



**Broker-Dealer Audits: Overcoming Costly Deficiencies  
in PCAOB Examinations, Avoiding Sanctions**

January 23, 2019



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# The Public Company Accounting Oversight Board Overview

# Overview: Origin and Mission

## Origin

- The Public Company Accounting Oversight Board was created by the Sarbanes-Oxley Act of 2002.
- It is a non-profit corporation established by Congress to oversee the audits of public companies and broker-dealers.
- Prior its creation, audit firms were self-regulated.
- The PCAOB employs over 780 staff members.  
*(note: 785 per annual report; 60% is DRI; this is a decrease when compared to 851 in 2015)*

## Mission

- To protect investors and the public interest by promoting informative, accurate, and independent audit reports.
- To promote investor protection through oversight of independent audits and compliance reports filed pursuant to federal securities laws.

# Overview: Registered Firms and Inspections

## PCAOB Registered Firm Totals

Year	Domestic	International	Total Firms	Jurisdictions
2017	1,036	889	1,925	88
2015	1,208	899	2,107	90

## PCAOB Issuer Audit Totals

Year	Issuer Audits Inspected	Total Firms
2017	760	195
2015	810	215

## PCAOB Broker-Dealer Audit Totals

Year	Broker-Dealer Audits Inspected	Total Firms
2017	115	75
2015	115	75

Source: 2015 and 2017 Public Company Accounting Oversight Board Annual Reports

## Overview: New Leadership

On December 12, 2017, the Securities and Exchange Commission appointed five new members to the Board. Collectively, the PCAOB's new leadership is a representation of the entire financial sector including investor-related, public company, auditor, academic, and board experience.

The new members were sworn in between January and April 2018, and each will serve a five-year term.



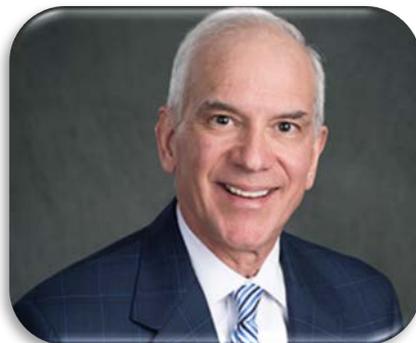
**William D. Duhnke III**  
*Chairman*



**Kathleen M. Hamm**  
*Board Member*



**J. Robert Brown**  
*Board Member*



**James G. Kaiser**  
*Board Member*



**Duane M. DesParte**  
*Board Member*

# Overview: New Leadership Statements

Chairman Duhnke's comments have alluded to transitional change.

I. The 2017 PCAOB annual report contains the following statement:

*"The new Board fully intends to use this opportunity to examine all aspects of the PCAOB's activities; every organization should, from time to time, reflect on lessons learned and make improvements where possible. The PCAOB is no exception."*

II. May 2018, Chairman Duhnke reiterated the sentiment in a public speech.

a) While the PCAOB was initially focused on carrying out *"day-to-day oversight responsibilities"*...

b) *"We look forward to working together with all of our constituencies to further enhance audit quality across the profession in the most effective, efficient and **least intrusive** way we can devise"* (emphasis added).

c) *"Substantial opportunities exist for us to improve our policy making and our external engagement."*

Sources: 2017 Public Company Accounting Oversight Board Annual Report; Chairman Duhnke's Speech, *PCAOB Transitions for the Future*, May 17, 2018

## Overview: Leadership Statements in Action

The Board's approach to creating a strategic plan is significantly different, when compared to prior years, and includes the following elements:

- I. Solicited public input related to strategic priorities
- II. Interviews with key constituents (investors, academics, regulators, audit firms, and public company interest groups)
- III. PCAOB staff input

The strategic plan draft and submitted public comments can be viewed online, and the final version is expected to be released in/around November 2018.

When considering the Chairman's comments, it is reasonable to conclude the Board is actively seeking ways to innovate in an effort to continue to improve audit quality.

Source: Chairman Duhnke's Speech, *PCAOB Transitions for the Future*, May 17, 2018



# The Public Company Accounting Oversight Board Division of Registration and Inspections

# Inspections

The Chairman has observed that many firms appear to have “plateaued in their progress toward achieving improved inspection results,” and the Board is seeking potential solutions to continue to drive enhanced audit quality by asking the following questions:

- Would an increase in random selections provide any insight?
- Can/should the inspection process place more emphasis on the role of quality control systems; would this approach prevent audit deficiencies?
- Can research from economic and risk analysis efforts be effectively integrated in shaping the inspection priorities and approach?
- Can inspection data be leveraged to gain insights to obtain more meaningful insights to further audit quality?
- Are there targeted actions that can be taken within the inspection approach to drive improvements in specific areas of continuing concern?
- Does the inspection process introduce unnecessary and unexpected costs into the financial reporting system, with corresponding benefits to audit quality and investor protection?

