[149]	Number of Attestation Engagements	Range of Minimum Net Capital Requirements	Range of Actual Net Capital Reported at Fiscal Year End[150]
Compliance report	77	\$100,000 - \$1,500,000,000	\$300,000 - \$11,000,000,000
Exemption report	270	\$5,000 - \$82,000,000	\$6,000 - \$300,000,000

Broker-Dealer	Number of Audits	Range of Minimum Net Capital Requirements	Range of Actual Net Capital Reported at Fiscal Year End
Did not claim exemption	146	\$100,000 - \$2,050,000,000	\$300,000 - \$16,000,000,000
Claimed exemption[151]	484	\$5,000 - \$82,000,000	\$6,000 - \$2,250,000,000

The following table presents the number of registered public accounting firms that issued audit reports on the financial statements of brokers-dealers that were filed for fiscal periods ended during 2017, 2016, and 2015.

Number of Broker-Dealer Audits per Firm	2017		2016		2015	
	Number of Firms[152]	Number of Broker-Dealers	Number of Firms	Number of Broker-Dealers	Number of Firms	Number of Broker-Dealers
1	144	144	155	155	199	199
2 to 20	259	1,454	286	1,484	307	1,639
21 to 50	24	751	23	715	22	772
51 to 100	9	633	9	666	8	599
More than 100	5	729	5	708	5	749
Total	441	3,711	478	3,728	541	3,958

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Endnotes

1 On June 14, 2011, the Board adopted Rule 4020T to establish an interim inspection program related to the audits of broker-dealers. See PCAOB Release No. 2011-001 (June 14, 2011). The SEC approved this rule on August 18, 2011. See Exchange Act Release No. 65163 (August 18, 2011).

2 Hereinafter, the use of the term "broker-dealer" refers to entities that are registered with the SEC as both a broker and a dealer and to entities that are registered as only one or the other.

3 Hereinafter, the use of the terms "firm" or "firms" refers to public accounting firms registered with the PCAOB.

4 Appendix B includes information regarding firms that performed audit and attestation engagement of broker-dealers, and the selection of firms for inspection and the audit and attestation engagements covered by the inspections during 2017.

5 Findings described in this section of the report relate to violations of SEC independence rules. Deficiencies related to non-compliance with PCAOB Rule 3526, *Communication with Audit Committees Concerning Independence* ("Rule 3526"), are described in the "Independence Communications to the Audit Committee (or equivalent)" section of this report.

6 For purposes of this report, firms that also audited issuers are those firms subject to regular inspection according to the frequency set forth by the Board in Rule 4003.

7 See question 4 in the Other Matters section of the Office of the Chief Accountant's *Application of the Commission's Rule on Auditor Independence Frequently Asked Questions*, available at: https://www.sec.gov/info/accountants/ocafaqaudind121304.htm.

8 The focus areas were selected for the inspections individually based on risk factors, including past inspection experience.

9 Appendix A provides a summary of the results of inspections under the interim inspection program during 2017, 2016, and 2015 of audits and attestation engagements required to be performed in accordance with PCAOB standards.

10 Some focus areas listed in the table for 2017 and 2016 were not covered by, or applicable to, all audits covered by the inspections.

11 Id.

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12 See Exchange Act Rule 15c3-1, *Net Capital Requirements for Brokers or Dealers* ("Rule 15c3-1" or the "Net Capital Rule").

13 See Exchange Act Rule 15c3-3, *Customer Protection – Reserves and Custody of Securities* ("Rule 15c3-3" or the "Customer Protection Rule").

14 As used in Rule 3526, "audit committee" means a committee (or equivalent body) established by and among the board of directors of an entity for the purpose of overseeing the accounting and financial reporting processes of the entity and audits of the financial statements of the entity, or, in the absence of such a body, the entire board of directors of the entity. For audits of non-issuers with respect to which no such committee or board of directors (or equivalent body) exists, "audit committee" means the person(s) who oversee(s) the accounting and financial reporting processes of the entity and audits of the financial statements of the entity. See PCAOB Rule 3501(a)(v).

15 See AS 2110.07 through .17.

16 See AS 2110.18 through .40, .68, and .72.

17 See AS 2110.59.

18 See AS 2301.16 and .18.

19 See paragraphs .25 through .27 of AS 1105, *Audit Evidence*.

20 See AS 2601.11.

21 See AS 2601.16.

22 See AS 2601.14.

23 See AS 1105.10. Also, see the PCAOB's *Staff Guidance for Auditors of SEC-Registered Brokers and Dealers*, when using information produced by a service organization.

