

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

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Overview

This Annual Report on the Interim Inspection Program Related to Audits of Brokers and Dealers summarizes results from our inspections of firms during 2018. Under the interim inspection program, the Public Company Accounting Oversight Board – referred to in this report as the PCAOB or the Board – conducted inspections to assess firms’ compliance with applicable laws, rules, and professional standards when performing audit and attestation engagements for broker-dealers.

In addition to the Board’s issuance of this annual report, PCAOB inspections staff communicated the following, as applicable, to each inspected firm:

- Defects, or potential defects, in its system of quality control;
- Deficiencies in its audit of the financial statements and supporting schedules, and its examination and review attestation engagements; and
- Independence findings.

We observed that the percentage of deficiencies for audit and attestation engagements remained high and continued improvement is needed. We believe significant positive impact on audit quality can be achieved if:

- Auditors focus on improving their systems of quality control;
- Auditors advance their knowledge and understanding of PCAOB standards; and
- Auditors focus on improving their performance in testing internal controls when employing controls-reliance audit strategies and for examination engagements.

To drive improvement in audit quality, we are focused on not only detecting audit deficiencies, but also preventing them from occurring in the first place. In this report, we describe the deficiencies identified and provide insights into the standards, as well as examples of procedures that may be effective, depending on actual facts and circumstances, related to the deficiencies. Our goal is to assist audit firms as they assess and refine their audit practices to prevent similar deficiencies from occurring in the future. We believe this report will also assist broker-dealer owners and audit committees (or equivalents) when overseeing the work of their auditors.

Our inspection procedures and approach under the interim inspection program continues to evolve and the 2018 annual report has been refined to advance the Board’s goal of providing auditors and other stakeholders with information in a more accessible and useful manner. Our hope is that this new format and approach provides a clearer view of our 2018 inspections of auditors of broker-dealers.

2018 Inspections By the Numbers	
67	Firms inspected
3	with no deficiencies
105	Audit engagements
25	with no audit deficiencies
55	with audit and attestation deficiencies
25	with audit deficiencies, but no attestation deficiencies
24	Examination engagements
6	with no deficiencies
79	Review engagements
36	with no deficiencies

What is Included in this Report

This annual report includes the following:

- Observations from our inspections during 2018, insights into applicable standards, and examples of effective procedures;
- Information about the selection of firms and engagements for inspection (Appendix A); and
- Historical results from our inspections under the interim program (Appendix B).

2018 Inspections

In selecting the firms to inspect and the engagements for review, we used both risk-based and random selection methods. We made selections based on our evaluation of firms and engagements using various characteristics of the firms and the broker-dealers. We also selected a number of firms and engagements randomly.

We performed procedures to assess firms' systems of quality control and performed reviews of specific engagements. We did not review every aspect of the selected engagements. Rather, we typically focused our attention on the more complex, challenging, or subjective areas, or other areas that presented greater risk based on our evaluation. Our observations are specific to the particular portions of the engagements reviewed and are not representative of the entirety of the specific engagements.

The firms inspected and the audit and attestation engagements covered by our inspections are not necessarily representative of the population of firms or of the audit or attestation engagements of broker-dealers. Further, the populations of firms and broker-dealers are not homogeneous. Therefore, the quality control findings, audit and attestation deficiencies, and independence findings are not necessarily representative of the population of all firms that perform broker-dealer audits or of all broker-dealer audit and attestation engagements.

The deficiencies we identified do not necessarily indicate that the broker-dealer's financial statements, supporting schedules, or compliance or exemption reports are not fairly stated, in all material respects. It is often not possible for us to reach a conclusion on those points based on our inspection because we have only the information in the broker-dealer's filings and information obtained from the auditor.

Additional Information

The PCAOB's website includes [additional information and resources for auditors of broker-dealers](#), including previous annual reports, information about our outreach forums, staff inspection briefs, and more. To receive periodic updates from the PCAOB, [please join our mailing list](#).

We Want to Hear from You

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

System of Quality Control Observations

The PCAOB's quality control standards require firms to have a system of quality control that provides reasonable assurance that the firm's personnel comply with applicable professional standards and the firm's standards of quality.

The firm's system of quality control, among other things, should provide reasonable assurance that, for broker-dealer audit and attestation engagements:

- The firm assigns engagement partners with knowledge and experience in broker-dealer accounting and regulatory requirements and PCAOB audit and attestation standards;
- The firm assigns engagement quality reviewers that meet the qualifications required by PCAOB standards;
- Due professional care, including professional skepticism, is exercised by all auditors participating in audit and attestation engagements; and
- All significant findings and issues related to the audit and attestation engagements are identified and documented.

In addition, we believe that the following practices, if implemented by firms, may result in enhanced quality of broker-dealer audit and attestation engagements:

- Expanding accountability for audit quality beyond the lead engagement partner;
- Developing and refining guidance and training to help auditors identify and assess risks of material misstatement, and in particular, those specific to the broker-dealer audit and attestation engagements; and
- Providing additional experienced personnel and specialists not assigned to the audit or attestation engagement to perform independent reviews.

During our 2018 inspections, we identified defects and potential defects related to engagement performance and monitoring, which are two required elements of a system of quality control. In addition, certain engagement-specific deficiencies that are included in this report also indicated potential defects in the firm's system of quality control related to engagement performance.

The following observations are specific to the engagement performance and monitoring aspects of the system of quality control for certain firms, and indicate areas where firm controls were not effective.

Engagement Performance (QC 20)

Audit Methodology:

- Engagement teams established materiality levels that were too high to plan and perform audit procedures to detect misstatements that could be material to the financial statements because the firm's audit methodology did not require appropriate consideration of certain relevant factors. The methodology also did not sufficiently instruct engagement teams to evaluate whether a lower materiality level was needed for particular accounts.
- Engagement teams determined sample sizes that were too small to provide sufficient, appropriate audit evidence because the firm's audit methodology allowed engagement teams to determine samples for substantive tests of details that did not take into consideration tolerable misstatement and the allowable risk of incorrect acceptance.

