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Audits of Small Broker Dealers: How to Mitigate the Rising Costs

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In recent years, corporate scandals and an uncertain economy have precipitated change in laws that have greatly impacted the small broker-dealer. One such dramatic change was the advent of the PCAOB taking over the policing of audit firms of broker-dealers in 2014. This effectively drove accountants, auditors and CFOs into a chaotic frenzy last audit season. Discussions with audit firms uncovered complaints of over-auditing and a lack of preparedness by the broker-dealers, which resulted in record breaking extensions filed and even late filings in 2015.

As anticipated, the PCAOB has outlined **several deficiencies in audits post-transition**. Recent deficiencies in audits under investigation by the SEC have resulted in fines levied against some audit firms and resulted in other firms stepping up procedures to mitigate risk, leading to skyrocketing fees in 2015.

The costs of these changes impacted the audit firms who then passed these increased fees onto their clients. This year when the dust settles, many audit firms will drop their small broker-dealer clients or drive the prices so high that it will send their clients scrambling for a new home. Some of these rising costs are driving the extinction of the smaller broker-dealer, and according to statistics presented by FINRA, the number of member firms has experienced a **steady decline in recent years**.

Choosing the right auditor at a reasonable fee will be a challenge for many small broker-dealers this year. You cannot bargain hunt in this highly regulated industry; however, you can take steps to keep the cost of your audit down so you can have the quality firm you deserve without breaking the bank.

Here are some helpful tips to keep the costs of your audit down while keeping the quality up:

1. Perform internal audits on a regular basis throughout the year to ensure you have the backup on file to support your general ledger.

2. Take an inventory of important documents required, such as the Form BD, Fidelity Bond, AML Testing Reports, etc. According to Auditing Standard No. 3, audit documentation is the written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor.

3. Sit down with your CFO or FinOp in October and if applicable prepare memos to explain any changes in the business from prior year.

4. Get to know the **FINRA examination priorities for the current year**. The auditors will likely also focus on FINRA target areas and hot button issues. They will want to understand the firms responses to these are areas of risk as outlined and handpicked by the regulators. It's prudent for a firm to review these publications of FINRA and eliminate any risks in these areas before they become audit red flags.

5. Be involved in the audit planning process with your audit engagement partner. Yes, it is the objective and responsibility of the audit firm to plan the audit so it is conducted effectively. However, since the planning phase sets the tone for the entire audit, why not get off to a good start. Walk through the general ledger with the audit firm. Understand why they are choosing items to test, and ask detailed questions. Consider the following factors with your auditor and provide them the details surrounding these basic concepts outlined in **Auditing Standard No. 9**.

6. Interim testing and meetings with your audit firm outside of tax season can be beneficial for you and your auditors so do not wait until the end of the year to sit down with them. Take the opportunity to discuss issues that have occurred during the year or changes in your business model to avoid year-end issues when you are under a 60-day time crunch.

7. Change the firm's fiscal year end for regulatory reporting purposes of the annual audit. There are many overall benefits to changing your firm's year end (for reporting purposes). You would have more attention from an audit firm in the summer, because it is notoriously a slow time for audit firms. Since you would be hiring them at a slower time you could likely negotiate a better fee structure as well.

If you need guidance on how to respond to the ever-changing regulatory environment of the broker-dealer industry, contact Elizabeth M. Attanasio, CPA, FinOp at 212.660.0050 (ext. 3001) or at EAttanasio@rmsbg.com.

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