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SEC proposed rule on reports to be made by certain brokers and dealers

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April 13, 1998

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

Re: File No. S7-7-98
SEC Proposed Rule on Reports to be Made by Certain Brokers and Dealers

Dear Mr. Katz:

The Year 2000 Issue has the potential to cause significant adverse consequences to many parties including securities industry entities and the investing public. We commend the Commission for recognizing and acting on this very important issue. We are pleased to have the opportunity to comment. In developing this letter, in addition to the views of the undersigned, we incorporated the views of Robert Herz, Chair of the SEC Regulations Committee, John Lynch, Chair of the Stockbrokerage and Investment Banking Committee, and several additional members of the AICPA committees and staff that we represent.

The AICPA also recognizes the significant public interest concerns and has acted to inform and provide guidance to its members, management of enterprises, and the public about this issue. The AICPA’s year 2000 task force and staff developed guidance for accountants and auditors and published The Year 2000 Issue: Current Accounting and Auditing Guidance, which the AICPA made available for free on its Web site and for a nominal charge in print. That guidance clarifies management and auditor responsibility for the issue and encourages auditors to communicate about the Year 2000 Issue with managements and boards of directors. The Auditing Standards Board made contributions to the aforementioned publication and has issued interpretations of the auditing standards to address the Year 2000 Issue. Those interpretations address the auditor’s responsibility, audit planning, reportable conditions, and service organizations. The Auditing Standards Board will soon issue a year 2000 interpretation on going concern. In developing this guidance, the AICPA provided working drafts to and consulted with the SEC staff. Consistent with its commitment to inform members and the public about the Year 2000 Issue, the AICPA has published a number of articles about the issue in the Journal of Accountancy and The CPA Letter. Also, various AICPA committees and divisions, notably those related to Information Technology, have published books and articles on the subject.

We must recognize that these efforts can, at best, sensitize the public, management and auditors to the potential severity of the issue, and encourage them to take appropriate action. They do not change any party’s responsibilities, nor do they sufficiently inform readers to make them expert in the steps necessary to fully address the issue.

The Commission and its staff are quite aware of the complexity of the efforts needed to address the Year 2000 Issue. In the 1997 Report to the Congress on the Readiness of the United States
Securities Industry and Public Companies to Meet the Information Processing Challenges of the Year 2000, the SEC staff stated:

It is not, and will not, be possible for any single entity or collective enterprise to represent that it has achieved complete Year 2000 compliance and thus to guarantee its remediation efforts. The problem is simply too complex for such a claim to have legitimacy.

Any regulation that requires an independent auditor’s attestation also must recognize what can reasonably be expected from auditors. The AICPA, in the publication referred to above, stated:

Auditors cannot be expected or required to be proficient in areas or disciplines that are remote from their main competencies of accounting and auditing. The effects of the Year 2000 Issue can be widespread throughout the entity and may be far removed from the accounting system. Often the most significant effects will relate to the efficiency of an entity’s operating functions and may not have any direct material effect on the fair presentation of the financial statements in accordance with generally accepted accounting principles.

We believe the Commission has shown sensitivity to these concerns in the Proposed Rule. However, we have some significant concerns about the proposal.

Principal Comments Relating to Accountants’ Attestation

The Proposed Rule 17a-5(e)(5)(v) requires an accountant’s opinion "attesting to whether there is a reasonable basis for the broker or dealer’s assertions." Some of the assertions, however, are not appropriate for accountant attestation in their current form and the assurance requested could easily be misunderstood.

Our concerns about the proposed assertions and related accountant attestation relate to the following aspects of the Proposed Rule:

- The assertions, as drafted, are not capable of reasonably consistent measurement against reasonable criteria, principally because there are no established criteria relating to year 2000 remediation efforts.
- There is a significant possibility that uninformed users of these reports will assume undue assurance from them.
- Since performing attestation procedures with respect to matters relating to year 2000 problems is a new type of engagement, there could be significant variability in the procedures accountants would perform under the Proposed Rule.