# Inspections

The Board will continue to collaborate with domestic and international peers by sharing information regarding the risks and benefits associated with different inspection approaches.

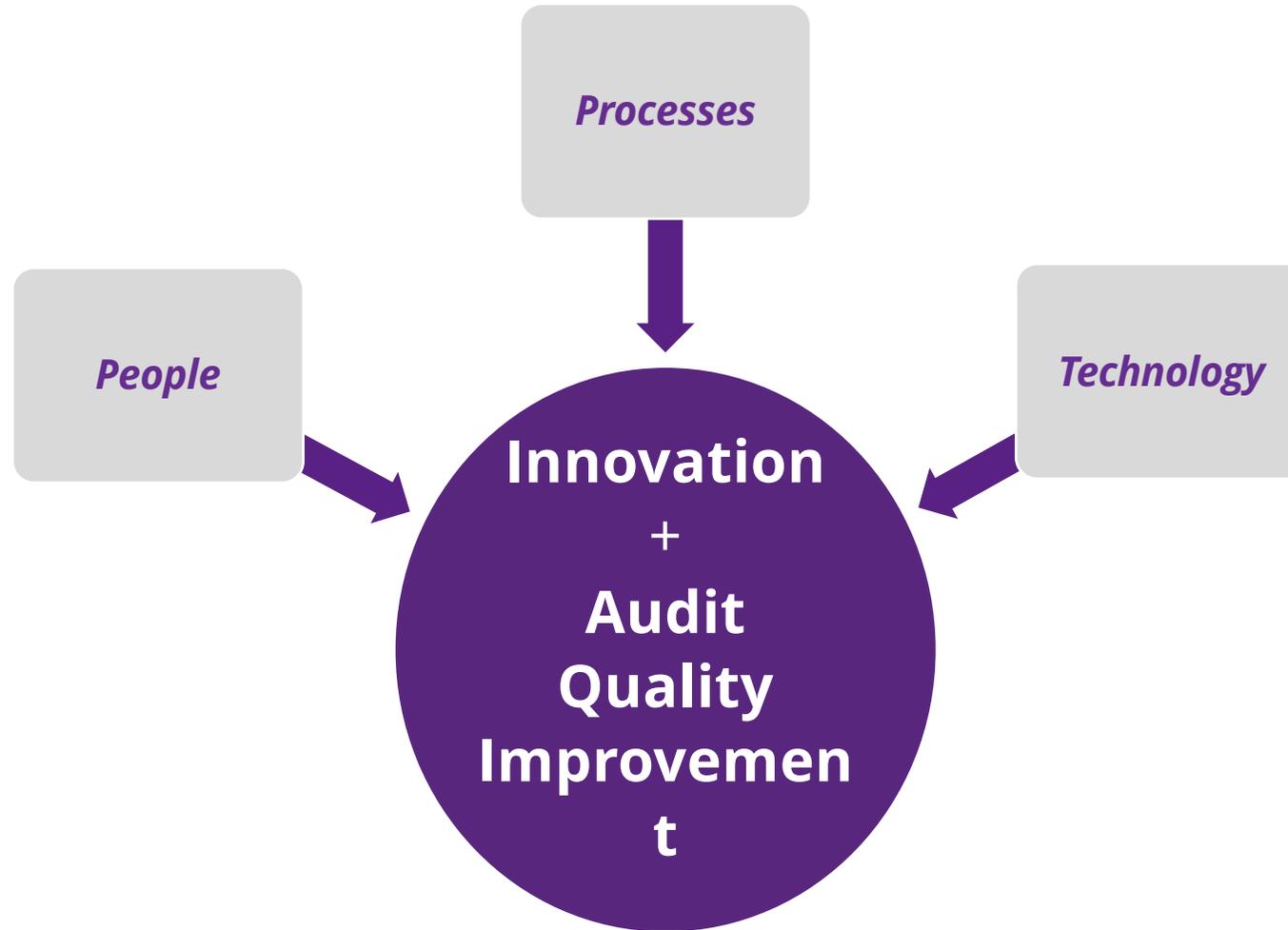
## Examples of International audit regulators

- Authority for Financial Markets (AFM), Netherlands
- Canadian Public Accountability Board (CPAB), Canada
- Financial Reporting Council (FRC), United Kingdom

## Examples of Domestic audit and banking regulators

- FDIC
- Federal Reserve Bank
- FINRA
- Securities and Exchange Commission

# Inspections: The Board is Challenging Existing Practices



## Inspections: New Leadership

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**George Botic**, newly appointed Acting Director (replaced Helen Munter)

- Previously led the Non-Affiliate Firm (NAF) program
- Former special advisor to Chairman Doty