Engagement Quality Review (AS 1220):

- Reviews were not performed;
- Reviewers had served as the engagement partner for the audit of the broker-dealer's financial statements for one or more of the previous two years, and therefore, did not meet the objectivity qualifications of an engagement quality reviewer; and
- Reviews did not include an evaluation of the engagement team's significant judgments and the related conclusions reached that formed the overall conclusion in the engagement report.

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

	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage
Audit Engagements	83	54	65%
Examination Engagements	19	5	26%
Review Engagements	51	22	43%

Auditor's Report (AS 3101):

- Audit reports were not prepared under the applicable auditing standard or did not accurately describe the financial reporting framework under which the broker-dealer's financial statements were prepared.

Audit Documentation (AS 1215):

- A complete and final set of audit documentation was not assembled for retention as of the documentation completion date, and any documentation added to the audit work papers subsequent to the report release date did not indicate the date the information was added, the name of the person who prepared the additional documentation, and the reasons for adding it.

Monitoring (QC 30)

A firm's internal inspections program did not detect certain audit deficiencies that we found when we subsequently reviewed the same audit work.

Attestation and Audit Engagements Observations

Attestation and audit engagements were found to be deficient when firms did not perform, or sufficiently perform, certain required procedures, or otherwise comply with the standards.

Deficiencies in Attestation Engagements

	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage
Examination Engagements	24	18	75%
Review Engagements	79	43	54%

Examination Engagements (AT No. 1)

The auditor performs an examination of statements made by the broker-dealer in its compliance report. The examination includes obtaining evidence about whether one or more material weaknesses existed in the broker-dealer's internal control over compliance ("ICOC") with the broker-dealer financial responsibility rules during, or as of the end of, the broker-dealer's most recent fiscal year. The examination also includes performing tests of the broker-dealer's compliance with the Net Capital Rule and paragraph (e) of the Customer Protection Rule (the "Reserve Requirements Rule") as of the end of the broker-dealer's fiscal year.

The following deficiencies were identified in the examination engagements:

Planning for the Examination:

Planning was not sufficient because the firms did not obtain an understanding, or a sufficient understanding, of certain of the financial responsibility rules or of the broker-dealer's processes, including relevant controls, regarding compliance with the financial responsibility rules.



Registered broker-dealers file annual reports that include a compliance report or an exemption report, along with the corresponding report by an independent public accountant.

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

Testing of Internal Controls over Compliance:

Testing of ICOC with the financial responsibility rules was not performed, or was not sufficient, including examinations in which no testing was performed of any ICOC related to one or more of the financial responsibility rules. The following were not tested, or not sufficiently tested:

- Management review controls, because a sufficient understanding was not obtained 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;
- Controls over the accuracy and completeness of information produced by either the broker-dealer or the broker-dealer's service organizations upon which the design and operating effectiveness of ICOC depended;
- Controls that were important to the auditor's conclusion about whether the broker-dealer maintained effective ICOC as of its fiscal year-end; and
- The design and operating effectiveness of information technology controls or automated controls important to the broker-dealer's ICOC.

Example of Effective Procedures

A broker-dealer relied on an automated securities movement and control system to identify segregation deficits by security CUSIP number. The auditor tested whether that system was programmed to properly calculate deficits pursuant to the Customer Protection Rule and tested the relevant information technology general controls. These procedures are not contemplated in isolation but rather in combination with other relevant procedures over the account or disclosure.



“Examples of Effective Procedures” provide brief scenarios and related examples of procedures that may be effective, depending on facts and circumstances, but do not modify or establish auditing or attestation standards. These procedures are not contemplated in isolation but rather in combination with other relevant procedures.

Firms also did not perform, or sufficiently perform, procedures to test important controls associated with the following processes related to compliance with the financial responsibility rules.

Financial Responsibility Rule	Processes Related to Compliance
Customer Protection Rule	<ul style="list-style-type: none"> ● Coding of accounts (i.e. customer, non-customer, or Proprietary Securities Account of a Broker-Dealer (“PAB account”)) used to determine amounts reported within the customer reserve and PAB account reserve computations ● Timing of deposits made to special reserve bank accounts ● Resolving deficits that required action by the broker-dealer within the required timeframe ● Maintaining custodial accounts free of any right, charge, security interest, lien, or claim
Quarterly Security Count Rule	<ul style="list-style-type: none"> ● Accounting for all securities subject to the broker-dealer’s control or direction, but not in its physical possession, and verifying all such securities in that status for more than 30 days ● Assigning appropriate personnel to make or supervise the quarterly security counts
Account Statement Rule	<ul style="list-style-type: none"> ● Delivering complete and accurate account statements, either electronically or by mail, to all customers

Performing Compliance Tests:

Example of Effective Procedures

An important control used by a broker-dealer for the Quarterly Security Count Rule was management's review of reconciliations of securities held by its custodians. For this control, an auditor obtained an understanding and tested the operating effectiveness of the review process through inquiry of management regarding their expectations for securities differences and procedures performed to account for and verify differences in accordance with the rule. The auditor also inspected documentation of management's review of the reconciliations and the verification procedures performed for the differences.

Tests for Compliance with the Net Capital Rule or the Reserve Requirements Rule as of the end of the broker-dealer's fiscal year were not performed, or were not sufficient, in the following areas:

- Tests of the accuracy and completeness of the information produced by the broker-dealer, or the broker-dealer's service organizations, that was used by the broker-dealer to prepare its schedules;
- Procedures to evaluate whether the amounts in the schedules were determined in accordance with the applicable rule; and
- Tests to determine whether the broker-dealer maintained a special reserve bank account for the exclusive benefit of its customers in accordance with the Reserve Requirements Rule.

Example of Effective Procedures

A broker-dealer maintained a special reserve bank account for the exclusive benefit of customers. When performing tests of compliance with the Reserve Requirements Rule, the auditor reviewed a letter issued by the bank and determined that the letter indicated that, among other terms, cash and qualified securities in this bank account were not subject to any right, charge, security interest, lien or claim of any kind in favor of the bank or any person claiming through the bank.

Evaluating Results of the Examination Procedures:

Evaluation of Results was not performed, or was not sufficient, to assess whether individually, or in combination with other deficiencies, one or more material weaknesses in ICOC existed.

