



## RELEASE

### Public

Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 32 in the subject or reference line. Comments should be received by the Board no later than February 15, 2011.

### Board

Contacts: Michael Stevenson, Deputy General Counsel (202/207-9054, [stevensonm@pcaobus.org](mailto:stevensonm@pcaobus.org)); Robert E. Burns, Associate General Counsel (202/207-9153, [burnsr@pcaobus.org](mailto:burnsr@pcaobus.org)).

### I. Introduction

The Sarbanes-Oxley Act of 2002 ("the Act"), as originally enacted, made it unlawful for public accounting firms that were not registered with the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer (generally defined to encompass most public companies the securities of which trade in U.S. capital markets<sup>1/</sup>). The Act also authorized and charged the Board to carry out a range of oversight responsibilities related to issuer audits. Those responsibilities include conducting a program of inspections of registered public accounting firms in connection with their performance of audits, issuance of audit reports, and related

---

<sup>1/</sup> As defined in Section 2(a)(7) of the Act, "issuer" means an issuer (as defined in Section 3 of the Securities Exchange Act of 1934 ("Exchange Act")) the securities of which are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 and that it has not withdrawn.

## RELEASE

matters involving issuers.<sup>2/</sup> The Board has been conducting such a program for several years.<sup>3/</sup>

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>4/</sup> amended various provisions of the Act ("the Dodd-Frank amendments"). Among other things, the Dodd-Frank amendments gave the Board oversight authority with respect to audits of brokers and dealers that are registered with the Securities and Exchange Commission ("Commission"). Specifically, the Dodd-Frank amendments provide the Board with authority to carry out the same oversight responsibilities it has carried out with respect to issuer audits – standards-setting, inspections, and investigations and disciplinary proceedings – in connection with registered public accounting firms' audits of brokers and dealers.<sup>5/</sup> The legislative history notes that this new authority "enables the PCAOB to use its inspection and disciplinary processes to identify auditors that lack expertise or fail to exercise care in broker and dealer audits, identify and address deficiencies in their practices, and, where appropriate, suspend or bar them from conducting such audits."<sup>6/</sup>

---

<sup>2/</sup> See Section 104(a)(1) of the Act (originally Section 104(a) of the Act).

<sup>3/</sup> Information about the Board's inspection program related to audits of issuers, including rules, general reports, and the public portions of reports on inspections of individual firms, is available at [pcaobus.org/Inspections/Pages/default.aspx](http://pcaobus.org/Inspections/Pages/default.aspx).

<sup>4/</sup> Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

<sup>5/</sup> The Dodd-Frank amendments to Section 102(a) of the Act also expanded the Act's registration requirement by making it unlawful for any person that is not a registered public accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any broker or dealer. Even before the Dodd-Frank amendments, however, Section 17(e)(1)(A) of the Exchange Act, as amended in 2002, required that the balance sheets and income statements filed with the Commission by registered brokers or dealers be certified by a public accounting firm registered with the PCAOB.

<sup>6/</sup> S. Rep. No. 176, 111<sup>th</sup> Cong., 2d Sess. (April 30, 2010) at 154.

## RELEASE

The Dodd-Frank amendments do not prescribe a specific program of inspection of registered public accounting firms that provide audit reports for a broker or dealer. Rather, the Dodd-Frank amendments authorize the Board to establish such a program by rule,<sup>7/</sup> and leave to the Board important questions concerning the elements of the program. Among other things, Section 104(a)(2) of the Act, as amended, (1) provides that, in establishing the program, the Board may allow for differentiation among classes of brokers and dealers; (2) requires that the Board consider whether differing inspection schedules would be appropriate with respect to auditors that issue audit reports only for brokers or dealers that do not receive, handle, or hold customer securities or cash or are not members of the Securities Investor Protection Corporation; and (3) provides that if the Board exempts any public accounting firm from such an inspection program, the firm would not be required to register with the Board.