24 See AS 1105.10.

25 See AS 2110.68 and paragraph .83 of AS 2401, *Consideration of Fraud in a Financial Statement Audit*.

26 See AS 2110.54.

27 See AS 2401.60.

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28 See AS 2401.61.

29 Id.

30 See AS 2301.13.

31 See Exchange Act Rule 15a-6, *Exemption of Certain Foreign Brokers or Dealers* ("Rule 15a-6").

32 See ASC 205-40-50, *Presentation of Financial Statements – Going Concern – Disclosure*.

33 See AS 2810.30 and .31. Also, see paragraph (d)(2)(i) of Rule 17a-5, *Reports to be Made by Certain Brokers and Dealers* ("Rule 17a-5"), which requires that the financial statements in a broker-dealer's financial report be prepared in accordance with GAAP.

34 See ASC 940-320-45, *Financial Services – Brokers and Dealers – Investments – Debt and Equity Securities – Other Presentation Matters*.

35 See ASC 505-10-45, *Equity – Overall – Other Presentation Matters*.

36 See ASC 605-45-45, *Revenue Recognition – Principal Agent Considerations – Other Presentation Matters*.

37 See ASC 946-320-35, *Financial Services – Investment Companies – Investments – Debt and Equity Securities – Subsequent Measurement*.

38 See ASC 220-10-S99, *Income Statement – Reporting Comprehensive Income – Overall – SEC Materials*.

39 See Rule 17a-5(d)(2)(i), which requires the financial statements to be presented in a format that is consistent with the FOCUS report Part II or Part IIA.

40 See AS 2410.04.

41 See AS 2410.05 through .07.

42 See AS 2410.11.

43 See AS 2301.16.

44 See AS 1105.10

45 See AS 2410.18.

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46 See AS 2410.14.

47 See AS 2410.15.

48 See AS 2502.09 through .14.

49 See AS 2502.26 through .42.

50 See AS 2110.18 through .40 and .72.

51 See AS 2110.59.

52 See AS 1105.25 through .27.

53 See AS 2301.45.

54 See AS 1105.10.

55 See Appendix D of Rule 15c3-1.

56 See Rule 15c3-1(c)(2)(i)(F). In addition, Financial Industry Regulatory Authority ("FINRA") Notice to Members 03-63, *Expense-Sharing Agreements*, provides guidance to broker-dealers regarding the net capital computation when liabilities associated with business expenses have been assumed by another party.

57 Rule 15c3-1(c)(2)(iv)(C) provides that commissions receivable from other broker-dealers that are outstanding longer than 30 days from the date they arise are non-allowable assets.

58 See FINRA Interpretations of Financial and Operational Rules ("FINRA Interpretation") 15c3-1(c)(2)(iv)(C)/09.

59 See Rule 15c3-1(c)(2)(vi).

60 Id.

61 See AS 2701.04(e).

62 See Rule 15c3-1(c)(2)(ix).

63 See FINRA Interpretation 15c3-1(c)(2)(iv)(B)/08 and /09.

64 See Rule 15c3-1(c)(2)(xiv).

65 See AS 2701.05.

66 See AS 2701.04(b).

67 See Rule 15c3-1(c)(2)(vii).

68 The supplemental information required by Rule 17a-5(d)(2)(ii) consists of supporting schedules that present the reserve requirements computation under Exhibit A of Rule 15c3-3, which include the customer reserve computation and the proprietary securities account of a broker-dealer ("PAB account") reserve computation, and information relating to requirements for possession or control of securities under Rule 15c3-3.

69 See AS 2701.04(e).

70 Id. Also, refer to the "Auditing Revenue" section of this report for discussion regarding auditing information produced by service organizations and by the broker-dealer.

71 See Exhibit A of Rule 15c3-3.

72 Rule 15c3-3(b)(1) requires a broker-dealer to promptly obtain and maintain the physical possession or control of all fully-paid securities and excess margin securities carried by the broker-dealer for the accounts of customers.

73 See FINRA Interpretation 15c3-3(c)(1)/041.

74 See Rule 15c3-3(e)(1). Broker-dealers that do not claim exemption from Rule 15c3-3 are generally required to maintain a bank account for the exclusive benefit of customers that is referred to in this report as a "special reserve bank account."