Obtaining a Representation Letter:

Management Representations were not obtained in writing from the broker-dealer.

Review Engagements (AT No. 2)

The auditor must plan and perform the review engagement to obtain sufficient appropriate evidence to obtain moderate assurance about whether one or more conditions exist that would cause one or more of the broker-dealer's assertions not to be fairly stated, in all material respects. The auditor should coordinate the review engagement with the audit of the financial statements and supplemental information, taking into account relevant evidence from the audit when evaluating the results of the procedures performed in the review engagement.

Performing Review Procedures:

The following deficiencies were identified in the review engagements:

An Understanding of Exemption Provisions identified by the broker-dealer and other rules and regulations relevant to the broker-dealer's assertions in its exemption report, which is necessary to properly perform the review engagement, was not obtained, or was not sufficient.

Inquiries of Management were not sufficient to identify exceptions to the exemption provisions asserted by the broker-dealer, as all required inquiries, including those that involve obtaining an understanding of management's controls and monitoring activities in place to comply with the claimed exemption provisions, were not made.

Example of Effective Procedures

Auditors should make the inquiries required by AT No. 2 to identify exceptions to the exemption provisions. For a broker-dealer with branch locations where customer funds could be received, the auditor inquired of management regarding the broker-dealer's controls over prompt transmittal of customer funds and securities received at the head office and branch locations. The auditor documented its understanding of the design of those controls and how the controls sufficiently addressed risks associated with prompt transmittal.

Evaluation of Evidence obtained through the audit that contradicted the broker-dealer's assertion of compliance with the claimed exemption provision was not performed.

Example of Effective Procedures

During its audit of revenue, the auditor obtained evidence that the broker-dealer, in addition to its business of introducing customers to its clearing broker, sold mutual fund shares to customers directly from the funds and not through a clearing broker. This mutual fund business did not fall within the exemption claimed by the broker-dealer under paragraph (k)(2)(ii) of the Customer Protection Rule, as stated in the broker-dealer's exemption report. The auditor, therefore, performed additional review procedures to address this evidence that indicated the broker-dealer's exemption report may not be fairly stated.



Financial statement audit procedures that may provide evidence relevant to compliance with the exemption provision(s) from the Customer Protection Rule identified in the broker-dealer's exemption report include:

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

Evaluating the Results of the Review Procedures:

Evaluation of Results did not include consideration of information obtained that indicated that the broker-dealer's assertion regarding the claimed exemption provision may not be fairly stated, in all material respects.

Example of Effective Procedures

Auditors should perform additional procedures in response to information that indicates exceptions to the exemption provisions might exist, beyond those disclosed in the exemption report. The broker-dealer stated in its exemption report that it complied with the exemption provisions of paragraph (k)(2)(ii) of the Customer Protection Rule throughout the year without exception. The auditor, through inquiry of the individual at the broker-dealer responsible for forwarding customer funds received to the clearing broker, learned that customer funds are forwarded by noon of the next business day, unless this individual is not working on that day. The auditor inspected the broker-dealer's record of funds received and determined that several exceptions to the prompt transmittal requirements occurred during the year. The auditor informed management of the broker-dealer of the exceptions identified. Management of the broker-dealer confirmed these were exceptions and revised the broker-dealer's exemption report to include them.

Obtaining a Representation Letter:

Management Representations were not obtained in writing from the broker-dealer.

Reporting on the Review Engagement:

Auditor's Review Report inaccurately stated that the broker-dealer asserted in its exemption report that it met the identified exemption provision without exception when the broker-dealer did not make this assertion. In addition, review reports were dated prior to the date on which the firm had completed its review procedures.

Auditing Supporting Schedules (AS 2701)

The supporting schedules broker-dealers are required to include in their annual filings with the Securities and Exchange Commission (“SEC”) must be audited in accordance with AS 2701, which requires auditors to obtain sufficient appropriate audit evidence to express an opinion as to whether the supplemental information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Deficiencies in Auditing Supporting Schedules

	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage
Net Capital Rule	65	19	29%
Customer Protection Rule	25	9	36%

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

Net Capital Rule:

Computation of Net Capital - firms did not perform, or sufficiently perform, procedures to test whether the following aspects of net capital computations were determined in accordance with the Net Capital Rule:

- Minimum net capital requirements;
- Adjustments to net worth, such as the addition of certain liabilities, including discretionary liabilities;
- Allowable assets and assets not readily convertible into cash;
- Haircuts for securities positions, taking into account the relevant characteristics of the securities (for example, maturity dates), and whether undue concentration charges were necessary;
- Operational charges and other deductions, including failed foreign security transactions, stock loan or stock borrow deficits, and deductible amounts with respect to required fidelity bond coverage; or
- Securities classified as marketable.



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

Example of Effective Procedures

Auditors should evaluate whether supplemental information complied with relevant regulatory requirements. A broker-dealer earned commissions for the sale of annuity products and classified as allowable assets the commissions receivable that were outstanding 30 days or less. To evaluate the classification of these receivables, the auditor obtained a report with commissions information generated by the broker-dealer's internally-developed sales system. The auditor tested the completeness and accuracy of the report by selecting samples of sales transactions from the sales system and from the receivables report and determining whether they were properly included in, or excluded from, the receivables report. The auditor also tested the accuracy of the aging of the commissions receivable by recalculating the number of days outstanding for the transactions in its samples.

Customer Protection Rule:

Computation for Determination of the Reserve Requirements - firms did not perform, or sufficiently perform, procedures to test whether customer reserve and PAB account reserve computations were complete and accurate, such as determining whether the broker-dealer's cash and qualified securities were maintained in an account that qualified as a special reserve bank account, including whether the bank notification requirements regarding security interests in the cash and qualified securities were met.

Example of Effective Procedures

As stated in the previous example of effective procedures, auditors should evaluate whether supplemental information complied with relevant regulatory requirements. A broker-dealer carried margin accounts for customers and used an unsecured debits report to prepare its customer reserve computation. The auditor tested the completeness and accuracy of the broker-dealer's unsecured debits report by selecting samples of customer margin accounts from the broker-dealer's customer ledger and the unsecured debits report and determining whether, based on the value of the long positions included in the customer's account, the debit balance was properly included in, or excluded from, the unsecured debits report and when included, whether the amount was accurate.

