



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

February 15, 2011

***Via Electronic Mail***

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, D.C. 20006-2083

Re: *Proposed Temporary Rule for an Interim Program of Inspection Related to Audits of Brokers and Dealers, PCAOB Rulemaking Docket Matter No. 32*

Dear Office of the Secretary:

The American Institute of Certified Public Accountants (“AICPA”) is pleased to comment on the Public Company Accounting Oversight Board’s (“PCAOB” or “Board”) proposed temporary rule to establish an interim inspection program (“Proposed Interim Inspection Rule”) related to brokers and dealers, as published in PCAOB Release No. 2010-008 on December 14, 2010, and in furtherance of oversight and rulemaking authority granted to the PCAOB as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“the Dodd-Frank Act”). The AICPA is the largest professional association of certified public accountants in the United States, with over 370,000 members in business, industry, public practice, government, and education. It is from this diverse perspective that we provide our comments and recommendations.

Overall, we support the Board’s Proposed Interim Inspection Rule as a means to strengthen investor protections in the U.S. securities markets. However, we are convinced that PCAOB registration and new inspections should apply only to auditors whose broker-dealer clients hold and invest customer securities or cash (clearing, carrying and/or custodial) and thus present actual risk to investors. We appreciate the Board’s desire to use its interim inspection program to gather critical information so that it can methodically determine what a final rule should encompass for those auditors of broker-dealers ultimately subjected to this registration and new inspection regime. Given

that the interim rule may vary significantly from a final rule, AICPA recommends that the interim inspection program's scope focus solely on firms which are already subject to PCAOB inspections (by virtue of auditing issuers) and those firms which audit clearing, carrying or custodial broker-dealers (but may not currently be subject to PCAOB inspection).

#### **I. AICPA's Position regarding PCAOB oversight of Broker-Dealers**

The AICPA firmly believes that PCAOB registration and inspection should apply to auditors of those broker-dealers holding and investing customer cash or securities (clearing, carrying and/or custodial). These broker-dealers present the only realistic risk to investors because of the activities they perform on behalf of investors. Introducing broker-dealers, on the other hand, do not or only have a limited right to handle cash, and accordingly pose no systemic risk to the markets and investors. We believe the auditors of this class of broker-dealers can and should be handled differently<sup>1</sup>.

The SEC has noted that broker-dealers that are not carrying, clearing or custodial firms are of enough risk to investors that their audits should be subject to PCAOB regulation because these broker-dealers are permitted to receive customer cash or securities on a limited basis.

We disagree with this conclusion. The Customer Protection Rule, or Rule 15c3-3, does, in fact, contain three exemptions that permit broker-dealers other than those that perform custodial or clearing functions to handle customer funds and securities on a limited basis<sup>2</sup>. Under these circumstances, all broker-dealers must "promptly transmit" funds and securities when received. Additionally, and, more importantly, these broker-dealers are required to maintain procedures designed to *prevent* their customers from transmitting funds to the broker-dealer firm. These procedures must also address the actions the broker-dealer will take to advise its customers (in writing) should a customer

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<sup>1</sup> On January 21, 2011, the AICPA's Peer Review Board approved a revision to the AICPA peer review program which will result in a greater emphasis being placed on the audits of introducing broker-dealers during the performance of peer reviews.

<sup>2</sup> Broker-dealers in certain mutual fund or life insurance products, broker-dealers who clear on a "receive versus delivery/delivery versus payment" basis and introducing brokers on a fully-disclosed basis.

send funds to the introducing brokerage firm in error<sup>3</sup>. Accordingly, these entities do not typically receive funds or securities and are therefore at a risk level that does not warrant PCAOB oversight<sup>4</sup>. Since resources are scarce in any oversight regime, we believe PCAOB should focus its resources on those broker-dealers that pose the only realistic risk (custodial, clearing and/or carrying).

Interestingly, during legislative consideration of Section 982 of the Dodd Frank Act granting the PCAOB its new rulemaking authority, Josephine Wang, General Counsel of the Securities Investor Protection Corporation (SIPC) indicated that between 1995 and 2008, the agency liquidated 52 introducing brokers at a cost to SIPC of approximately \$137 million.<sup>5</sup> However, our further analysis of this data indicates that there have only been 10 liquidations involving introducing broker-dealers since 2003<sup>6</sup> with a *net cost* to SIPC of virtually zero. Of those 10 liquidations, 4 broker-dealer firms did not file financial statements with the SEC after 2001. Of the 6 remaining, at least 2 were audited by firms *registered with and inspected by* the PCAOB as of the date of their most recent SEC-filing<sup>7</sup>.