Under Statement on Standards for Attestation Engagements (SSAE) No. 1, Attestation Standards
(AICPA, *Professional Standards*, vol. 1, AT sec. 100.11) assertions must be capable of reasonably consistent measurement against reasonable criteria. There are no standards for year 2000 remediation plans. Therefore, for some of the assertions included in the Proposed Rule, there are no reasonable criteria to use in determining whether there is a reasonable basis for the assertions. The lack of such criteria also could lead to significant variability in the attest procedures performed by accountants. As a result, it would be difficult for users of the reports to have a clear understanding of what accountants actually did to support their report.

Although the literal assertions in subsections (A) through (E) of the Proposed Rule appear to be susceptible to reasonably consistent measurement, an attestation that the actions in (A) through (E) of the Proposed Rule have taken place should be used only for limited purposes. We are concerned that users of the attestation report will assume some level of assurance about the quality of the actions. The quality of the actions, particularly the broker-dealer's actions underlying the assertions at subsection (A), (D), and (E), are not capable of reasonably consistent measurement against reasonable criteria since, as noted above, there are no standards for year 2000 remediation plans.

The matters covered by the assertions in subsections (F) and (G) are even more problematic. An attestation could address whether testing had occurred; however, it would be extremely difficult for an accountant to assess the reasonableness of the testing plan and the accuracy and validity of the test results. Additionally, it may not be possible for an accountant to obtain satisfaction that the testing (both internal and integrated or industry-wide) is on schedule and that the broker-dealer has modified its software to correct Year 2000 Problems, as the draft assertions imply.

**Alternative means of achieving the Commission's objectives**

Even though we have reservations about the means proposed by the Commission for obtaining input from accountants on broker-dealers' year 2000 remediation plans, we believe that the broker-dealer's auditor can assist the Commission in its oversight role with respect to broker-dealers.

We propose an alternative approach to address the three concerns discussed above, including the following elements:

- The proposed assertions should be modified to allow for reasonably consistent measurement.
- The accountant's reports should not be made part of the public record.
- Agreed-upon procedures engagements provide a more effective vehicle for the Commission to meet its specified objectives.

**The proposed assertions should be modified to allow for reasonably consistent measurement.** Proposed modifications to the assertions contained in the Release provide for a clearer association with the elements of the broker-dealer's report. For example, Proposed Rule 17a-5(e)(5)(v)(C) suggests that a specific director must be responsible for the execution of the plan; however, there is
no such requirement in the rest of the proposal. Proposed modifications also address the difficulty in consistently measuring the proposed assertions. We suggest that Proposed Rule 17a-5(e)(5)(v)(A) through (G) be revised as follows:

(A) Whether the broker-dealer has developed written plans for assessing, modifying, preparing and testing the broker-dealer’s computer systems for potential Year 2000 Problems;

(B) Whether the board of directors (or similar body) of the broker-dealer has approved the plans described in paragraph (e)(5)(v)(A) of this section;

(C) Whether a member of the broker-dealer’s board of directors (or similar body) is has identified one or more members of its management to be responsible for the execution of the plans described in paragraph (e)(5)(v)(A) of this section;

(D) Whether the broker-dealer’s plans described in paragraph (e)(5)(v)(A) of this section address the broker-dealer’s domestic and international operations, including the activities of each of the firm’s subsidiaries, affiliates, and divisions. (Subsidiaries, affiliates, and divisions that are regulated by U.S. or foreign regulators other than the Commission are exempted from these provisions;)

(E) Whether the broker-dealer has assigned existing employees, hired new employees, or engaged third parties to implement the broker-dealer’s plan described in paragraph (e)(5)(v)(A) of this section;

(F) Whether the broker-dealer or third party has conducted internal testing, whether the broker-dealer has determined that such testing is on schedule in accordance with the broker-dealer’s plan described in paragraph (e)(5)(v)(A) of this section, and whether the broker-dealer has determined as a result of the internal testing whether management’s plans to that the firm has address Year 2000 Problems need to be modified its software to correct Year 2000 Problems; and

(G) Whether the broker-dealer has conducted participated in external-integrated or industry-wide testing, whether the broker-dealer has determined that such testing is on schedule in accordance with the broker-dealers’ [sic] plan described in paragraph (e)(5)(v)(A) of this section, and whether the broker-dealer has determined as a result of the external-integrated or industry-wide testing whether management’s plans to address Year 2000 Problems need to be that the firm has modified its software to correct Year 2000 Problems.

These assertions form the basis for the assertions in the sample report that appears in the attachment to this letter. If the Final Rule contains assertions that differ from the assertions stated above, the
resulting report would need to be modified accordingly.