**Carol Swaniker**, newly appointed Deputy Director, Registration (replaced Sarah Williams)

- Former regional coordinator of NAF (responsible for inspection coordination/  
detail inspection report review)

**Christine Gunia**, newly appointed Deputy Director, Global Network Firm (GNF) Inspection Program (replaced John Fiebig)

**Robert Maday**, Deputy Director, Broker-Dealer Audit Firm Inspection Program

**G. Alan Skinner**, Deputy Director, Non-Affiliate Firm (NAF) Inspection Program

## Interim Inspection Program

- 2010 – Dodd Frank Wall Street Reform and Consumer Protection Act
- In place since 2011 – PCAOB Rule 4020T, Interim Inspection Program Related to Audits of Brokers and Dealers
- 2013 – SEC Adopts amendments to Rule 17a-5
- 2013 – PCAOB adopts AT No. 1 and AT No. 2
- Most recent report issued on August 18, 2017
- Continued collaboration with FINRA and the SEC

## Permanent Inspection Program

- Key questions related to scope, frequency, and nature
- Review of System of Quality Control, new for auditors of broker-dealer firms
- Proposal previously expected in 2018/2019

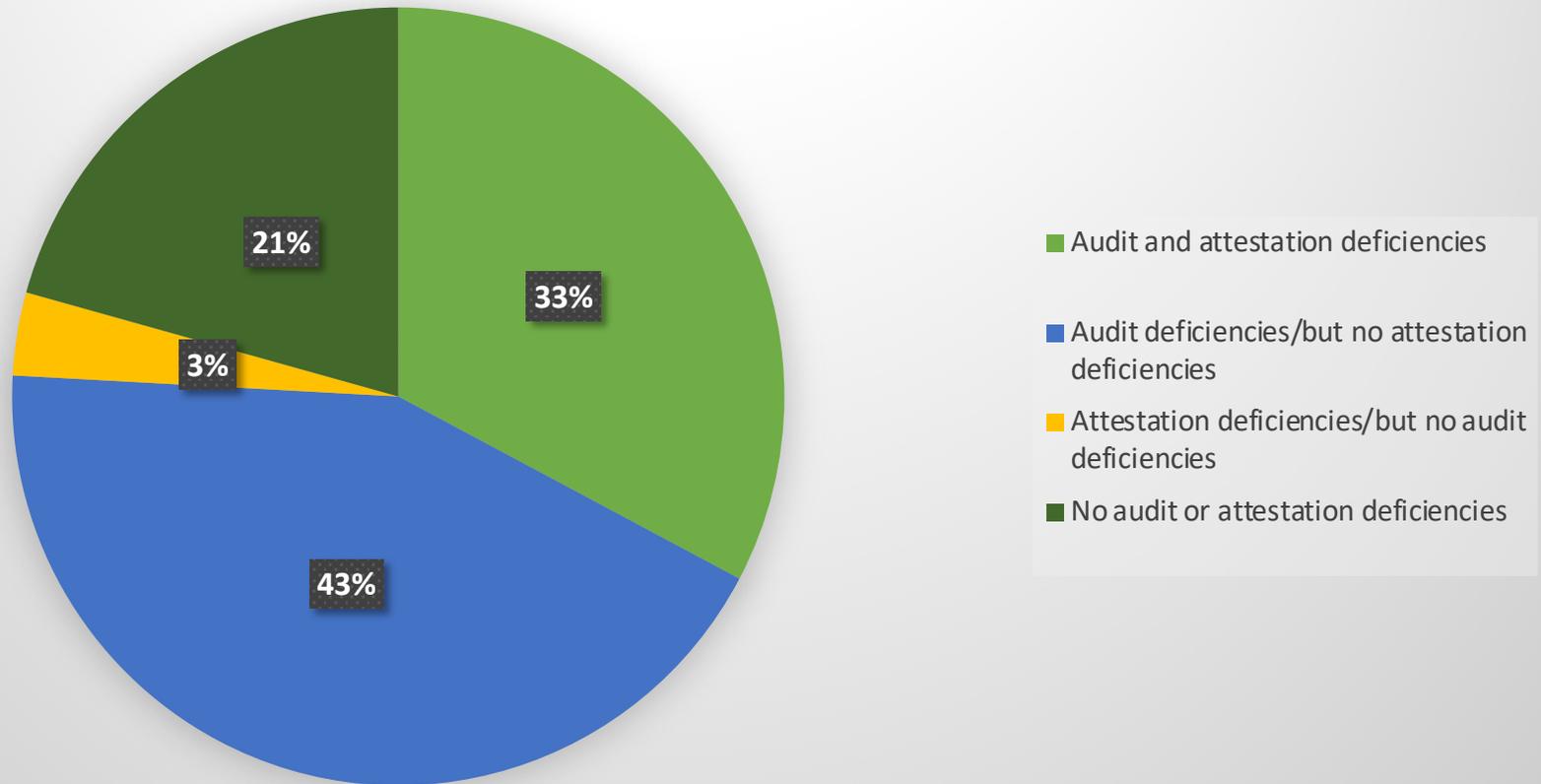
**Current legislation is being considered.**