Information Relating to the Possession or Control Requirements - firms did not perform, or sufficiently perform, procedures to test whether information related to whether the broker-dealer maintained possession or control of customer securities was complete and accurate.

Auditing Financial Statements

The financial statements broker-dealers are required to include in their annual filings with the SEC must be audited in accordance with PCAOB standards, which require auditors to obtain sufficient appropriate audit evidence to express an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States ("GAAP").

Some of the deficiencies described in this report can be attributed to ineffective risk assessment procedures. As part of its risk assessment, auditors should obtain an understanding of the broker-dealer and its environment, and its internal control over financial reporting. Effective risk assessment procedures should enable the auditor to better identify the risks of material misstatement at the financial statement level and the assertion level, including the risk of material misstatement due to fraud. The identification and assessment of risks of material misstatement should include risks associated with related parties and relationships and transactions with related parties. Quality audits typically start with clear identification and assessment of the risks of material misstatement based upon robust risk assessment procedures.

Areas of the Financial Statement Audit with Deficiencies

Audit Areas	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage
Revenue	100	60	60%
Risks of Material Misstatement Due To Fraud	17	8	47%
Related Party Relationships and Transactions	47	21	45%
Financial Statement Presentation and Disclosures	105	38	36%
Receivables and Payables	28	6	21%
Fair Value Measurements	21	3	14%

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

Revenue:

Risk Assessment Procedures such as understanding the broker-dealer's internal control over financial reporting, were not performed, or sufficiently performed, and contributed to deficiencies in testing revenue. (AS 2110)

Extent of Testing was insufficient to respond to the auditor's assessed risks of material misstatement including instances where sampling procedures were not appropriately designed or performed. (AS 2301 and AS 2315)

Example of Effective Procedures

When sampling, auditors should make selections that can be expected to be representative of the entire population, and provide all items an opportunity to be selected. A broker-dealer earns a spread for underwriting securities offerings and also advises clients on mergers and acquisitions. Both sources of revenue are material. The auditor tested all individually significant underwriting transactions and a sample from the remaining population of underwriting transactions using a statistically valid sampling technique. The auditor also selected a representative sample from the population of advisory fee transactions using a random number generator.

Substantive Analytical Procedures were not sufficient to obtain the necessary evidence because firms did not, among other deficiencies, evaluate the reliability of the data from which the firms' expectations were developed or develop expectations that were sufficiently precise to identify misstatements. (AS 2305)

Example of Effective Procedures

When performing substantive analytical procedures, auditors should develop an expectation that is sufficiently precise to identify misstatements. A broker-dealer earns commissions selling a variety of securities and insurance products. Commission rates vary widely by product. The auditor established expectations for commissions earned at each product level that took into consideration the differences in commission rates by product and resulted in the auditor using a range of expected differences sufficiently precise for detecting misstatements.

Information about Controls at the Broker-Dealer's Service Organization was not sufficiently evaluated to support the assessment of control risk below the maximum and the related modification of the nature, timing, and extent of substantive audit procedures because firms did not, among other deficiencies, test or sufficiently test the operating effectiveness of necessary controls at the broker-dealer (user organization controls) specified in the service auditor's report. (AS 2601)

Example of Effective Procedures

A broker-dealer uses information from a clearing broker for financial reporting. The auditor relied on controls at the broker-dealer's clearing broker in order to modify the nature, timing, and extent of its substantive procedures for commissions revenue. A service auditor's report provided information about the operating effectiveness of controls at the clearing broker for the first seven months of the broker-dealer's fiscal year. The auditor performed sufficient, appropriate procedures on the information included in the service auditor's report. In addition, the auditor reviewed information from the clearing broker regarding changes in its controls since the date of the service auditor's report. The auditor also identified controls at the broker-dealer over commissions revenue and tested those controls throughout the year.

Information Produced by the Broker-Dealer or the Broker-Dealer's Service Organization was used as audit evidence, but had not been sufficiently tested for accuracy and completeness, whether by obtaining evidence about controls (including instances where the auditor used the report of a service auditor but did not perform appropriate procedures to use the report), testing the information, or a combination of both. (AS 1105 and AS 2601)

Other Procedures to Test Revenue did not address, or sufficiently address, risks of material misstatement for relevant assertions (occurrence, completeness, valuation or allocation, and presentation and disclosure). These instances included evaluating the recognition of revenue and the accuracy and completeness of inputs used in the calculation of revenue. (AS 2301)

Example of Effective Procedures

Auditors should perform procedures to assess whether revenue has been reported at the proper amount. A broker-dealer earns asset management fees based on the value of each customer's account holdings. After assessing the risks of material misstatement, the auditor performed procedures to test the occurrence and completeness of revenue transactions. The auditor also performed procedures to test the valuation of revenue by testing the completeness and accuracy of customer account holdings and the accuracy of the management fee rates that the broker-dealer used to determine the amount of revenue reported.

Risks of Material Misstatement Due to Fraud:

Risk Assessment Procedures were not performed, or sufficiently performed, to identify and assess the risks of material misstatement due to fraud because firms did not, among other deficiencies, identify improper revenue recognition as a fraud risk, and the audit documentation did not demonstrate that the firms overcame the presumption that improper revenue recognition was a fraud risk. (AS 2110)

Audit Responses to Risks of Material Misstatement due to Management Override of Controls were not sufficient because journal entries and other adjustments were not examined, or not sufficiently examined. (AS 2401)

Audit Responses to Risk of Fraud Related to Improper Revenue Recognition were not sufficient because tests of details specifically responsive to assessed risks were not performed. (AS 2301)

Related Party Relationships and Transactions:

Risk Assessment Procedures were not sufficient to identify and assess the risks of material misstatement associated with the broker-dealer's relationships and transactions with related parties. The firms failed to sufficiently perform procedures to understand the broker-dealer's process for identifying, authorizing, accounting for, and disclosing related party relationships and transactions. (AS 2410)

Audit Responses to Risks of Material Misstatement did not include testing, or sufficient testing, of the basis for, and the computation of, the allocation of revenues and expenses related to formal agreements between the broker-dealer and its parent or affiliates, including not testing whether the allocated amounts were in accordance with the terms of those agreements. (AS 2410)

Example of Effective Procedures

Auditors must design and implement audit responses that address the identified risks of material misstatement associated with related parties and relationships and transactions with related parties. The auditor identified a risk of material misstatement for the broker-dealer's operating expenses that were allocated to the broker-dealer from affiliated companies under the terms of an expense sharing agreement. The expenses were allocated based on factors such as office space or headcount. The auditor performed detail testing to determine whether expenses were allocated to the broker-dealer in a manner consistent with the terms of the agreement.