## **II. Suggested inspection process (limited to auditors already subject to PCAOB inspection and auditors of clearing and carrying BDs)**

The AICPA appreciates the Board's desire to use its interim inspection program as a means to inform its thought process as it formulates a permanent inspection program and, specifically, to assess whether the program should exempt certain classes of broker-dealers from PCAOB oversight. Because the final, permanent inspection program could vary significantly at the end of the interim program, AICPA recommends that the interim inspection program's scope focus solely on firms which are *currently subject* to PCAOB inspections (by virtue of auditing issuers) and those firms which audit *clearing, carrying or custodial* broker-dealers. Among these firms, the PCAOB could, on a voluntary basis,

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<sup>3</sup> SEC Release No. 34-31511 (No, 93-6, November 1993).

<sup>4</sup> All broker-dealers are subject to examination by the SEC and a self-regulatory organization, or "SRO," such as the Financial Industry Regulatory Authority (FINRA)..

<sup>5</sup> SIPC letter dated November 2, 2009.

<sup>6</sup> Since Sarbanes-Oxley Act, creating the PCAOB, was passed in 2002, we believe the relevant universe is liquidations which have occurred beginning in 2003.

<sup>7</sup> These firms were registered and inspected with the PCAOB because they audited issuers.

additionally discuss and study the audits of introducing broker-dealer clients performed by these audit firms to assess whether a later rule inspecting introducing broker dealers is warranted.

Because the differences among classes of broker-dealers and the universe of potentially affected parties under this proposed rule are significant<sup>8</sup>, the issuance of an overly broad interim rule could create significant confusion and undue costs on firms who ultimately may not be covered in a final rule.

As noted above, we understand that there may be certain instances where introducing broker-dealers may have brief and limited access to investor funds. In such situations, where there may be a heightened opportunity for fraud or malfeasance, rather than automatically extending new oversight over the auditors of introducing broker-dealers, a fresh discussion of the different benefits to investors of oversight by principal and secondary regulators may more appropriately solicit ideas for stronger safeguards by the principal regulators themselves. This sort of collaboration and study can ensure that regulations by the PCAOB, the SEC, and FINRA related to introducing broker-dealers and their auditors are the right kinds of regulation, the most effective forms of regulation, and fully warranted regulations.

### **III. Conclusion**

Overall, the AICPA supports the PCAOB's new authority under the Dodd Frank Act and an interim rulemaking program to determine the level of oversight over auditors of clearing, carrying, and custodial broker-dealers. Indeed, the AICPA endorsed Section 982 of the Dodd-Frank Act, at the time of passage, and believes that this rulemaking will ultimately prove to be an important investor protection created by the passage of this provision. However, we are convinced that the cost of including auditors of introducing

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<sup>8</sup> Indeed, as of December 1, 2010 there were approximately 4,538 active broker-dealer firms (of the 5,000+ registered with the SEC), and 868 audit firms registered with the PCAOB by virtue of having a broker-dealer client. Of those broker-dealers, the vast majority – an estimated 90% - are introducing broker-dealers, who do not have access to investor funds. Consequently, the potential pool of audit firms covered by the PCAOB's new regulations will vary greatly based upon which classes of broker-dealers are ultimately included in the rule.

broker-dealers under PCAOB oversight clearly outweighs the benefits. Accordingly, we urge the PCAOB not to extend oversight authority to these auditors and suggest additional study, in conjunction with the principal regulators of broker-dealers, the SEC and FINRA.

An interim rule which focuses on broker-dealers which present a realistic level of risk, while performing additional due diligence where such research is required, will lead to the best outcome for investors, auditors of broker-dealers, and broker-dealers. In addition, we believe that the AICPA's peer review program will continue to be an important safeguard overseeing the work of auditors of introducing broker-dealers.

We appreciate the opportunity to comment and welcome the opportunity to serve as a resource to the PCAOB on these issues. If we can be of further assistance, please contact me at (212) 596-6001.

Sincerely,



Barry C. Melancon, CPA  
AICPA President & CEO

cc:

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