## Firms Auditing Broker-Dealers 2017 and 2012

Broker-Dealer Audits per Firm	Number of Firms – 2017	Percentage of Firms – 2017	Number of Firms – 2012	Percentage of Firms - 2012
1	144	33%	363	46%
2 to 5	170	39%	293	37%
6 to 20	89	20%	90	12%
21 to 50	24	5%	23	3%
51 to 100	9	2%	8	1%
More than 100	5	1%	6	1%
<b>Total</b>	<b>441</b>	<b>100%</b>	<b>783</b>	<b>100%</b>

## 2017 Inspection Results

### 2017 Inspections Covering 116 Audits and the Related Attestation Engagements



## Audit and Other Deficiencies - 2017

Audit and Other Deficiencies	Number of Audits with Deficiencies	Number of Applicable Audits	Percentage of Audits with Deficiencies
Revenue	73	112	65%
Assessing and Responding to Risks	16	25	64%
Financial Statement Presentation	38	116	33%
Related Party Relationships	21	66	32%
Fair Value Measurements	7	25	28%
Receivables and Payables	11	35	31%
Net Capital Rule	28	78	36%
Customer Protection Rule	14	29	48%
Auditor's Reporting on the Financials	12	116	10%
Audit Documentation	15	116	13%
Engagement Quality Review	55	93	59%
Evaluation of Control Deficiencies	8	116	7%
Independence Comm's to Audit Comm.	14	48	29%

## Attestation and Other Deficiencies - 2017

Attestation and Other Deficiencies	Number of Attestation Engagements with Deficiencies	Number of Applicable Attestation Engagement	Percentage of Attestation Engagements with Deficiencies
Examination Procedures	19	27	70%
Review Procedures	28	87	32%
Examination Report	2	27	7%
Examination Documentation	2	27	7%
Engagement Quality Review (Related to Examination Engagements)	4	20	20%
Review Report	11	87	13%
Review Documentation	5	87	6%
Engagement Quality Review (Related to Review Engagements)	14	54	26%

# Inspections: Reporting

The Board continues to question the usefulness of audit firm inspection reports and the transparency of remediation efforts. For example:

- Does the current reporting format and approach meet the needs of investors, audit committee members and the broader public interest?
- Aside from the number of audits with Part 1 deficiencies, are there better ways to present or quantify inspection results?
- Finally, what methods or tools can be used to more accurately define and promote audit quality?

Source: Chairman Duhnke Speech, *PCAOB Transitions for the Future*, May 17, 2018

## Inspections: Remediation

The Board is encouraging more engagement from firms during the remediation process.

- Recent inspection reports include language that suggest firms, in certain circumstances, perform “independent reviews” of audits that were not inspected by the PCAOB.
  - Independent reviews are not “required”; however, they fall within the scope of QC 30, *Monitoring a CPA Firm’s Accounting and Auditing Practice*.
  - Firms voluntarily undertaking these reviews and reporting results will be considered by the Board.
- With respect to remediation, the Board is considering whether additional guidance and transparency about the remediation process can be provided.

# Inspections: Observations

In recent years, the following themes have consistently appeared in comment forms and inspection reports.

## Key Inspection Themes

Assessing and  
Responding to Risks  
of Material  
Misstatement

Auditing Accounting  
Estimates, Including  
Fair Value  
Measurements

Internal Controls  
Over Financial  
Reporting

Professional  
Skepticism

*Refer to [Appendix A](#) for further details*



# The Public Company Accounting Oversight Board Legislative Matters

## Legislation: Small Business Correction Act of 2018

Earlier this year, legislation was introduced to amend the Sarbanes-Oxley Act of 2002. If passed, these bills would directly impact privately held, non-custody brokers and dealers in good standing; such broker and dealers would no longer be required to use a PCAOB registered audit firm for annual audits. Additional legislative details are as follows:

Audit firms who audit only broker-dealers and the definition above would:

- Apply AICPA standards
- No longer required to be registered with PCAOB
- No longer subject to PCAOB inspection

What would not change:

- SEC requirements including Rule 17a-5
- Independence requirements
- Filing requirements with SEC or SRO designated to examine broker-dealers
- Requirement to share work papers with SEC or SRO if requested for the purpose of examination

# Legislation: Small Business Correction Act of 2018

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## Observations

### **Most broker-dealer audits not effected**

58% of auditors conducting these audits audit less than 20 broker-dealers and do not audit issuers

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But these firms represent less than 25% of all broker-dealers subject to audit

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### **No Change in SEC/SRO requirements**

Requirements in Rule 17(a)-5 drive the majority of audit work

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# The Public Company Accounting Oversight Board Division of Enforcement and Investigations

# Enforcement: Background

## Authority

The PCAOB has authority to investigate and discipline registered public accounting firms and persons associated with those firms for noncompliance with the Sarbanes-Oxley Act of 2002, rules of the PCAOB and the Securities and Exchange Commission, and other laws, rules, and professional standards governing the audits of public companies, brokers, and dealers.

