



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

November 18, 2010

AICPA Stockbrokerage and
Investment Banking Expert Panel
Attention: Stephen Zammitti, Chair
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Requirements for broker-dealer annual audits pursuant to Rule 17a-5 under the Securities Exchange Act of 1934

Dear Mr. Zammitti:

We have determined that it may be useful to remind auditors of the importance of complying with existing requirements of Rule 17a-5¹ that apply when conducting the "review of the accounting system, the internal accounting control and procedures for safeguarding securities" in connection with the annual audits of broker-dealers.

Rule 17a-5 under the Securities Exchange Act of 1934 ("Exchange Act") requires broker-dealers, among other things, to file annual financial reports, supporting schedules and supplemental reports with the Commission (as applicable).² The supporting schedules filed with the annual financial statements must be comprised of a computation of required and actual net capital under Rule 15c3-1, and, if applicable, a computation of the customer reserve requirement under Rule 15c3-3 and information relating to the possession or control requirements under Rule 15c3-3.³

Pursuant to Rule 17a-5 and Exchange Act Section 17(e), the broker-dealer must file an accountant's report from a registered public accounting firm covering the annual financial statements and supporting schedules. The audit that supports the accountant's report must be conducted in accordance with generally accepted auditing standards. Auditors currently apply the professional standards of the AICPA.⁴ In addition, and as reflected in the excerpt from Rule 17a-

¹ 17 CFR 240.17a-5

² 17 CFR 240.17a-5.

³ See 17 CFR 240.17a-5(d). See also 17 CFR 240.15c3-1 and 17 CFR 240.15c3-3.

⁴ We note that, pursuant to Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Public Company Accounting Oversight Board has been granted the authority to issue auditing and attestation standards for PCAOB-registered auditors of broker-dealers. However, as noted in the Commission's recently published interpretation, auditors should continue to use AICPA standards pending further anticipated rulemaking. See Release No. 34-62991 (September 24, 2010). The AICPA's Accounting and Auditing Guide *Brokers and Dealers in Securities* ("Broker-Dealer Audit Guide") also provides interpretive guidance applicable to performance of the audit.

5 included below, the registered public accounting firm also must perform a review of the accounting system, the internal accounting control and procedures for safeguarding securities.

The following is an excerpt from the requirements for the annual audit contained in Rule 17a-5:

The audit shall be made in accordance with generally accepted auditing standards and shall include a review of the accounting system, the internal accounting control and procedures for safeguarding securities including appropriate tests thereof for the period since the prior examination date. The audit shall include all procedures necessary under the circumstances to enable the independent public accountant to express an opinion on the statement of financial condition, results of operations, cash flow, and the Computation of Net Capital under § 240.15c3-1, the Computation for Determination of Reserve Requirements for Brokers or Dealers under Exhibit A of § 240.15c3-3, and Information Relating to the Possession or Control requirements under § 240.15c3-3. The scope of the audit and review of the accounting system, the internal control and procedures for safeguarding securities shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination in (a) the accounting system; (b) the internal accounting controls; (c) procedures for safeguarding securities; and (d) the practices and procedures whose review is specified [in Rule 17a-5] would be disclosed.⁵

The requirement above clearly states that the “scope of the audit and review...shall be sufficient to provide reasonable assurance that any material inadequacies existing at the date of the examination...would be disclosed.”⁶ Material inadequacy for these purposes is defined in the requirements of Rule 17a-5.⁷

Consistent with this rule, the Broker-Dealer Audit Guide states that “in planning and performing the audit of financial statements, the auditor should obtain reasonable assurance that any material inadequacies existing at the audit report date...would be disclosed.”⁸ The Broker

⁵ 17 CFR 240.17a-5(g)(1). Additionally, as specific objectives, the audit shall include reviews of the practices and procedures followed by the client: (i) in making the periodic computations of aggregate indebtedness and net capital under §240.17a-13(a)(11) and the reserve required by §240.15c3-3(e); (ii) in making the quarterly securities examinations, counts, verifications and comparisons and the recordation of differences required by §240.17a-13; (iii) in complying with the requirement for prompt payment for securities of section 4(c) of Regulation T (§220.4(c) of chapter II of title 12) of the Board of Governors of the Federal Reserve System; and (iv) in obtaining and maintaining physical possession or control of all fully paid and excess margin securities of customers as required by §240.15c3-3. Such review shall include a determination as to the adequacy of the procedures described in the records required to be maintained pursuant to §240.15c3-3(d)(4). See 17 CFR 240.17a-5(g)(1)(i) – (iv). See also Sections 5.06, 5.09 and 5.10 of the Broker-Dealer Audit Guide.

⁶ *Id.*

⁷ See Rule 17a-5(g)(3) (17CFR 240.17a-5(g)(3)).

⁸ See Section 5.09 of the Broker-Dealer Audit Guide. The disclosure of material inadequacies is limited to the areas of the accounting system, internal control, procedures for safeguarding securities and the practices and procedures specified in Rule 17a-5.

Dealer Audit Guide further states that “the audit should include a review of the broker-dealer’s practices, procedures and controls to ensure compliance with the securities possession or control and the cash reserve elements of the Customer Protection Rule and should include those tests that the auditor considers necessary to provide reasonable assurance that any material inadequacies (and significant deficiencies or material weaknesses) existing at the date of the examination would be disclosed.”⁹ In order to obtain reasonable assurance to support the reporting of material inadequacies to the Commission, the auditor should follow the requirements contained in existing professional standards, including the AICPA’s Statements on Standards for Attestation Engagement.

Both the annual financial statement audit and the compliance examination procedures performed by the auditor are critical compliance elements relative to the Commission’s regulatory oversight of broker-dealers. Auditors currently planning or performing audits of broker-dealers should ensure that they do so in a manner that is in conformity with the requirements of the applicable rules and professional standards.

If you have any questions, please contact John Ramsay, Deputy Director, Division of Trading and Markets, at (202) 551-5500 or Brian Croteau, Deputy Chief Accountant, Office of the Chief Accountant, at (202) 551-5300.

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Sincerely,



Robert W. Cook
Director
Division of Trading and Markets



James L. Kroeker
Chief Accountant
Office of the Chief Accountant

cc: Charles Landes, AICPA Vice President, Professional Standards and Services
Cynthia Fornelli, Executive Director, Center for Audit Quality
Martin Baumann, PCAOB Chief Auditor and Director of Standard Setting
George Diacont, Director, PCAOB Division of Registration and Inspections

⁹ See Section 3.27 of the Broker Dealer Audit Guide.