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Agenda

- ❖ **Broker-Dealer Rulemaking**
 - Background/Rulemaking Timeline
 - Existing SEC Annual Reporting Requirements
 - Final Amendments to SEC Annual Reporting Requirements
 - Compliance Report (Examination)
 - Exemption Report (Review)
 - Other Requirements
- ❖ **Applicability of Auditor Independence Rules to Broker-Dealer Audits**



Broker-Dealer Rulemaking

Background/Rulemaking Timeline

- ❖ **July 21, 2010 – Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act granted the PCAOB oversight over audits of brokers and dealers registered with the Commission**
- ❖ **Sept. 24, 2010 – Commission published interpretive guidance to clarify the application of certain rules, regulations, releases, and staff bulletins in light of the PCAOB's oversight**
- ❖ **Nov. 18, 2010 – Letter issued by SEC Director of Trading and Markets and SEC Chief Accountant concerning requirements for broker-dealer annual audits pursuant to Rule 17a-5**

Background/Rulemaking Timeline

- ❖ **June 14, 2011 – PCAOB adopted final rules for allocation of the Board’s accounting support fee among issuers, brokers, and dealers, and other amendments to the Board’s funding Rules**
- ❖ **June 14, 2011 – PCAOB adopted temporary rule for an interim program of inspection related to audits of brokers and dealers**
- ❖ **August 18, 2011 - Commission order approving the rules noted above**
- ❖ **October 10, 2013 - PCAOB adopted new attestation standards and a new auditing standard, subject to Commission approval**

Rulemaking Timeline

- ❖ **June 15, 2011 – Commission proposed amendments to broker-dealer financial reporting rules to:**
 - Update existing requirements of Rule 17a-5
 - Facilitate the ability of the PCAOB to implement oversight of independent public accountants of broker-dealers
 - Eliminate potentially redundant requirements for certain broker-dealers affiliated with, or dually registered as, investment advisors
 - Other amendments included:
 - Access to audit documentation
 - New Form Custody

Rulemaking Timeline

- ❖ **Comment period closed on August 26, 2011**
 - 27 comment letters received
- ❖ **Areas of public comment included:**
 - Material non-compliance and material weakness
 - Reporting of remediation of material weaknesses
 - Relationship between internal control over compliance with Financial Responsibility Rules and internal control over financial reporting
 - Internal control considerations related to broker-dealer's books and records

Rulemaking Timeline

- ❖ **Areas of public comment included (cont'd):**
 - **Period or “as of date” exemption from Rule 15c3-3**
 - **Notification requirements to the Commission**
 - **Effective date and transition period**
 - **Access to audit documentation**
 - **Interaction with other regulatory rules and requirements**

Rulemaking Timeline

- ❖ **On July 30, 2013, the SEC finalized amendments to broker-dealer financial responsibility requirements and financial reporting rules**
 - **The amendments to the reporting rules are expected to improve compliance with the SEC's financial responsibility rules**

Final Amendments to SEC Financial Responsibility Rules

- ❖ **Amendments made to:**
 - **Customer Protection Rule (15c3-3)**
 - **Net Capital Rule (15c3-1)**
 - **Books and Records Rules (17a-3 and 17a-4)**
 - **Notification Rule (17a-11)**
- ❖ **The amendments to the financial responsibility rules are expected to better protect customers and enhance the SEC's ability to monitor and prevent unsound practices.**

Existing SEC Annual Reporting Requirements

- ❖ **Broker-dealers are required to file an annual report with the SEC and the broker-dealer's designated examining authority pursuant to Rule 17a-5**
 - Annual report must contain audited financial statements and certain supporting schedules and supplemental reports, as applicable
 - The audit is conducted in accordance with GAAS (i.e., not PCAOB standards)

Existing SEC Annual Reporting Requirements

❖ **Report on internal controls**

- The auditor is required to obtain reasonable assurance that any *material inadequacies* existing at the audit report date in the following areas are disclosed:
 - Accounting system
 - Internal control
 - Procedures for safeguarding securities, and
 - Practices and procedures specified by Rule 17a-5
- Study of practices and procedures followed, including consideration of control activities for safeguarding securities
- Broker-dealers that are exempt from Rule 15c3-3