The Board intends to take a careful and informed approach to those questions in establishing a permanent inspection program for auditors of brokers and dealers. In doing so, the Board will be guided by the Act's core directive to the Board: "to oversee the audit of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports."<sup>8/</sup>

Establishing the elements of an inspection program that appropriately protects and furthers those interests necessarily involves consideration of potential costs and regulatory burdens that would be imposed on different categories of registered public accounting firms and classes of brokers and dealers. The Board does not intend to attempt to make the judgments necessary to establish a permanent program of inspection without first gathering and assessing relevant information. At the same time, some exercise of this new inspection authority may serve the investor protection and public interests described above even before fully informed judgments can be made about all elements of a permanent program.

---

<sup>7/</sup> Section 104(a)(2)(A) of the Act, as amended.

<sup>8/</sup> Section 101(a) of the Act, as amended. In connection with expanding the Board's authority to encompass audits of brokers and dealers, the quoted language's reference to "companies" replaced the Act's original, narrower reference to "companies the securities of which are sold to, and held by and for, public investors."

## RELEASE

Accordingly, the Board is proposing a temporary rule that would establish an interim program of inspection related to audits of brokers and dealers. An interim inspection program would both allow the Board to begin inspection work without delay and provide a source of information to help guide decisions about the scope and elements of a permanent program.

### II. The Proposed Interim Inspection Program

The interim program would have two purposes. First, it would enable the Board to begin the work of assessing the degree of compliance of registered public accounting firms and their associated persons with the Act, the Board's rules, the Commission's rules, and professional standards in connection with the performance of audits, issuance of audit reports, and related matters involving brokers and dealers. Second, it would inform the Board's eventual determinations about the elements of a permanent program, including whether and how to differentiate among classes of brokers and dealers, whether to exempt any category of public accounting firm, and the establishment of minimum inspection frequency schedules.<sup>9/</sup>

#### A. Scope, Focus, and Duration of the Interim Program

To inform the Board's determinations about a permanent program, the interim program would include within its scope all categories of registered public accounting firms that audit brokers and dealers and all classes of securities brokers and dealers audited by them. The inclusive scope of the interim program, though, should not be construed as either foreshadowing the likely scope of a permanent program or suggesting that every broker or dealer auditor will be subject to inspection procedures as part of the interim program.

---

<sup>9/</sup> Any temporary rule that the Board adopts for an interim program would take effect only if approved by the Commission. Before later adopting any final rules for a permanent program of inspection, the Board would seek public comment on proposed rules for such a program. Final rules for a permanent program would take effect only if separately approved by the Commission, a process that typically includes a separate round of public notice and comment.

## RELEASE

The inspection procedures performed in the interim program would be carried out in accordance with, and subject to, the provisions of Section 104 of the Act.<sup>10/</sup> The substantive focus of those procedures will be on compliance with applicable Board and Commission rules and professional standards. At this time, the standards that apply to audits of brokers and dealers have not changed from what they were before the Dodd-Frank amendments. The Commission has provided transitional guidance on this point, stating that "references in Commission rules and staff guidance and in the federal securities laws to GAAS [Generally Accepted Auditing Standards] or to specific standards under GAAS, as they relate to non-issuer brokers or dealers, should continue to be understood to mean auditing standards generally accepted in the United States of America, plus any applicable rules of the Commission."<sup>11/</sup>

The Board recognizes that the applicable standards refer to the role of interpretive publications, including auditing guidance in Audit and Accounting Guides published by the American Institute of Certified Public Accountants ("AICPA"), and that the AICPA publishes an Audit and Accounting Guide on Brokers and Dealers in Securities. The standards state that such publications "are not auditing standards" but are "recommendations on the application of the [auditing standards] in specific circumstances, including engagements for entities in specialized industries."<sup>12/</sup> The standards also provide, however, that the auditor "should be aware of and consider"

---

<sup>10/</sup> Among other things, this means that the confidentiality provisions of Sections 104(g)(2) and 105(b)(5) of the Act will apply, as will the provisions for a firm to review and respond to a draft inspection report (Section 104(f)) and to seek Commission review of certain matters (Section 104(h)). Additional issues related to inspection reports are discussed below.

<sup>11/</sup> Exchange Act Rel. No. 62991 (September 24, 2010). The release includes a footnote, immediately following the phrase "auditing standards generally accepted in the United States of America" quoted above, that reads "Audit and attestation standards established by the AICPA." The release also notes that "[m]any parts of Commission rules and staff guidance related to obligations of brokers and dealers refer to GAAS and contain requirements for audits to be conducted in accordance with GAAS." *Id.* at 2 n.5 (citing, e.g., Rule 17a-5(g)(1) under the Exchange Act).