## Investigations

PCAOB investigations are confidential and nonpublic.

### → Process:

- Informal Inquiry
- Formal Investigation
- Order Instituting Proceedings
  - Settle vs Litigate (Hearing Officer)
  - Right to Appeal (Board, SEC, United States Court of Appeals)

### → Case Source:

- Public information (news articles, blogs, public filings)
- Tip Submissions
- Referrals
  - PCAOB Division of Registration and Inspections
  - PCAOB Office of Research and Analysis
  - Other regulators such as SEC, FINRA, CFTC, Foreign Regulators

## Enforcement: Regulator Collaboration

The SOX Act requires confidentiality of information; however, the PCAOB may share information with other state, federal and international regulators including the DOJ, SEC, U.S. State Accounting Boards and IFIAR MOU.

Increase of  
PCAOB  
Referrals to  
SEC  
("Assistance of  
the PCAOB")

- **Deloitte & Touche Chartered Accountants LLP**  
Zimbabwe affiliate: AAER #3928; March 2018
- **KPMG**  
Zimbabwe affiliate: AAER #3929; March 2018  
South Africa affiliate: AAER #3927; March 2018
- **BDO Canada LLP**: AAER #3926; March 2018

PCAOB  
Acknowledges  
SEC Assistance

- **Grant Thornton LLP**: Release #105-2017-054, December 2017
- **Deloitte & Touche LLP**: Release #105-2018-008, May 2018
- **PricewaterhouseCoopers LLP**: Release #105-2017-032, August 2017

The PCAOB and SEC will continue to pursue various audit matters.

## Enforcement: Board Reflections and New Leadership

In a speech earlier this year, the Chairman raised the following enforcement questions:

- A. Is the right mix of enforcement cases being pursued, and are they being pursued and adjudicated in a timely manner?
- B. Are the remedies being imposed effective and appropriate in the enforcement cases pursued?

Based upon those comments, we would expect that PCAOB Enforcement will continue to focus on its priorities (i.e. international, actions undermining oversight, etc.), but there may be an increased focus on timely case turnover, and the nature of case

### Leadership Changes

On May 29, 2018 it was announced that Claudius Modesti, Director of the Division Enforcement and Investigations, was leaving the PCAOB after 14 years. Modesti had been the Division's first and only enforcement director.

The Division's Chief Trial Counsel, Mark Adler, was named Acting Director. He was formerly Acting Chief and Deputy Chief Litigation counsel at the SEC and former Department of Justice counsel.

# Enforcement: Recent Court Decisions - Right to Counsel and Administrative Law Judges

## Right to Counsel

- On March 23, 2018, Judge Kavanaugh issued an opinion in the Laccetti case; this matter was the first PCAOB action to be appealed through the SEC and a U.S. Court of Appeals.
- Judge Kavanaugh determined that “the right to counsel in this context encompasses the right to have the assistance of an accounting expert during the interview.”
- This decision allows accounting experts to be present during PCAOB enforcement investigation testimony/interviews.

## Administrative Law Judges

- In *Lucia v. SEC*, the Supreme Court ruled that SEC administrative law judges qualify as “officers of the United States” and are subject to the Appointments Clause of the Constitution, which means they must be appointed by the SEC Commissioners.
- The ruling is consistent with the *Free Enterprise Fund* and *Beckstead and Watts, LLP v. PCAOB* outcome.
- Potential impact for the PCAOB’s hearing officer appointment process.

# Enforcement: Extraordinary Cooperation and Admissions

## I. No changes, yet, regarding:

- a) Extraordinary Cooperation Policy
- b) Admissions Policy

## II. In 2018:

- a) One settlement noting extraordinary cooperation
- b) Three settlements noting admissions (two admissions related to work paper alterations, and one admission regarding lack of EQR)
  - i. 2017 - 13 settlements (eight related to a lack of EQR; two related to independence; two related to improper work paper alterations; one related to a non-cooperation)

## III. Board will likely seek admissions in the following types of cases:

- a) Non-cooperation with Division of Inspections and Division of Enforcement
  - i. Examples include: Undisclosed workpaper alteration, failure to produce the documents under ABD, failure to cooperate with inspections, failure to attend testimony
- b) Independence violations
- c) Form filings violations (failure to file a form/filed incorrect form)
- d) Failure to perform a required Audit Procedure - EQR



## Enforcement: Priorities

- Four Enforcement Priorities:
- Investigations involving significant audit violations, including a lack of due professional care and professional skepticism
- Audit matters relating to the independence and integrity of the audit
- Matters threatening or eroding the integrity of the Board's regulatory oversight process
- Investigations focusing on the risks associated with cross border audits

## Enforcement: PCAOB Settled Orders

The PCAOB settled 20 orders in 2018.