Final Amendments to SEC Annual Reporting Requirements

- ❖ **In addition to existing requirements to file audited financial statements and certain supporting schedules (“Financial Report”), the revised Rule 17a-5 also requires the following new reports:**
 - **Carrying broker-dealer that has custody of customer assets to file a new Compliance Report, that will be examined by its independent public accountant**
 - **Non-carrying broker-dealer that does not have custody of customer assets to file a new Exemption Report, that will be reviewed by its independent public accountant**

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Audits of the Financial Report, the examination of the Compliance Report and the review of the Exemption Report are to be conducted in accordance with PCAOB standards, instead of GAAS**
 - The PCAOB has developed new attestation standards (AT Nos. 1 & 2) specifically tailored to the examination of the Compliance Report and the review of the Exemption Report, as well as a new auditing standard for supplemental information included with the financial statements

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Carrying broker-dealers are required to file a Compliance Report which would include statements as to whether:**
 - The broker-dealer has established and maintained Internal Control over Compliance;
 - Internal Control over Compliance was effective during the most recent fiscal year;
 - Internal Control over Compliance was effective as of the end of the most recent fiscal year;
 - The broker-dealer was in compliance with Rule 15c3-1 and Rule 15c3-3(e) as of its fiscal year-end;
 - The information used to state whether it was in compliance was derived from the books and records of the broker-dealer.

Final Amendments to SEC Annual Reporting Requirements

- ❖ **If applicable, a carrying broker-dealer would be required to include:**
 - **A description of each material weakness in the Internal Control Over Compliance of the broker or dealer during the most recent fiscal year**
 - **A description of each instance of non-compliance with Rules 15c3-1 or 15c3-3(e) as of the end of the most recent fiscal year**

Final Amendments to SEC Annual Reporting Requirements

❖ **Internal Control Over Compliance**

- **Internal controls that have the objective of providing the broker or dealer with reasonable assurance that non-compliance with Rules 15c3-1, 15c3-3, 17a-13, or any rule of the designated examining authority of the broker or dealer that requires account statements (an “Account Statement Rule”) to be sent to the customers of the broker or dealer will be prevented or detected on a timely basis**

Final Amendments to SEC Annual Reporting Requirements

❖ The rules covered by the term **Internal Control Over Compliance (“ICOC”)** are broader than those covered by the compliance report statement

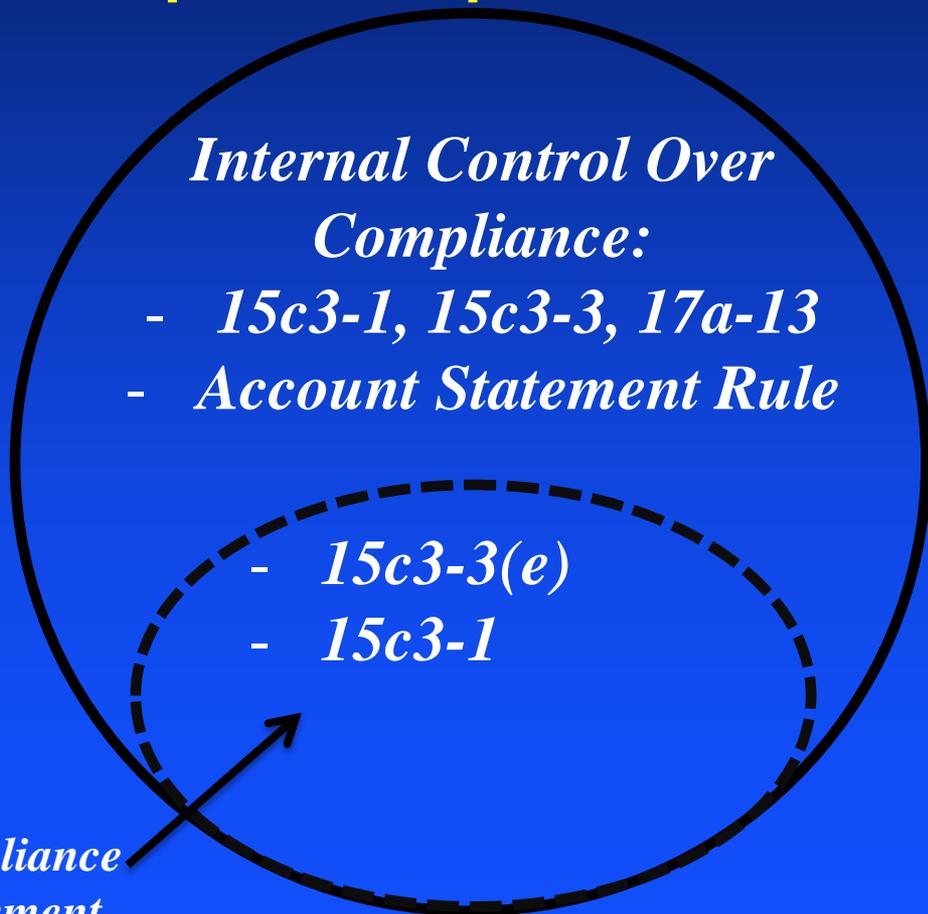
❖ Additionally, the statements in the **Compliance Report on ICOC** cover the entire year and year end, where the statement on compliance is as of year end only