<sup>12/</sup> Statement on Auditing Standards No. 98, AU § 150.05.

## RELEASE

applicable interpretive publications and that an auditor who does not apply the published interpretive guidance "should be prepared to explain how he or she complied with the [auditing standards] addressed by" the guidance.<sup>13/</sup>

In assessing compliance during an interim inspection program, the Board would take appropriate account of the interpretive guidance. The Board anticipates that an important benefit of an interim inspection program would be to afford the Board a broad view of what actual practice has been in light of the guidance.

In addition, the Board expects that the rules and standards governing broker-dealer audits will evolve during the interim inspection program. The requirement today for brokers and dealers to include audited financial statements in the annual reports they make with the Commission derives from Commission Rule 17a-5 under the Exchange Act, *Reports to be Made by Certain Brokers and Dealers* ("Rule 17a-5"). That rule requires, among other things, that the audit include a review of the accounting system, a review of the internal accounting control and procedures for safeguarding securities, and all procedures necessary to enable the auditor to express an opinion on the following:

- the statements of financial condition, results of operations, and cash flows;
- the computation of net capital pursuant to Rule 15c3-1 under the Exchange Act;
- the computation for determination of reserve requirements pursuant to Exhibit A to Rule 15c3-3 under the Exchange Act; and
- information relating to the possession or control requirements under Rule 15c3-3.<sup>14/</sup>

---

<sup>13/</sup> Statement on Auditing Standards No. 95, AU § 150.06.

<sup>14/</sup> See generally Letter of November 18, 2010, from Robert W. Cook, Director, Commission's Division of Trading and Markets, and James L. Kroeker, Chief Accountant, Commission's Office of Chief Accountant, to AICPA Stockbrokerage and Investment Banking Expert Panel (available on the Commission's web site at <http://sec.gov/news/whatsnew/wn111810.shtml>).



## RELEASE

The Commission has announced its intention to propose amendments to update and strengthen Rule 17a-5.

The Board also has authority to establish, subject to approval by the Commission, professional standards and rules applicable to audits of brokers and dealers. The Board intends to adopt such standards, and related rules,<sup>15/</sup> informed at least in part by information gathered early in the interim inspection program. In particular, the Board is evaluating whether to issue or amend auditing or attestation standards to provide specific procedures regarding the regulatory reports required under SEC Rule 17a-5, such as, among other things, the reports on internal accounting controls and on the procedures for safeguarding customer securities, and the computation of net capital.<sup>16/</sup> The Board anticipates that relevant PCAOB standards and rule amendments, if approved by the Commission to supplant the currently applicable standards, will eventually take effect for audits that will be subject to review as part of, though near the end of, the interim inspection program.

The proposed temporary rule would make cooperation with Board inspection procedures under the interim program mandatory for registered firms and their associated persons. Even before any such rule takes effect, however, the Board expects to be able to conduct relevant procedures with the voluntary cooperation of certain firms. Subject to consideration of comments on the proposed temporary rule, the Board anticipates that it would adopt a version of the temporary rule in 2011 and, if the Commission approves the rule, carry out procedures under the interim program in

---

<sup>15/</sup> Current Board rules applicable to the conduct of audits are typically framed in terms of audits of issuers, either specifically or by incorporating other terms that are defined by reference to issuers. This should not be understood generally to mean, however, that the Board's current rules do not apply to registered public accounting firms that audit brokers or dealers, or that those rules have no application at all to audits of brokers or dealers. The applicability of any Board rule must be judged on its specific terms. Firms that are registered with the Board solely because they audit brokers or dealers have, for example, the same obligations as issuer auditors to comply with Board rules on annual and special reporting (Rules 2200-2207).

<sup>16/</sup> See Broker-Dealer Audit Considerations (PCAOB Staff Briefing Paper for the Board's Standing Advisory Group) (July 15, 2010) at 4 (available at on the Board's web site at [pcaobus.org/News/Events/Pages/07152010\\_SAGMeeting.aspx](http://pcaobus.org/News/Events/Pages/07152010_SAGMeeting.aspx)).