The accountant’s reports should not be made part of the public record. As discussed above, merely reporting on whether certain actions have taken place, with no assurance offered on the quality of these actions, is potentially dangerous because uninformed users may assume unintended assurance from the accountant’s report. For this reason, the accountant’s report should not be relied upon by third parties other than the Commission. We have confidence that the Commission staff would understand the nature of the engagement. Therefore, we recommend that the accountants’ reports not be made part of the public record. This would be consistent with the Commission’s stated desire to receive this information for the purpose set forth in the Summary section of Release No. 34-39724. If the Commission determines that the report is a matter of public record or subject to the Freedom of Information Act, we request that the Commission provide safe-harbor protection to the reporting accountant.

We suggest that the reporting model be the same as that developed by the Derivatives Policy Group. Under this model the accountant renders his or her report to the broker-dealer and the report contains the language permitting use by the Commission. Consistent with this position, we are of the view that any report by an accountant relating to the broker-dealer’s assertions regarding Year 2000 Problems should not be combined with, or submitted as part of, any other report rendered by the accountant in his or her role as external auditor for the entity. Similarly, such a report should not be included or referred to in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Agreed-upon procedures engagements provide a more effective vehicle for the Commission to meet its specified objectives. Pursuant to such an engagement, the broker-dealer would engage a certified public accountant to perform and report on specific procedures designed to meet the Commission’s objectives in evaluating the broker-dealer’s Second Report. There is a great deal of flexibility in such an engagement in that the procedures that the accountant performs may be as limited or as extensive as the objectives require, as long as they meet the conditions specified in SSAE No. 4, Agreed-Upon Procedures Engagements (AICPA, Professional Standards, vol. 1, AT sec. 600).

An advantage to an agreed-upon procedures engagement over the examination level engagement required under the Proposed Rule is that there is a clear understanding of the procedures that the accountant performs. Examination procedures with respect to year 2000 remediation plans are likely to vary significantly due to the lack of recognized criteria in this area. Because of this lack of recognized criteria and established procedures, the results of the examinations would not be susceptible to consistent evaluation by the Commission.

To assure that agreed-upon procedures are applied consistently among broker-dealers, the Commission can include specified procedures within its Rule or, alternatively, the AICPA will
undertake to develop specified procedures and promulgate them to its membership. Those procedures would be available to Commission staff for review. The procedures performed and the report on the findings can be designed so that the findings appear in an objective format that the Commission can easily review for findings that indicate exceptions requiring further investigation. Additionally, the Commission can easily aggregate findings for reporting purposes.

Accordingly, we suggest that the introductory portion of Proposed Rule 17a-5(e)(5)(v) be revised as follows:

(v) The report prepared pursuant to paragraph (e)(5)(iii) of this section shall also include assertions in response to the following and an opinion report on agreed-upon procedures by an independent public accountant attesting to whether there is a reasonable basis for the broker or dealers assertions in response to the following relating to such assertions:

The attachment to this letter includes an example of an accountant’s report on agreed-upon procedures prepared pursuant to our suggested approach.

Other Comments

1. The Commission seeks comment on whether the attestation contemplated in the Proposed Rule is part of the auditor’s responsibility to “opine on whether a broker-dealer can continue as a going concern.” In an audit conducted in accordance with generally accepted auditing standards (GAAS), the auditor does not have a responsibility to opine on whether a broker-dealer can continue as a going concern. Additionally, the elements of the attestation required by the Proposed Rule are not currently a part of the auditor’s responsibility in an audit of financial statements conducted in accordance with GAAS, nor are they an extension of that responsibility. Rather, we believe that the elements of the attestation required by the Proposed Rule represent a separate engagement, or a separate element of a broker-dealer’s obligation to file reports with the Commission.

Statement on Auditing Standards No. 59, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (SAS No. 59) sets forth the auditor’s responsibility to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time. The auditor’s going concern evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the completion of the audit fieldwork. GAAS does not require the auditor to design audit procedures solely to identify conditions and events that indicate there could be substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time. SAS No. 59 states that the results of auditing procedures designed and performed to achieve other audit objectives should be sufficient for that purpose.
The Audit Issues Task Force of the AICPA's Auditing Standards Board is developing an interpretation of SAS No. 59 to address the Year 2000 Issue and expects to complete and issue that interpretation soon. The following discussion is based on the draft of that interpretation available as of the date of this letter.