Of those 20 orders

- 12 relate to Firms/ Individuals at NAFs
- 8 relate to Firms/ Individuals at GNFs
  - DT (US) and affiliates (Canada, Mexico, Turkey, UK); KPMG (US)

Three orders included admissions.

Six orders relate to broker-dealer audits.

One order notes extraordinary cooperation.

54 orders were settled in both 2016 and 2017.

- Orders related to issuers audits = 35 (2016) and 32 (2017)
- Orders related to broker-dealer audits = 9 (2016) and 14 (2017)

## Enforcement: Broker-Dealer Settlements

- See *In the Matter of Brian D. Donahue, CPA (Violation of Bar)*
  - Donahue was previously sanctioned by the Board.
  - Donahue referred issuer and broker-dealer audit clients to Leigh J. Kremer CPA since he was barred from performing the work himself.
  - Donahue received a percentage of audit fees from Kremer for two issuer and ten broker-dealer referred clients.
  - In receiving payment from the firm based on a percentage of the firm's issuer and broker-dealer audit fee, he became an associated person of the firm despite the bar that the Board had imposed against him.
  - Sanctions – censure, 5-yr bar, and \$15K penalty.
  
- See *In the Matter of Leigh J. Kremer CPA and Leigh J. Kremer, CPA (Violation of Bar)*
  - Firm violated Section 105(c)(7)(A), Rule 5301(b), AS 1220; Individual violated 3502.
  - No EQR performed (AS 1220).
  - Sanctions - Firm: censure, 3-yr revocation, and \$10K penalty; CPA: censure and 3-yr bar.
  
- See *Baum & Company, P.A. and Joel S. Baum, CPA (Interference w/Board Processes)*
  - Firm violated AS 1215 and PCAOB Rule 4006.
  - Baum added, backdated, and otherwise altered work papers in advance of a 2017 inspection.
  - Baum self-reported the conduct at the start of the inspection.
  - Firm given extraordinary cooperation credit.
  - Sanctions - Firm: censure, 1-yr revocation, and \$10K penalty; CPA: censure and 1-yr bar.

## Enforcement: Broker-Dealer Settlements (cont'd)

- See *In the Matter of Richard J. Girasole, CPA PC and Rechar J. Girasole, CPA (Independence)*
  - Firm and individual sanctioned for violations of auditor independence, AT 2, AS 1220, and Rule 2203, *Special Reports*, among other violations.
  - Respondents changed line item amounts and updated footnote disclosures in a broker-dealer' financial statement and prepared net capital calculation and exemption report.
  - Failed to perform any procedures to identify exceptions to exemption provisions as required by AT 2.
  - EQR was senior accountant at the firm, not a partner or an equivalent position.
  - Sanctions – Firm: censure, 2-yr revocation, and \$10K penalty; CPA: censure and 2-yr bar.
  
- See *In the Matter of Breard & Associates, Inc. CPAs and Kevin G. Breard, CPA (EQR)*
  - Firm repeatedly violated AS 1220; Individual violated 3502.
  - No EQR performed for 135 broker-dealer clients 2014, 2015, and 2016.
  - Sanctions - Firm: censure, 5-yr revocation, and \$75K penalty; CPA: censure and 5-yr bar.

## Enforcement: Broker-Dealer Settlements (cont'd)

- See *In the Matter of Shedjama, Inc. and Edward Opperman, CPA (EQR)*
  - Firm repeatedly violated AS 1220; Individual violated 3502.
  - No EQR performed for 23 broker-dealer clients in 2015 and 30 broker-dealer clients in 2016.
  - Sanctions - Firm: censure, 2-yr revocation, and \$10K penalty; CPA: censure and 2-yr bar
  
- See *In the Matter of Tarvaran Askelon & Company, LLP, et al. (Attestation Violations)*
  - Firm and 2 individuals violated AS 2701, *Auditing Supplemental Information* and AT 1, among other violations in connection with audit of carrying broker-dealer's financial statements and examination of compliance report.
  - With respect to customer reserve/net capital, Respondents failed to test information produced by B-D for completeness and accuracy.
  - Respondents also failed to perform any procedures to test B-D's Internal Control Over Compliance (ICOC).
  - Sanctions - Firm: censure, 2-yr revocation, and \$15K penalty; Engagement partner: censure, 2-yr bar, and \$5K penalty; EQR: censure, 1-yr bar, and \$5K penalty.