Evaluation of the Broker-Dealer's Identification of Related Parties and Relationships and Transactions with Related Parties was not performed or sufficiently performed. (AS 2410)



Related parties often play a significant role in the operations of broker-dealers. AS 2410 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.

Financial Statement Presentation and Disclosures:

Financial Statement Presentation was not sufficiently evaluated, as the financial statements appeared to include revenue recognition policies, descriptions of balance sheet accounts, offsetting of balance sheet accounts, or net presentation of revenue that were not in conformity with GAAP. In addition, statement of income presentation was not sufficiently evaluated in instances where broker-dealers presented multiple significant categories of revenue as a single line item, which was inconsistent with regulatory reporting requirements. (AS 2810)

Financial Statement Disclosures were not sufficiently evaluated for conformity with GAAP requirements as follows:

- **Related Party Disclosures** necessary to understand related party relationships and the effects of related party transactions on the financial statements were incomplete or inaccurate; (Financial Accounting Standards Board Accounting Standards Codification (“ASC”) Topic 850, *Related Party Disclosures*) (AS 2410)
- **Going Concern Disclosures** regarding management’s plans to alleviate substantial doubt about the broker-dealer’s ability to continue as a going concern were omitted, or not assessed for feasibility; (ASC Topic 205, *Presentation of Financial Statements*) (AS 2415)
- **Revenue Recognition Policy Disclosures** were incomplete; (ASC Topic 235, *Notes to Financial Statements*) (AS 2810)
- **Risks and Uncertainties Disclosures** necessary for the users of the financial statements to understand the nature of the broker-dealer’s operations and associated risks were incomplete; and (ASC Topic 275, *Risks and Uncertainties*) (AS 2810)
- **Fair Value Disclosures** concerning the classification of securities as Level 1, Level 2, or Level 3 were not sufficiently tested. (ASC Topic 820, *Fair Value Measurement*) (AS 2502)

Example of Effective Procedures

A broker-dealer experienced operating losses and negative cash flow from operations for three consecutive years. The broker-dealer’s owner, in addition to making capital contributions, had plans to reduce expenses until the revenue outlook for the broker-dealer improved. Management of the broker-dealer concluded that substantial doubt existed regarding the broker-dealer’s ability to continue as a going concern and that its plans would mitigate the substantial doubt. To assess the likelihood that management’s plans would be effective, the auditor assessed their feasibility and mitigating effects, including the capability of the owner to make capital contributions. The auditor verified that the broker-dealer’s disclosures included the conditions and events that caused management to conclude that substantial doubt existed, the possible effects of those conditions and events, and information about management’s plans to mitigate the substantial doubt.

Receivables and Payables:

Extent of Testing was insufficient because sampling procedures were not appropriately designed and performed. (AS 2315)

Information Produced by the Broker-Dealer was used as audit evidence, but had not been sufficiently tested for accuracy and completeness, whether by testing controls, testing the information, or a combination of both. (AS 1105)

Confirmation Procedures were not sufficient because the nature of alternative procedures applied to nonresponses to positive confirmation requests for receivables did not provide the evidence necessary to reduce audit risk to an acceptably low level, or confirmation procedures were not performed for receivables despite the firm's risk assessment that indicated the firm should request confirmation. (AS 2310)

Fair Value Measurements:

An Understanding of the Broker-Dealer's Process for Determining the Fair Value of Assets was not obtained, or was not sufficient to develop an effective audit approach. (AS 2502)

Testing of Fair Value Measurements was not sufficient because the procedures did not include testing management's significant assumptions, the valuation model, or the underlying data; developing independent fair value estimates for corroborative purposes; or reviewing subsequent events and transactions. (AS 2502)

Auditor's Report on the Financial Statements and Supporting Schedules

Deficiencies in the Auditor's Report

	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage
Auditor's Report on the Financial Statements and Supporting Schedules	105	19	18%

Elements of the Auditor's Report:

None of the deficiencies in the auditor's report on the financial statements observed in our inspections during 2018 relates to an audit of a broker-dealer whose fiscal year-end preceded the effective date of the amended standard. (AS 3101)

Elements were omitted, or not properly presented, as follows:

- Did not identify, or correctly identify, the financial statements and notes to the financial statements that were the subject of the audit; (AS 3101)
- Inaccurately described the financial reporting framework under which the broker-dealer's financial statements were prepared as PCAOB auditing standards rather than GAAP; (AS 3101)
- Did not state that the audit procedures performed included performing procedures to test the completeness and accuracy of the supplemental information; (AS 2701)
- Did not state that the firm evaluated whether the supplemental information, including its form and content, complied, in all material respects, with the specified regulatory requirements; (AS 2701)
- Incorrectly described the supplemental information subject to audit procedures; or (AS 2701)
- Provided an incorrect tenure for the firm. (AS 3101)

Date of the Auditor's Report was prior to completion of the audit procedures performed by the firm. (AS 3110)

Auditor Communications

PCAOB rules and standards require certain communications be made to the broker-dealer's audit committee (or equivalent).

Deficiencies in Auditor Communications

	Number of Applicable Audits Reviewed	Number of Audits with Deficiencies	Percentage
Communications to the Audit Committee (or equivalent)	49	9	18%
Communications about Control Deficiencies	105	4	4%

Communications to the Audit Committee (or equivalent):

Firms did not make the annual independence communications required by PCAOB Rule 3526 and/or did not comply with communication or documentation requirements of AS 1301 because they did not:

- Include all required matters in their engagement letters;
- Communicate an overview of the overall audit strategy and significant risks identified;
- Communicate the results of the audit, including uncorrected misstatements identified during the audit, and the basis for their determination that the uncorrected misstatements were immaterial;
- Document oral communications made to the audit committee (or equivalent); or
- Make the required communications prior to the issuance of the auditor's report.

