

December 2017

B/D Alert #9: Supplemental Information

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 present supplemental information in their annual reports to meet regulatory compliance requirements. Under the provisions of SEC Rule 17a-5(d), brokers and dealers are required to file with the SEC, among other things, a financial report containing financial statements, and supplemental information. Thus, the auditor's opinion, covering the financial report, addresses both the financial statements and supplemental information.³ AS 2701, *Auditing Supplemental Information Accompanying Audited Financial Statements* (AS 2701), provides, among other things, the requirements for obtaining sufficient and appropriate audit evidence to report on the accompanying supplemental information.

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>.

³ See AS 2701.11.

Auditors of brokers and dealers should also consider whether the entity is dually registered as an introducing broker or futures commission merchant with the US Commodity Futures Trading Commission (CFTC), which would have an impact on the regulatory and financial reporting requirements of the broker or dealer, including the supplemental information the broker or dealer is required to include with its annual financial statements. Additionally, it is important to consider which audit, attestation, and independence requirements are applicable to the engagement based upon whether the broker or dealer is registered with the SEC and/or the CFTC. Please see the following resource, “[AICPA Stockbrokerage and Investment Banking Expert Panel: Applicable Audit, Attestation, and Independence Standards](#),” for a summary of the applicable standards to the various types of engagements with brokers and dealers. In addition to the questions below, the auditor should also consider the information and questions in B/D Alert #3 *Examination Engagements* and B/D Alert #5 *Review Engagements* when planning and executing their procedures over the supplemental information.

Questions to Consider

Consider the following questions when developing and performing audit procedures to test supplemental information:

- Has the auditor obtained a sufficient understanding of how the supplemental information is prepared in order to develop procedures responsive to the risk of material misstatement identified?
 - Who is responsible for preparing and reviewing the supplemental information? Have there been changes in the personnel responsible for preparing and reviewing the supplemental information?
 - What methods and processes does management have in place to prepare and review the supplemental information?
 - What systems are used to prepare the supplemental information? Does the audit plan contemplate the use of information or reports from service organizations to test the supplemental information? Has the completeness and accuracy of that information been considered?
 - How does the company determine its required minimum net capital? How do they determine the appropriate haircut percentages that need to be applied to the broker’s or dealer’s securities?
 - How do they determine other components of the net capital computation?
 - How did they determine they were in compliance with the customer protection rule?
 - Are there changes in the business that would have an impact on the supplemental information the broker or dealer prepares?
- Was the same materiality used to plan, perform, and evaluate the results of the audit of the supplemental information as was used for the audit of the financial statements?
- Has the Financial Industry Regulatory Authority (FINRA), the SEC, or other regulators examined the broker or dealer recently? Are there exams in process with the regulator?

- Has all of the broker's or dealer's correspondence with regulators been requested and obtained? Has the correspondence been evaluated for the impact that any matters raised by regulators could have on the audits of the financial statements and supplemental information?

Audit Deficiencies

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

- Net Capital - Auditors did not perform sufficient procedures (any one or more of the following) to:
 - Test whether components of the net capital computation are in accordance with the appropriate regulatory requirements
 - Test the broker's or dealer's classification of allowable and non-allowable assets
 - Evaluate the completeness of the reported amounts of operational charges and other deductions to arrive at the broker's or dealer's net capital, because they did not evaluate whether a deduction from net worth was necessary
 - Evaluate whether haircuts on securities' values were determined in accordance with the Net Capital Rule
- Customer Protection Rule - Auditor did not:
 - Obtain an understanding of the methods used by the broker or dealer to prepare the supporting schedule that included information relating to possession or control requirements, evaluate the appropriateness of those methods, and determine whether those methods had changed from the methods used in the prior period
 - Perform sufficient procedures to determine whether the amounts in the supplemental schedules reconcile to the broker's or dealer's underlying accounting and other records or to the financial statements, as applicable
 - Perform sufficient procedures to test the information presented in the customer reserve supporting schedule, including obtaining sufficient evidence about the accuracy and completeness of information that the auditor relied upon, which was produced by a broker's or dealer's service organization, to support adjustments to the customer reserve computation
 - Perform sufficient procedures to test the broker's or dealer's information relating to possession or control requirements (as an example not sufficiently testing the classification of good control locations)

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