75 See AS 2701.05.

76 See AS 2701.10.

77 Portions of AS 3101, *Reports on Audited Financial Statements* ("AS 3101"), were replaced and renamed AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*. Audits covered by the 2017 inspections were governed by AS 3101 in effect prior to being replaced and renamed and references in this report refer to the prior standard. See AS 3101.08.

78 See AS 3101.06 and .08.

79 See paragraph .01 of AS 3110, *Dating of the Independent Auditor's Report*, and AS 2701.12.

80 See AS 1215.13.

81 See AS 1215.12.

82 See AS 1215.14 and .15.

83 See AS 1215.16.

84 See AS 1220.01.

85 See AS 1220.10.

86 See AS 1220.03. In addition, because the engagement quality review is intended to be an objective second look at work performed by the engagement team, the reviewer should be able to withstand pressure from the engagement partner or other firm personnel, such as members of the firm's national office. When considering an outside individual for the role of engagement quality reviewer, the firm will likely need to make additional inquiries to obtain necessary information about the individual's qualifications. See PCAOB Release No. 2009-004 (July 28, 2009).

87 See AS 1220.05.

88 See AS 2301.32 and .34.

89 See AS 1305.01 through .03.

90 Id.

91 Deficiencies described in this section of the report only relate to non-compliance with PCAOB Rule 3526. Independence findings related to violations of SEC independence rules are described in the "Independence Findings" section of this report.

92 See Rule 3526(b)(3).

93 See Rule 17a-5(d)(1)(i)(B). Also, see Rule 17a-5(d)(3) and (4).

94 See Rule 17a-5(d)(1)(i)(C).

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95 See Rule 17a-5 (g)(2)(i) and (ii). The auditor must also undertake to prepare a report based on an examination of the financial report in accordance with PCAOB standards. See Rule 17a-5(g)(1).

96 See AT No. 1.08 and AT No. 2.07.

97 See paragraph (e) of Rule 15c3-3 (the "Reserve Requirements Rule") that describes the requirements for broker-dealers related to special reserve bank accounts.

98 See AT No. 1.09 and .10.

99 See Exchange Act Release No. 34-70073 for the adopting amendments to Rule 17a-5. As used in that release, the term "financial responsibility rules" is used in this report to refer to the Net Capital Rule, the Customer Protection Rule, Exchange Act Rule 17a-13, *Quarterly Security Counts to be Made by Certain Exchange Members, Brokers and Dealers* ("Rule 17a-13"), and any rule of a designated examining authority that requires the broker-dealer to periodically send account statements to customers.

100 See AT No. 1.11.

101 See AT No. 1.13.

102 See Rule 15c3-3(e)(3)(i).

103 See AT No. 1.12.

104 See AT No. 1.13.

105 See Rule 15c3-3(c).

106 See FINRA Rule 2340, which is one example of a rule of a designated examining authority that requires account statements to be sent to a broker-dealer's customers.

107 See Rule 17a-13(b)(3).

108 See Rule 17a-13(d).

109 See AT No. 1.21.

110 See Exhibit A of Rule 15c3-3.

111 See Rule 15c3-1(c)(2)(iv)(B).

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112 See AT No. 1.21(d).

113 See Rule 15c3-3(f).

114 See AT No. 1.26.

115 See FINRA Interpretation 15c3-3(c)(1)/04. Also, see FINRA Interpretation 15c3-3(c)(1)/041 that states that in order for mutual fund custody accounts to be considered good control locations, the fund must provide the broker-dealer acknowledgment letters to demonstrate that there are no liens against the securities.

116 See AT No. 1.32.

117 See AT No. 2.05(b).

118 See AT No. 2.10(b) through .10(d).

119 See AT No. 2.10(g).

120 Hereinafter referred to as a "Special Account." See Rule 15c3-3(k)(2)(i) and Rule 15c3-3(f).

121 See AT No. 2.10(h).

122 See FINRA Rule 2330.

123 See AT No. 2.13 and .14.

124 See AT No. 1.36.

125 See AS 1215.13.

126 See AS 1220.18A and .18B.

127 See AT No. 2.16 and .18.

128 See AS 1215.13.

129 See AS 1215.14 and .15.

130 See AS 1220.18A and .18B.

131 Fifty-four of the 310 firms have been inspected more than once. The 409 inspections include the inspection of 10 firms reported in the first annual report,

43 firms reported in the second annual report, 60 firms reported in the third annual report, 66 firms reported in the fourth annual report, five firms reported in the January 28, 2015 supplemental report, 75 firms reported in the fifth annual report, 75 firms reported in the sixth annual report, and 75 firms inspected in 2017.