The draft interpretation describes four categories of conditions and events relating to the Year 2000 Issue that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. Those categories are noncompliant computerized systems; actions of other affecting the entity; problems of customers, vendors, and service providers; and related costs.

The draft interpretation also is consistent with the requirements of SAS No. 59, and states, "Thus, the auditor does not have a responsibility to plan and perform procedures solely to identify conditions and events relating to the Year 2000 Issue." Because of the nature of the auditor's responsibility, the auditor would not necessarily consider management's year 2000 remediation plan in every audit of financial statements conducted in accordance with GAAS. The draft interpretation instructs the auditor to consider management's plan if he or she believes that there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, and the conditions and events underlying that belief include conditions and events relating to the Year 2000 Issue.

2. The Commission seeks comment on whether the accountant's report relating to the Second Report should be prepared by the same independent public accountant who prepares the annual audit of the broker-dealer's 1998 fiscal year-end financial statements. We are not aware of any reason why the broker-dealer's independent auditor should not be engaged to render the services required by the Commission. It would be more difficult, and more costly, for an accountant who is unfamiliar with a broker-dealer's systems and governance system to perform the related agreed-upon procedures engagement.

3. The Supplementary Information in the Proposed Rule describes the broker-dealer reports as addressing "the broker-dealer's preparation for the Year 2000 and the steps the broker-dealer is taking to avoid Year 2000 Problems." The broker-dealer may not be able to avoid all Year 2000 Problems. This is recognized in the request for information about contingency plans, at Proposed Rule 17a-5(e)(5)(iv)(E). We suggest that the word "avoid" be replaced with the word "address" throughout the document.

4. Proposed Rule 17a-5(e)(5)(iv)(A) implies that the board of directors of the broker-dealer should have funded plans for addressing Year 2000 Problems. We do not believe that the Commission intended that broker-dealers need to set aside funds projected to be needed to address Year 2000 Problems. The Commission should clarify what it means by "funded plans."
5. Footnote 5 to the discussion at Section II.C.(4) of the Supplementary Information requires broker-dealers to “communicate with its vendors and significant customers about their Year 2000 readiness.” However, this requirement does not appear anywhere in the Proposed Rule. Also, it is not clear why all vendors would need to be contacted. We recommend restating the requirement implicit in this footnote as follows:

In addition to assessing what steps it should take to make its computer systems year 2000 compliant, the broker-dealer should consider what steps it needs to take to understand the potential effect of Year 2000 Problems of significant vendors and customers on its operations.

6. The Commission should be aware that based on the proposal certain broker-dealers with fiscal year ends in early 1998 may be required to file the Second Reports either before or very soon after the First Reports are due. The Commission should reconsider the due date for the Second Report for such entities.

7. The Commission’s rules generally refer to “independent public or certified public accountant.” The Proposed Rule only refers to “independent public accountant.” We assume that the omission of reference to “certified public accountants” is an oversight.

* * * * * * *

We would be pleased to discuss our comments or answer any questions that the Commission or staff may have.

Sincerely,

Alan W. Anderson  Deborah D. Lambert
Senior Vice-President  Chair
Technical Services  Auditing Standards Board
Agreed-Upon Procedures — Sample Report

The procedures listed in this sample report reflect the suggested changes to the assertions. If the assertions in the Final Rule differ from those in the Proposed Rule, and the difference results from changes other than those suggested herein, the assertions and procedures in the sample report may need to be changed accordingly.

Independent Accountant's Report
on Applying Agreed-Upon Procedures

To the Board of Directors of ABC Broker-Dealer

We have performed the procedures enumerated below [as specified by Securities and Exchange Commission Rule 240.17a-5], solely to assist you in evaluating ABC Broker-Dealer’s assertions included in its Second Report to the SEC dated XX, 199x (copy attached). This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

<table>
<thead>
<tr>
<th>Assert.</th>
<th>Procedure</th>
<th>Findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>(v)(A)</td>
<td>Determined by _________(describe procedure performed) that a written document exists addressing the broker-dealer's plans for assessing, modifying and testing the broker-dealer’s computer systems for potential Year 2000 Problems. (In performing this procedure, we did not evaluate the adequacy of the plan.)</td>
<td>X Exception</td>
</tr>
<tr>
<td>(v)(B)</td>
<td>Determined by _________(describe procedure performed) that the Board of Directors (or similar body) of the broker-dealer approved the plans described in (v)(A).</td>
<td>X</td>
</tr>
<tr>
<td>(v)(C)</td>
<td>Determined by _________(describe procedure performed) that the broker-dealer identified one or</td>
<td>X</td>
</tr>
</tbody>
</table>
more members of its management to be responsible for the execution of the plans in (v)(A) above.