Communications about Control Deficiencies:

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 material weaknesses for purposes of communication to management and the audit committee (or equivalent). When significant deficiencies were identified during the audit, firms did not make the required written communications to management and the audit committee (or equivalent) prior to the issuance of the auditor's report. (AS 1305)

Engagement Documentation (AS 1215)

Deficiencies in Documentation

	Number of Applicable Engagements Reviewed	Number of Engagements with Deficiencies	Percentage
Audit Documentation	105	26	25%
Review Documentation	79	13	16%

Firms did not properly complete an engagement completion document, assemble a complete and final set of audit and review documentation ("engagement file") by the documentation completion date, and properly document additions to the engagement file after the documentation completion date.

Auditor Independence

Independence Findings

	Number of Applicable Audits Reviewed	Number of Audits with Findings	Percentage
Auditor Independence	37	2	5%

Firms assisted in the preparation of the broker-dealer's financial statements or supplemental information, which impaired the firms' independence. Assistance by the auditor with the preparation of financial statements being audited is not a permissible service as prescribed by Rule 2-01 of Regulation S-X.

PCAOB Rule and Standards Referenced

Rule 3526	Communication with Audit Committees Concerning Independence
QC 20	System of Quality Control for a CPA Firm's Accounting and Auditing Practice
QC 30	Monitoring a CPA Firm's Accounting and Auditing Practice
AS 1105	Audit Evidence
AS 1215	Audit Documentation
AS 1220	Engagement Quality Review
AS 1301	Communications with Audit Committees
AS 1305	Communications About Control Deficiencies in an Audit of Financial Statements
AS 2110	Identifying and Assessing Risks of Material Misstatement
AS 2301	The Auditor's Responses to the Risks of Material Misstatement
AS 2305	Substantive Analytical Procedures
AS 2310	The Confirmation Process
AS 2315	Audit Sampling
AS 2401	Consideration of Fraud in a Financial Statement Audit
AS 2410	Related Parties
AS 2415	Consideration of an Entity's Ability to Continue as a Going Concern
AS 2502	Auditing Fair Value Measurements and Disclosures
AS 2601	Consideration of an Entity's Use of a Service Organization
AS 2701	Auditing Supplemental Information Accompanying Audited Financial Statements
AS 2810	Evaluating Audit Results
AS 3101	The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion
AS 3110	Dating of the Independent Auditor's Report
AT No. 1	Examination Engagements Regarding Compliance Reports of Brokers and Dealers
AT No. 2	Review Engagements Regarding Exemption Reports of Brokers and Dealers

Appendix A: The Selection of Firms and Engagements for Inspections

We selected 67 firms for inspection during 2018. These inspections covered 105 audits of financial statements and 103 attestation engagements of brokers and dealers that had financial statement periods ended during the period April 1, 2017 through March 31, 2018. These selections were made from the population of firms and broker-dealer audits depicted in the following table:

Number of Broker-Dealer Audits per Firm	Number of Firms	Number of Broker-Dealer Audits
1	140	140
2 to 20	257	1,443
21 to 50	24	758
51 to 100	9	641
More than 100	5	727
Total	435	3,709

The firms and the audit and attestation engagements were generally selected based on characteristics of the firms and the broker-dealers. The firm characteristics included, among others, the number of broker-dealer audits performed, whether the firm conducted examination engagements, whether the firm also issued audit reports for issuers, previous inspection results, history of the firm or firm personnel in auditing broker-dealers, and 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 pursuant to Rule 17a-5, whether the broker-dealer was a subsidiary of an issuer and its significance to the issuer's consolidated financial statements, changes in auditors and certain circumstances related to the changes, existence of disciplinary actions against the broker-dealer by the SEC, Financial Industry Regulatory Authority, or other regulatory authorities, and the engagement partner's workload, experience in auditing broker-dealers, and previous inspection results. We also selected a number of firms and engagements randomly.

Selection of Firms and Audit and Attestation Engagements for Inspection in 2018

The following tables present information about the firms inspected in 2018 and the number of audits reviewed during those inspections. The tables provide the number of broker-dealer audits performed by the inspected firms, as determined at the time of the inspection, whether or not the firms also audited issuers, and whether the firms audited broker-dealers that filed a compliance report or only audited broker-dealers that filed an exemption report:

Number of Broker-Dealer Audits per Firm	Number of Firms Inspected	Number of Audits Reviewed
1	8	8
2 to 20	43	46
21 to 50	5	6
51 to 100	7	13
More than 100	4	32
Total	67	105

Firms	Number of Firms Inspected	Number of Audits Reviewed
Also audited issuers	37	73
Did not audit issuers	30	32
Total	67	105

Firms	Number of Firms Inspected	Number of Audits Reviewed
Audited broker-dealers that filed compliance reports	25	58
Only audited broker-dealers that filed exemption reports	42	47
Total	67	105

At the time of the 2018 inspections, 37 of the 67 firms also audited issuers. Of these 37 firms, four audited more than 100 issuers and 33 audited 100 or fewer issuers. The remaining 30 firms did not audit issuers and were not subject to inspection other than under the interim inspection program.

The following tables present the number of audits and attestation engagements reviewed during the inspections in 2018, the ranges of minimum net capital requirements and actual net capital reported for the broker-dealers that filed either a compliance report or an exemption report, stratified by whether the broker-dealer did or did not claim exemption from the Customer Protection Rule and the type of report (compliance or exemption) filed:

Broker-Dealers	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (in thousands)	Range of Actual Net Capital Reported at Fiscal Year End (in thousands)
Did not claim exemption	28	\$5 - \$2,000,000	\$600 - \$13,000,000
Claimed exemption	77	\$5 - \$1,000	\$6 - \$100,000
Total	105	\$5 - \$2,000,000	\$6 - \$13,000,000

Broker-Dealers Filed	Number of Attestations Reviewed Covered	Range of Minimum Net Capital Requirements (in thousands)	Range of Actual Net Capital Reported at Fiscal Year End (in thousands)
Compliance report	24	\$250 - \$2,000,000	\$700 - \$13,000,000
Exemption report	79	\$5 - \$48,000	\$6 - \$140,000

Certain of the 105 audits reviewed during the inspections had a related attestation engagement that was not reviewed during the inspection or had more than one related attestation engagement reviewed during the inspection.