132 For four of the 351 audits covered by the inspections, the broker-dealers did not file either a compliance report or an exemption report.

133 For purposes of this Appendix, not all areas were included for, or applicable to, each broker-dealer audit included in the inspections. Focus areas are determined on an individual inspection basis and based on several risk factors, including past inspection experience.

134 This was the third inspection year in which all audits and the related attestation engagements were required to be performed in accordance with PCAOB standards and amended Rule 17a-5.

135 Included in the 2015 results discussed in all tables throughout this Appendix are inspections performed during 2014 of five firms covering portions of five audit and four attestation engagements that were required to be performed under PCAOB standards.

136 The 2017 and 2015 results in these tables are for 115 and 119 audits, respectively, as one broker-dealer in each of 2017 and 2015 did not file either a compliance or an exemption report and was audited by a firm that only audited the one broker-dealer. The 2017 and 2015 results in these tables are for 114 and 118 attestation engagements, respectively, as two broker-dealers in each of 2017 and 2015 did not file either a compliance or an exemption report.

137 Five broker-dealers that did not claim exemption from Rule 15c3-3 filed an exemption report.

138 Information about the number of firms that performed audit and attestation engagements for broker-dealers and their engagements is based on financial statements filed through May 15, 2018, for fiscal years ended during the period from July 1, 2016 through June 30, 2017. These firms were registered with the PCAOB at the time their audit and attestation reports were issued.

139 Information about the firms that audited issuers is derived from data on audit reports issued from April 1, 2016 through March 31, 2017 obtained from the firms' annual reports on Form 2. PCAOB Rule 2201 requires each firm to file an annual report on Form 2 by June 30 of each year. The report covers the twelve-month period ending March 31. Information about the number of firms that

performed audit and attestation engagements for broker-dealers and the number of these engagements is based on financial statements filed through May 15, 2018, for fiscal years ended during the period from July 1, 2016 through June 30, 2017. These firms were registered with the PCAOB at the time their audit and attestation reports were issued.

140 One of the firms inspected only audited one broker-dealer and that broker-dealer did not file either a compliance report or an exemption report. The firm and the audit are not included in this table.

141 The results are for 114 attestation engagements as two broker-dealers did not file either a compliance or an exemption report.

142 Excluded from the range of actual net capital reported at fiscal year end in this table and the following table is one instance of reported negative net capital.

143 The number of attestations includes one broker-dealer that did not claim exemption from Rule 15c3-3 but filed an exemption report.

144 The number of audits includes one broker-dealer that did not claim exemption from Rule 15c3-3 but filed an exemption report.

145 One firm that audited one broker-dealer was inspected more than once.

146 The sum of the number of firms inspected does not add to 321 because of 11 firms that were inspected more than once are reported in multiple stratifications due to a change in the number of broker-dealer audits performed by the firms.

147 Two of the firms inspected only audited one broker-dealer and those broker-dealers did not file either a compliance report or an exemption report. The firms and audits are not included in this table. In addition, another two broker-dealers did not file either a compliance or an exemption report.

148 The number of firms inspected does not add to 204 because two firms that were inspected more than once are included in both stratifications.

149 For four of the 351 audits covered by the inspections, the broker-dealers did not file either a compliance report or an exemption report. These four broker-dealers had minimum net capital requirements ranging from $5,000 to $250,000 and actual net capital reported at year end ranging from approximately $20,000 to $600,000, respectively.

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150 Excluded from the range of actual net capital reported at fiscal year end in this table and the table that follows are two and three instances of reported negative net capital, respectively.

151 The number of audits includes the audits of three broker-dealers that claimed exemption from Rule 15c3-3 for certain portions of their business and did not claim exemption for other portions of their business.

152 Information in this table about the number of firms that audited broker-dealers and their broker-dealer audits is based on financial statements filed through May 15, 2018, 2017, and 2016 for fiscal years ended during 2017, 2016, and 2015, respectively. These firms were registered with the PCAOB at the time the audit reports were issued.