# Enforcement: 2018 Audit Violation Examples

## AT No. 1

Examination Engagements Regarding Compliance Reports of Brokers and Dealers

No procedures performed related to testing ICOC controls & evidence of design and operational effectiveness; failed to perform any procedures that tested the accuracy and completeness of information used to compute Net Capital Rule and Reserve Requirement Rule compliance; failed to perform any procedures to understand ICOC (other than reading a manual).

## AS 1220

Engagement Quality Reviewer

Lack of Engagement Quality Reviewer

Unqualified Engagement Quality Reviewer

Violation of "cooling-off" period

## AS 2410

Related Parties

Failed to perform any audit procedures to determine whether the company had properly identified, accounted for and disclosed its related parties and relationships and transactions with related parties.

One recent settlement involved undertakings with respect to QC policies and procedures related to EQRs.

The Board continues to focus on pursuing potential violations involving:\*

- Board Processes (primarily non-cooperation)
- Cross-Border audits
- Independence
- Lack of Professional Skepticism

\*C. Modesti speech Crossing Borders, Digging Deep: DEI's Investor Protection Efforts in 2017 - December 6, 2017

## Enforcement: 2018 Adjudicated Matters

The PCAOB enforcement process is non-public even through the appeals process, and the board routinely seeks consent to make proceedings public.

### 2018

Five adjudicated matters were posted.

- Mark E. Laccetti, CPA
- S. Brent Farhang, CPA
- Melissa K. Koepfel, CPA
- George W. Stewart, Jr., CPA
- Michael Freddy

### 2017

One adjudicated matter was posted.

- Kabani & Co., Inc.; Hamid Kabani, CPA; Michael Deutchman, CPA; and Karim Khan Muhammad, CPA



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# Appendix A - Inspections

# Appendix A: Inspections - Key Inspection Themes

## Internal Controls Over Financial Reporting - Staff Practice Alert 11

- Sufficiency of procedures performed to identify, test and evaluate controls that address the assessed risks of material misstatement
- Sufficiency of testing the design and operating effectiveness especially those that include a review element AS 2201.42 and .44)

## Assessing and Responding to Risks of Material Misstatement

- Sufficiency of testing the design and operating effectiveness
- Testing the level of Precision of the Control Tested
- Testing of controls over the accuracy and completeness of system generated data and reports (AS 1105.10)
- Whether substantive procedures were specifically responsive to fraud risks and other identified significant risks of material misstatement (AS 2301.11 and .13)
- Evaluating the presentation of the financial statements, including the accuracy and completeness of the disclosures (AS 2810.30-31)
- Evaluation of relevant audit evidence that appears to contradict certain assertions in the financial statements (AS 2810.03 and .34)

# Appendix A: Inspections - Key Inspection Themes

## Auditing Accounting Estimates, including Fair Value Measurements

- Continues to be a focus of inspections due to the increased risk of material misstatement that estimates pose to the financial statements.
- Deficiencies commonly relate to evaluating impairment analyses for goodwill and other long-lived assets, valuations of assets and liabilities acquired in a business combinations and allowance for loan losses.
- Many of the deficiencies relate to testing controls over managements cash-flow forecasts or other assumptions used in determining estimates related to revenue, business combinations, asset impairments and reserves. (See Slide on ICFR and SAPA 11)
- Inspection staff continues to focus on the auditors understanding of how the estimates are developed and testing of data and evaluation of the assumptions used by management that are significant to the estimate. (AS 2501.10-.11)

## Professional Skepticism

- Lack of appropriate professional skepticism in areas that involve significant management judgements or transactions outside the normal course of business including the consideration of fraud.
- Evidence was only obtained that supported management's judgements and representations rather than critically assess the reasonableness of those judgements and consideration of all relevant information regardless of whether it confirmed or contradicted management's assertions.

## System of Quality Control

- Audit Performance
- Client acceptance and continuance
- Independence
- Internal Inspections/ Monitoring
- Partner management and compensation
- Tone at the top
- Training

These areas are reviewed **every** inspection cycle.

# Appendix B: Inspections - Example Findings

## Responding to Significant Risks

The auditor identified a fraud risk involving revenue recognition. To test revenue, the auditor (1) performed substantive analytical procedures, (2) confirmed a sample of accounts receivable as of an interim date, (3) performed roll-forward testing of the accounts receivable balance from the interim date to year-end, and (4) tested sales cutoff.

The auditor failed to perform sufficient procedures, as the auditor limited tests of details to revenue recorded between the interim date and year-end, and to those balances included in accounts receivable balance testing at interim, even though the fraud risk was not confined to those portions of revenue.