## RELEASE

2011 and 2012 and possibly into 2013. At that point, the Board anticipates being in a position to propose rules for a permanent program.

### B. Reporting and Related Matters

The proposed temporary rule provides that no less frequently than every twelve months, beginning twelve months after the date the rule takes effect and continuing until rules for a permanent program take effect, the Board will publish a report on the interim program. Each report would describe the progress of the interim program and any significant observations that either may bear on the Board's consideration of a permanent program or the publication of which may otherwise be appropriate to protect the interests of investors or to further the public interest. As is typical of Board inspection reports, consistent with restrictions imposed by the Act,<sup>17/</sup> the reports would not identify brokers or dealers the audits of which are the subject of observations described in the report. As is also typical of general Board reports collecting observations from numerous inspections, the reports would not identify the registered public accounting firm or firms to which the observations relate.

As with any Board inspection, the inspection procedures would involve identifying audit deficiencies and bringing them to the firm's attention with the expectation that the firm will address the deficiencies and take steps to avoid future such deficiencies. The Board would also report to the Commission, and could report to certain other authorities (including the Financial Industry Regulatory Authority ("FINRA")), information suggesting violations of law or rules by brokers and dealers.<sup>18/</sup> In addition, if appropriate, information obtained through the interim program could lead the Board to commence an investigation or disciplinary proceeding concerning the conduct of a registered public accounting firm or associated persons of such firms.<sup>19/</sup>

---

<sup>17/</sup> See Section 105(b)(5)(A) of the Act; See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004) ("Statement Concerning Inspection Reports") at 4-6.

<sup>18/</sup> See Section 104(c) of the Act and PCAOB Rule 4004; see also Section 105(b)(5)(B)(V) of the Act, as amended.

<sup>19/</sup> The Board intends to propose comprehensive conforming amendments to align its existing rules with the Dodd-Frank amendments. In the interim, the proposed rule for an interim inspection program would incorporate in the Board's rules on

## RELEASE

The Board would also issue firm-specific inspection reports that encompass inspection procedures performed as part of the interim program, although the Board would expect to do so only after rules for a permanent program take effect. The Board expects inspection procedures performed on a firm as part of the interim program to constitute a foundational portion of the first inspection of the firm's broker and dealer audit practice, which eventually would be completed and encompassed within a firm-specific inspection report following the establishment of the permanent program if the firm is included in the permanent program.<sup>20/</sup> During the interim program, the Board will be obtaining a broad view of practice under current standards and interpretive guidance, and at the same time the standards and rules applicable to the audits will be evolving. Having both that broad view and the new standards as a foundation will be helpful to making consistent and meaningful evaluations of the types of quality control issues that, going forward, firms need to address in their practices related to audits of brokers and dealers.<sup>21/</sup>

---

investigations and adjudications the revised definitions of "audit," "audit report," and "professional standards" now found in Section 110 of the Act. This will make clear that the Board's enforcement rules – which encompass, among other things, "the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto" – will encompass the obligations of auditors with respect to audit reports for brokers and dealers, such as those obligations set out in Rule 17a-5. Information about Board investigations and disciplinary proceedings is subject to restrictions on public disclosure, as described in Sections 105(b)(5), 105(c)(2), and 105(d)(1)(C) of the Act, unless and until a Board-imposed sanction takes effect. See Statement Concerning Inspection Reports at 8-9.

<sup>20/</sup> If the Board exempts a firm from the permanent program, the Board would not issue an individual report on the interim program's procedures concerning that firm, principally because a complete inspection of the firm, including finalizing consideration of the sufficiency of the firm's quality control system in light of the inspection observations, would not have been conducted.

<sup>21/</sup> While the interim program is in place, a Board inspection of a firm that performs audit work for issuers and for brokers or dealers would include the full, regular inspection – including the firm-specific inspection report – of the firm's issuer practice. Such an inspection could also include inspection procedures under the interim program with respect to the firm's broker and dealer practice, but the Board would not expect to incorporate any evaluation of the firm's broker and dealer practice into the public portion

## RELEASE

### III. Request for Public Comment

Interested persons are encouraged to submit their views to the Board. The Board seeks comment on all aspects of the proposal. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 32 in the subject or reference line and should be received by the Board no later than February 15, 2011. The Board will consider all timely comments.