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

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

Number of Broker-Dealer Audits per Firm	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
1	67	68	5	35
2 to 20	234	296	29	161
21 to 50	32	106	5	41
51 to 100	16	58	6	34
More than 100	7	207	56	78
Total	338	735	101	349

The sum of the number of firms inspected does not total to 338 because 18 firms that were inspected more than once since the inception of the interim inspection program are reported in multiple stratifications due to changes in the number of broker-dealer audits performed by those firms. In addition, one firm that audited one broker-dealer was inspected more than once.

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

Firms	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
Also audited issuers	144	473	89	221
Did not audit issuers	198	262	12	128
Total	338	735	101	349

The sum of the number of firms inspected does not total to 338 because four firms that were inspected more than once since the inception of the interim inspection program are reported in both stratifications due to a change over time in whether the firms also audited issuers.

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

Broker-Dealers	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (in thousands)	Range of Actual Net Capital Reported at Fiscal Year End (in thousands)
Did not claim exemption	174	\$5 - \$2,000,000	\$300 - \$16,000,000
Claimed exemption	561	\$5 - \$82,000	\$6 - \$2,250,000

The following table presents the number of firms inspected during 2018, 2017, 2016, and 2015, and five firms inspected during 2014, the number of audits reviewed during the inspections, and the number of attestation engagements covered by the inspections, stratified by whether the firms audited broker-dealers that filed compliance reports or only audited broker-dealers that filed exemption reports:

Firms	Number of Firms Inspected	Number of Audits Reviewed	Number of Examinations Covered	Number of Reviews Covered
Audited broker-dealers that filed compliance reports	56	234	101	131
Only audited broker-dealers that filed exemption reports	191	220	N/A	218
Total	242	454	101	349

The number of firms inspected does not total to 242 because five firms that were inspected more than once are included in both stratifications due to a change over time in whether the firms also audited broker-dealers that filed compliance reports. In addition, two of the firms inspected that only audited one broker-dealer and those broker-dealers did not file either a compliance or exemption report are not included in this table. Also, certain of the audits reviewed during the inspections (1) did not have a related attestation engagement, (2) had a related attestation engagement not covered during the inspection, or (3) had more than one related attestation engagement covered during the inspection.

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

Broker-Dealers Filed	Number of Audits Reviewed	Range of Minimum Net Capital Requirements (in thousands)	Range of Actual Net Capital Reported at Fiscal Year End (in thousands)
Compliance report	101	\$100 - \$2,000,000	\$300 - \$13,000,000
Exemption report	349	\$5 - \$82,000	\$6 - \$300,000

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

Since the inception of the interim inspection program in 2011 through 2018, the PCAOB has performed 476 inspections of 338 of the firms that conducted audits of broker-dealers. The 476 inspections covered portions of 735 audits, of which 456 were required to be performed in accordance with PCAOB standards and 279 were required to be performed in accordance with generally accepted auditing standards. The inspections covered 450 attestation engagements that were required to be performed in accordance with PCAOB standards. The 735 audits and the 450 attestation engagements had financial statement periods ended December 31, 2010 through March 31, 2018 and June 30, 2014 through March 31, 2018, respectively.

In this appendix, the term cumulative refers to the inspections conducted during 2014 through 2018 that covered audits and attestation engagements required to be performed in accordance with PCAOB standards (“Cumulative”).

The following tables summarize the independence findings and audit, attestation, and other deficiencies identified from reviews of audits and attestation engagements performed in accordance with PCAOB standards under the interim inspection program through 2018:

Summary of Findings and Deficiencies

Inspection Year	Percentage of				
	Audits with Independence Findings	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
2018	5%	76%	32%	75%	54%
2017	8%	76%	32%	70%	40%
Cumulative	8%	79%	34%	73%	46%

Attestation and other deficiencies in the table above include deficiencies in attestation procedures, documentation, and engagement quality reviews.

Attestation, Audit, and Other Deficiencies

Deficiencies	Percentage of Applicable Engagements with Deficiencies		
	2018	2017	Cumulative
Deficiencies in Attestation Procedures			
Examination Engagements	75%	70%	73%
Review Engagements	51%	38%	40%
Deficiencies in Auditing Supporting Schedules			
Net Capital Rule	29%	36%	30%
Customer Protection Rule	36%	48%	47%
Deficiencies in Auditing Financial Statements			
Revenue	60%	65%	66%
Risks of Material Misstatement Due to Fraud	47%	64%	52%
Related Party Relationships and Transactions	45%	32%	34%
Financial Statement Presentation and Disclosures	36%	33%	36%
Receivables and Payables	21%	31%	25%
Fair Value Measurements	14%	28%	31%
Deficiencies in Auditor's Report			
Auditor's Report on the Financial Statements and Supporting Schedules	18%	10%	12%
Deficiencies in Auditor Communications			
Communications to the Audit Committee (or equivalent)	18%	29%	17%
Communications about Control Deficiencies	4%	7%	5%
Deficiencies in Documentation			
Audit Documentation	25%	13%	23%
Examination Documentation	0%	7%	8%
Review Documentation	16%	6%	15%
Deficiencies in Engagement Quality Reviews			
Audit Engagements	65%	59%	60%
Examination Engagements	26%	20%	31%
Review Engagements	43%	26%	32%

The following tables present the percentages of audit and attestation engagements with deficiencies, stratified by certain firm characteristics:

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

In 2018, we identified a high percentage of audits, areas, and attestation engagements with deficiencies across the firms inspected. We noted that firms that only audited broker-dealers that filed exemption reports had significantly higher percentages of deficiencies when compared to firms that audited broker-dealers that filed compliance reports. The 2018 results are consistent with 2017.