## Review Control Deficiency

The auditor selected for testing certain issuer controls related to the assessment of possible impairment of the issuers long-lived assets. These controls consisted of the preparation and review of quarterly impairment memoranda and meetings to discuss various matters that could have an effect on accounting for these assets.

The auditor limited the procedures to test these controls to obtaining evidence of management approval of the memoranda, attending certain issuer meetings, and reading the issuer's memoranda, which did not include detailed information such as the relevant indicators of possible impairment that management reviewed.

The auditor failed to perform sufficient procedures, as the auditor did not obtain an understanding of the actions performed by management during their review, which was necessary to evaluate whether the control was designed and operating to prevent or detect on a timely basis misstatements that could cause the financial statements to be materially misstated.

# Appendix B: Inspections - Example Findings

## Evaluation of Management Assumptions

In performing substantive procedures to test the valuation of an issuer's goodwill, the auditor reviewed the issuer's impairment analysis and (1) compared the forecasted revenue growth rates to the historical growth rate of the company and (2) compared the issuer's fourth-quarter forecasted revenue to the actual results for the quarter.

Based on these procedures, the auditor identified significant differences between the issuer's analysis and the historical and actual results. The auditor inquired of management about the reason for the differences, but did not corroborate management's explanations with other audit evidence.

Additionally, the auditor failed to evaluate whether the differences identified should have an effect on its conclusions about management ability to prepare reasonable forecasts.

## Developing an Independent Estimate

Investment securities without readily available values composed a significant portion of an issuer's assets at year-end. The issuer used an external pricing source to determine fair values of these securities.

The auditor assessed the risk of material misstatement as high for the valuation of investment securities, and planned its audit approach to determine independent estimates of fair value for a sample of these securities, using an external pricing source.

The audit failed to develop an independent estimate because it used the same external pricing source that the issuer used for the majority of its sample.

## Appendix B: Inspections - Example Findings

### Identifying and Selecting Controls

The auditor identified a fraud risk involving improper revenue recognition. The auditor identified and tested certain controls over the occurrence, completeness, and valuation of revenue.

The auditor, however, failed to identify and test controls over the data input into the issuer's system maintaining the contract terms, including various fees that were used to determine the amount of revenue recognized.

### Testing Controls over the Accuracy and Completeness of Financial Information

In a financial statement audit, the auditor planned to rely on an entity-level control for testing revenue recognition that included management review of variances between actual, budgeted, and forecasted revenue, as well as various business metrics that may have influenced changes in the amounts recorded.

The information reviewed by management in this control included system-generated data. As a result, the effectiveness of the entity-level control depended, in part, on the issuer's controls over the accuracy and completeness of these data.

The auditor, however, failed to perform procedures to test the controls over

## Appendix B - Enforcement

## Appendix B: Enforcement - Admissions Policy

Admissions may be sought “... In matters where heightened accountability and acceptance of responsibility are in the public interest”

Recommendation Considerations include:

- Egregious and intentional misconduct where the respondent knowingly and intentionally violated the applicable laws, rules or standards
- Misconduct that obstructs the Board’s processes, such as noncooperation with an inspection or an investigation
- Significant harm or risk of harm to investors or the securities markets
- Situations where an admission can send a particularly important message to audit firms, their associated persons or to the public; and
- Situations where the wrongdoer poses a particular future threat to investors, e.g.; recidivists

## Appendix B: Enforcement - Extraordinary Cooperation

- Extraordinary cooperation is voluntary and timely action and goes beyond compliance with legal or regulatory obligations.
  
- Types of cooperation:
  - ✓ Self-Reporting
  - ✓ Remedial or Corrective Action
  - ✓ Substantial Assistance to the Board's Investigation
  
- Application of extraordinary cooperation:
  - ✓ Reduction of charges and/or sanctions
  - ✓ Language in settlement documents noting the cooperation and its positive effect on the final settlement by the firm or associate
  - ✓ In exceptional cases, no disciplinary action against firms has occurred

## Appendix B: Enforcement - Sanctions

PCAOB Rule 5300(a) allows the Board to impose disciplinary or remedial sanctions as it determines appropriate; some examples are as follows:

- Temporary suspension or permanent revocation of registration
- Temporary or permanent suspension, or bar, of a person from further association with any registered public accounting firm
- Temporary or permanent limitation on the activities, functions or operations of a firm or person
- Censure and/or civil monetary penalties
- Require additional professional education or training
- Require a registered public accounting firm to engage an independent monitor
- Require a registered firm to engage counsel or another consultant to design policies to effectuate compliance with the Act; Rules of the Board; securities laws; related to the preparation and issuance of audit reports and the obligations and liabilities of accountants
- Require a registered firm to obtain an independent review and report on one or more engagements