On the 14th day of December, in the year 2010, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour  
Secretary

December 14, 2010

Appendix –

Proposed Rule Amendments

---

of a firm-specific report before the first inspection of the firm that occurs after a permanent program takes effect. Nothing in the temporary rule, however, would necessarily preclude the Board from issuing a firm-specific inspection report on, or including, inspection observations from the interim program before a permanent program takes effect.

Appendix – Proposed Rule Amendments

The Board proposes to amend Section 1 of its rules by adding notes following Rules 1001(a)(v), 1001(a)(vi), and 1001(p)(vi), and Section 4 of its rules by adding Rule 4020T. The text of the proposed notes and proposed Rule is set out below.

**RULES OF THE BOARD**

**SECTION 1. GENERAL PROVISIONS**

\* \* \*

**Rule 1001. Definitions of Terms Employed in Rules**

\* \* \*

**(a)(v) Audit**

\* \* \*

Note: Effective [insert effective date of Rule 4020T], pursuant to Rule 4020T, when used in Rule 3502, Section 5 of the Rules of the Board, or the definition of "disciplinary proceeding" in Rule 1001(d)(i), the term "audit" has the meaning provided in Section 110 of the Act.

**(a)(vi) Audit Report**

\* \* \*

Note: Effective [insert effective date of Rule 4020T], pursuant to Rule 4020T, when used in Rule 3502, Section 5 of the Rules of the Board, or the definition of "disciplinary proceeding" in Rule 1001(d)(i), the term "audit report" has the meaning provided in Section 110 of the Act.

\* \* \*

**(p)(vi) Professional Standards**

\* \* \*

Note: Effective [insert effective date of Rule 4020T], pursuant to Rule 4020T, when used in Rule 3502, Section 5 of the Rules of the Board, or the definition of "disciplinary proceeding" in Rule 1001(d)(i), the term

"professional standards" has the meaning provided in Section 110 of the Act.

\* \* \*

## **SECTION 4. INSPECTIONS**

\* \* \*

### **Rule 4020T. Interim Inspection Program Related to Audits of Brokers and Dealers**

#### **(a) Purposes of Interim Inspection Program**

This rule provides for an interim program of inspection in connection with audits of brokers and dealers in order, among other things –

(1) to assess the degree of compliance of registered public accounting firms and their associated persons with the Act, the Board's rules, the Commission's rules, and professional standards in connection with the performance of audits, issuance of audit reports, and related matters involving brokers and dealers;

(2) to inform the Board's consideration, in connection with establishing a permanent program of inspection to assess the matters described in paragraph (1), of –

- (i) whether to differentiate among classes of brokers and dealers;
- (ii) whether to exempt any category of public accounting firms; and
- (iii) the establishment of minimum inspection frequency schedules.

#### **(b) Definitions**

When used in this rule, the terms "broker" and "dealer" have the meaning provided in Section 110 of the Act, and "interim program," means the interim program of inspection described in paragraph (c). When used in this rule, Rule 3502, Section 5 of the Rules of the Board, or the definition of "disciplinary proceeding" in Rule 1001(d)(i), the terms "audit," "audit report," and "professional standards" have the meaning provided in Section 110 of the Act.

#### **(c) Interim Program of Inspection**

On an interim basis, the Board shall conduct a program of inspection, for the purposes described in paragraph (a), that may include inspection procedures to assess the policies, practices, and procedures of any registered public accounting firm related

to the performance of audits or the issuance of audit reports for any broker or dealer after July 21, 2010. The provisions of Rules 4000(b), 4000(c), 4004, 4006, and 4010 shall apply to the interim program.

**(d) Reporting**

No less frequently than every twelve months, beginning twelve months after the date this rule takes effect and continuing until rules for a permanent program of inspection in connection with audits of brokers and dealers take effect, the Board will publish a report that describes the progress of the interim program, including data about the number of registered public accounting firms and the number of broker or dealer audits that have been subjected to inspection procedures and any significant observations from those procedures.