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B/D Alert #5: Auditing Information Produced by a Service Organization

This alert is intended to provide certain auditing considerations that may be relevant for audit and attestation engagements for brokers and dealers registered with the US Securities and Exchange Commission (SEC). The alert discusses some of the more judgmental or complex areas of the audit and attestation engagements, including some of those identified by the Public Company Accounting Oversight Board (PCAOB).¹

While the alert highlights certain areas and questions for consideration, it should not be relied upon as definitive or all-inclusive, and should be read in conjunction with applicable rules, standards, and guidance in their entirety. The questions posed in this alert are a mixture of (1) questions applicable to all audits of brokers and dealers and (2) questions that may require further action if certain circumstances are present at the broker or dealer.

Please see previously issued CAQ Alert #2017-05, *Select Auditing Considerations for the 2017 Audit Cycle for Brokers and Dealers* where additional areas of the audit and attestation engagements are highlighted for consideration.²

Developing and Performing Audit Procedures

Brokers and dealers may use service organizations to process certain transactions as part of their financial reporting system. Brokers and dealers may also use service organizations to perform trade processing and other back-office functions. Obtaining a sufficient understanding of how information is produced by a service organization can sometimes be challenging because these systems and controls are outside the broker or dealer entity. [AS 2601](#), *Consideration of an Entity's Use of a Service Organization* (AS 2601), establishes the auditing requirements for when a company uses the services of a service organization that affect the broker's or dealer's accounting records and financial reporting processes.

¹ See PCAOB Staff Inspection Brief: *Information about 2017 Inspection of Auditors of Brokers and Dealers* and PCAOB Staff Inspection Brief: *Preview of Observations from 2016 Inspections of Auditors of Brokers and Dealers*.

² CAQ Alert #2017-05 is available at <http://www.thecaq.org/caq-alert-2017-05-select-auditing-considerations-2017-audit-cycle-brokers-and-dealers>.

Questions to Consider

Consider the following questions when developing and performing procedures to audit information produced by a service organization:

- Does the broker or dealer use the services of a service organization that affect the broker's or dealer's accounting records and financial reporting processes? Consider how the broker or dealer ensures the completeness and accuracy of the transfer of data and how they maintain their own books and records.
- Is a service auditor's report available for the service organization?
- Is the broker or dealer an intended user of the service auditor's report?
- What is the period covered by the service auditor's report in relation to the period under audit of the broker or dealer?³
- Is the opinion unqualified or qualified? Does the report identify any exceptions?
- What services are not covered by the opinion?
- Is there a subservice organization not covered by the service auditor's report? Are those services applicable to the audit? How has the engagement team addressed services performed by the subservice organization?
- How will changes to the processes and controls at the service organization for the period not covered by the service auditor's report be identified and evaluated?
- Are there key reports produced by the service organization being utilized by the broker or dealer, and if yes, are these key reports within the service auditor's report? If the key reports are not included in the service auditor's report, what procedures will be performed to test the completeness and accuracy of the reports?
- Are all relevant assertions addressed by controls in the service auditor's report? Is the service auditor's testing of the control(s) appropriate? Does the report identify any exceptions?
- Which relevant complementary user entity controls at the broker or dealer are required to achieve the stated control objectives in the service auditor's report? Are they designed and operating effectively?

³ See AS 2601.15.

Audit Deficiencies

The following are examples of deficiencies that have been identified in previous PCAOB inspections related to this area:⁴

- The auditor obtained the service auditor's report but did not evaluate the report or consider whether the report provided sufficient evidence about the design and operating effectiveness of the controls relied on in the report.
- The auditor did not test the operating effectiveness of necessary user organization controls that are specified in the service auditor's report.
- The auditor does not evaluate whether the scope of the service auditor's report included testing the design and operating effectiveness of controls over information used by the auditor as audit evidence (e.g., the auditor relies on a report produced by the service organization that is being used by the broker or dealer that has not been tested for completeness or accuracy).
- The auditor does not obtain evidence about the effectiveness of necessary controls in place at subservice organizations specified in the service auditor's report.
- The auditor does not evaluate the period covered by the service auditor's report and may not adequately address any gap between that period and the financial statement period under audit.

⁴ As of the date of this publication the most recent annual interim inspection report was published by the PCAOB on [August 18, 2017](#).