Internal Control Over Compliance:

- *15c3-1, 15c3-3, 17a-13*
- *Account Statement Rule*

- *15c3-3(e)*
- *15c3-1*

Compliance Statement



Final Amendments to SEC Annual Reporting Requirements

- ❖ **Internal Control Over Compliance (ICOC) is intended to focus on a broker-dealer's net capital requirements, oversight of custody arrangements and protection of customer assets.**
 - **ICOC differs from Internal Control over Financial Reporting, which focuses on the reliability of financial reporting and the preparation of financial statements.**
 - **The Final Rule does not require that the effectiveness of internal control over financial reporting be included as one of the statements made by the broker-dealer in the compliance report, or opined on by the auditor**

Final Amendments to SEC Annual Reporting Requirements

❖ **Material Weakness**

- A deficiency, or a combination of deficiencies, in Internal Control Over Compliance such that there is a reasonable possibility that non-compliance with Rule 15c3-1 or Rule 15c3-3(e) will not be prevented or detected on a timely basis or that non-compliance to a material extent with Rule 15c3-3, except for paragraph (e), Rule 17a-13, or any Account Statement Rule will not be prevented or detected on a timely basis

- ❖ **Existing term “material inadequacy” no longer relevant**

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Carrying broker-dealer is not permitted to conclude that its Internal Control Over Compliance was effective**
 - during the fiscal year if there were one or more material weaknesses in ICOC during the fiscal year
 - as of the end of the fiscal year if there were one or more material weaknesses in ICOC as of the end the fiscal year
- ❖ **Carrying broker-dealer required to engage an independent public accountant to:**
 - Prepare a report based on an examination of certain of the broker-dealer's statements contained in the Compliance Report

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Non-carrying broker-dealer required to state the following in its Exemption Report:**
 - The provisions in Rule 15c3-3(k) under which the broker-dealer claimed an exemption from Rule 15c3-3
 - Either:
 - The broker-dealer met the identified exemption provisions in Rule 15c3-3(k) throughout the most recent fiscal year without exception, or
 - The broker-dealer met the identified exemption provisions except as described in the Exemption Report
 - If applicable, an identification of each exception, a description of the nature of each exception, and the approximate date(s) on which the exception existed

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Non-carrying broker-dealer required to engage an independent public accountant to:**
 - Prepare a report based on a review of the broker-dealer's statements contained in the Exemption Report

- ❖ **Note that a broker-dealer must file an exemption report if it did claim that it was exempt from Rule 15c3-3 throughout the most recent fiscal year, even in situations in which the broker-dealer had exceptions to meeting the exemption provisions in 15c3-3(k).**