	Percentage of					
	Audits with Audit and Other Deficiencies			Areas with Audit and Other Deficiencies		
	2018	2017	Cumulative	2018	2017	Cumulative
Firms that audited broker-dealers that filed compliance reports	64%	66%	66%	23%	24%	23%
Firms that only audited broker-dealers that filed exemption reports	91%	85%	92%	45%	39%	46%

	Percentage of					
	Examinations with Attestation and Other Deficiencies			Reviews with Attestation and Other Deficiencies		
	2018	2017	Cumulative	2018	2017	Cumulative
Firms that audited broker-dealers that filed compliance reports	75%	70%	73%	41%	17%	27%
Firms that only audited broker-dealers that filed exemption reports	N/A	N/A	N/A	64%	52%	58%

Firms that also Audited Issuers and Firms that did not Audit Issuers:

	Percentage of					
	Audits with Audit and Other Deficiencies			Areas with Audit and Other Deficiencies		
	2018	2017	Cumulative	2018	2017	Cumulative
Firms that also Audited Issuers:						
Broker-dealers that filed a compliance report	63%	83%	75%	23%	33%	26%
Broker-dealers that filed an exemption report	74%	65%	69%	29%	25%	25%
Firms that did not Audit Issuers:						
Broker-dealers that filed a compliance report	100%	100%	100%	25%	43%	58%
Broker-dealers that filed an exemption report	90%	95%	95%	47%	44%	52%

	Percentage of Attestations with Attestation and Other Deficiencies		
	2018	2017	Cumulative
Firms that also Audited Issuers:			
Broker-dealers that filed a compliance report	73%	71%	71%
Broker-dealers that filed an exemption report	43%	32%	33%
Firms that did not Audit Issuers:			
Broker-dealers that filed a compliance report	100%	67%	92%
Broker-dealers that filed an exemption report	73%	64%	69%

We noted that deficiencies were generally higher at firms that did not audit issuers. The 2018 results are consistent with 2017. In addition, we 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.

Firms Inspected More than Once:

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

Inspection Year	Percentage of			
	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
2018	51%	18%	57%	15%
2017	61%	17%	65%	17%
2016	60%	11%	57%	21%
2015	48%	10%	46%	24%

The percentage of audits and attestation engagements with deficiencies for firms inspected in all four years decreased in 2018 compared to 2017. The percentage of audit areas with deficiencies increased in 2018 compared to 2017. The individual firm results were varied across these seven firms.

An additional 31 firms were inspected twice during 2015 through 2018. We noted that the percentage of audits and areas with deficiencies was lower in the subsequent inspections when compared to the initial inspections, while the percentage of examination and review engagements with deficiencies remained the same. The following table shows the percentage of audits, areas, and attestation engagements with deficiencies for the 31 firms that were inspected twice during 2015 through 2018:

Inspection Year	Percentage of			
	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
Subsequent inspections	80%	37%	100%	45%
Initial inspections	93%	44%	100%	45%

The following tables present Cumulative audit, attestation, and other deficiencies 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	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
1	90%	54%	100%	69%
2 to 20	94%	45%	93%	61%
21 to 50	72%	31%	100%	32%
51 to 100	78%	35%	100%	35%
More than 100	55%	14%	55%	19%

Firms that also Audited Issuers and Firms that did not Audit Issuers:

Firms	Percentage of			
	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
Also audited issuers	71%	26%	71%	33%
Did not audit issuers	96%	53%	92%	69%

Percentage of Audits with Audit, Attestation, and Other Deficiencies Stratified by whether the Broker-Dealer Claimed or did not Claim Exemption from the Customer Protection Rule:

Broker-Dealers	Percentage of			
	Audits with Audit and Other Deficiencies	Areas with Audit and Other Deficiencies	Examinations with Attestation and Other Deficiencies	Reviews with Attestation and Other Deficiencies
Did not claim exemption	76%	29%	73%	50%
Claimed exemption	79%	36%	N/A	46%

The remaining tables in this appendix present the number of audits with deficiencies and related percentages for the inspections during 2018, the percentages of audits with deficiencies for inspections during 2017, and the Cumulative percentages of audits with deficiencies stratified by whether the broker-dealers did not claim, or claimed, exemption from the Customer Protection Rule:

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

Audit and Other Deficiencies	Number of Applicable Audits Reviewed	2018		2017	Cumulative
		Number of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Net Capital Rule	20	6	30%	47%	31%
Customer Protection Rule	24	8	33%	50%	46%
Revenue	28	10	36%	71%	59%
Risks of Material Misstatement Due to Fraud	8	2	25%	50%	40%
Related Party Relationships and Transactions	12	5	42%	25%	25%
Financial Statement Presentation and Disclosures	28	7	25%	18%	23%
Receivables and Payables	14	3	21%	56%	28%
Fair Value Measurements	14	2	14%	10%	16%
Auditor's Report on the Financial Statements and Supporting Schedules	28	2	7%	4%	7%
Communications to the Audit Committee (or equivalent)	8	2	25%	40%	15%
Communications about Control Deficiencies	28	2	7%	21%	14%
Audit Documentation	28	0	0%	14%	11%
Engagement Quality Reviews	18	8	44%	46%	45%

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

Audit and Other Deficiencies	Number of Applicable Audits Reviewed	2018		2017	Cumulative
		Number of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies	Percentage of Audits with Deficiencies
Net Capital Rule	45	13	29%	33%	30%
Customer Protection Rule	1	1	100%	0%	71%
Revenue	72	50	69%	63%	68%
Risks of Material Misstatement Due to Fraud	9	6	67%	71%	58%
Related Party Relationships and Transactions	35	16	46%	34%	37%
Financial Statement Presentation and Disclosures	77	31	40%	38%	41%
Receivables and Payables	14	3	21%	6%	23%
Fair Value Measurements	7	1	14%	40%	41%
Auditor's Report on the Financial Statements and Supporting Schedules	77	17	22%	13%	14%
Communications to the Audit Committee (or equivalent)	41	7	17%	28%	18%
Communications about Control Deficiencies	77	2	3%	2%	2%
Audit Documentation	77	26	34%	13%	27%
Engagement Quality Reviews	65	46	71%	64%	64%