Final Amendments to SEC Annual Reporting Requirements

❖ **Notification requirements**

- **An auditor must immediately notify the CFO of the broker-dealer if**
 - **the auditor determines, in the course of preparing its reports, that the broker-dealer was not in compliance with any of the financial responsibility rules, or**
 - **In the performance of an examination of the Compliance Report, the accountant determines that any material weakness existed in the broker-dealer's ICOC**

Final Amendments to SEC Annual Reporting Requirements

❖ **Notification requirements (cont'd)**

- **The broker-dealer must file a notification with the Commission and its DEA if the auditor's notice relates to an instance of non-compliance that would trigger notification, and provide a copy of the notification to the auditor**
- **If the auditor does not receive a copy of the notification within 1 business day, or if the auditor does not agree with the statements in the notification, the auditor must notify the SEC and DEA within one business day**

Final Amendments to SEC Annual Reporting Requirements

❖ **Form Custody**

- **New form to be filed by broker-dealers quarterly**
- **Filed with DEA concurrent with FOCUS Reports**
- **Comprised of 9 items designed to elicit information about a broker-dealer's custodial activities.**
- **The Commission believes that the information required by Form Custody will provide the Commission with an enhanced understanding of the scope of broker-dealer introducing/carrying relationships and activities, and the custodial practices of broker-dealers involved in such relationships.**

Final Amendments to SEC Annual Reporting Requirements

❖ **Access to audit documentation**

- **Clearing and Carrying broker-dealers to consent to permitting their independent public accountants to:**
 - **Make available to the Commission and Designated Examining Authority (“DEA”) examiners the audit documentation associated with its annual reports required under Rule 17a-5**
 - **Discuss findings relating to the audit reports with the Commission and DEA examiners**

Final Amendments to SEC Annual Reporting Requirements

❖ **Effective dates:**

- **New Form Custody requirement effective on December 31, 2013.**
- **Broker-dealer annual reports must be filed with SIPC for fiscal years ending on or after December 31, 2013**
- **The filing of compliance reports and exemption reports and the related auditor reports effective for fiscal years ending on or after June 1, 2014**
- **Amendments to the notification requirements effective for fiscal years ending on or after June 1, 2014**

Final Amendments to SEC Annual Reporting Requirements

- ❖ **Interaction with the Investment Advisors Custody Rule:**
 - **Broker-dealers that must also comply with the Custody Rule are required to obtain annually an auditor's written internal control report**
 - **The Commission has determined that the independent public accountant's report based on an examination of the compliance report will satisfy this requirement**

***Applicability of Auditor
Independence Rules to Broker-
Dealer Audits***

Applicability of Auditor Independence Rules to Broker-Dealer Audits

- ❖ **Auditors of both issuer and non-issuer broker-dealers are required to be qualified and independent in accordance with the Commission's auditor independence requirements in Rule 2-01 of Regulation S-X, *Qualifications of Accountants***
 - **No currently proposed changes to current requirements**

Applicability of Auditor Independence Rules to Broker-Dealer Audits

❖ **Examples of applicable independence requirements:**

- **Non-Audit Services – An accountant is not independent if, at any point during the audit and professional engagement period, the accountant provides, among others, the following non-audit services to an audit client:**
 - **Bookkeeping or Other Services Related to the Accounting Records or Financial Statements of the Audit Client.**
 - **Management Functions**
- **Other Financial Interests in Audit Client**

Applicability of Auditor Independence Rules to Broker-Dealer Audits

- ❖ **Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence Frequently Asked Questions**
 - Auditors of non-issuer brokers-dealers are not subject to SEC rules related to:
 - Partner rotation requirements
 - Certain partner compensation arrangements
- ❖ **Auditors of non-issuer broker-dealers are also not subject to rules related to:**
 - Audit committee administration requirements
 - “Cooling off” period requirements

Contact Information

- ❖ **Office of the Chief Accountant Involvement in Auditor Independence Matters**
 - **Professional Practice Group – Independence**
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Questions?