(v)(D) Determined by _________(describe procedure performed) that the broker-dealer’s plans described in (v)(A) above address the broker-dealer’s domestic and international operations, including the activities of each of the firm’s subsidiaries, affiliates, and divisions. (These provisions do not apply to subsidiaries, affiliates, and divisions of the broker-dealer that are regulated by U.S. or foreign regulators other than the Commission. In performing this procedure, we did not evaluate the adequacy of the plan with respect to the firm’s subsidiaries, affiliates, and divisions.)

(v)(E) Determined by _________(describe procedure performed) that the responsible member(s) of management designated in (v)(C) received reports indicating that existing employees were assigned, and new employees were hired, to implement the broker-dealer’s plans described in (v)(A). Inquired of broker-dealer personnel with data processing and other responsibilities relevant to implementation of the plans described in (v)(A) to determine that their understanding of personnel assignments is consistent with that assertion.

(v)(E) Determined by _________(describe procedure performed) that the responsible member(s) of management designated in (v)(C) received reports indicating that the broker-dealer engaged third parties to implement the broker-dealer’s plans described in (v)(A) above. Determined that contracts or other written evidence of engagement exists for each of the third parties.

(v)(F) Determined by _________(describe procedure performed) that the responsible member(s) of
management designated in (v)(C) received reports indicating that the broker-dealer conducted internal testing in accordance with the plan described in (v)(A) above and that the broker-dealer determined that such testing is on schedule as called for in that plan. Inquired of broker-dealer personnel with data processing and other responsibilities relevant to such testing to determine that their understanding of the status of testing is consistent with the internally reported status. (In performing this procedure, we did not evaluate the adequacy of the internal testing, its effectiveness or the results thereof, or the broker-dealer’s assessment of the timeliness of such testing.)

(v)(F) Determined by _________(describe procedure performed) the responsible member(s) of management designated in (v)(C) received reports indicating that the plans to address Year 2000 Problems were modified as considered necessary as a result of internal testing conducted in accordance with the plan described in (v)(A). Inquired of broker-dealer personnel with data processing and other responsibilities relevant to such testing to determine that their understanding of the results of testing is consistent with the results reported to the responsible member(s) of management. (In performing this procedure, we did not assess the adequacy of the modifications made to the plans to address year 2000 Problems.)

(v)(G) Determined by _________(describe procedure performed) that the responsible member(s) of management designated in (v)(C) received reports indicating that the broker-dealer conducted integrated or industry-wide testing in accordance with the plan described in (v)(A) above and whether the broker-dealer has determined that such testing is on schedule as called for in that plan. Inquired of broker-dealer personnel with
data processing and other responsibilities relevant to such testing to determine that their understanding of the status of testing is consistent with the internally reported status. (In performing this procedure, we did not evaluate the adequacy of the integrated or industry-wide testing, its effectiveness or the results thereof, or the broker-dealer’s assessment of the timeliness of such testing.)

(v)(G) Determined by _________(describe procedure performed) that the responsible member(s) of management designated in (v)(C) received reports indicating that the plans to address Year 2000 Problems were modified as considered necessary as a result of integrated or industry-wide testing conducted in accordance with the plan described in (v)(A). Inquired of broker-dealer personnel with data processing and other responsibilities relevant to such testing to determine that their understanding of the results of testing is consistent with the results reported to the responsible member(s) of management. (In performing this procedure, we did not assess the adequacy of the modifications made to the plans to address year 2000 Problems.)

[The practitioner should provide explanations of any exceptions noted in the report.]

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the accompanying Second Report of ABC Broker-Dealer pursuant to Rule 240.17a-5. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. Our procedures also do not provide assurance that ABC Broker-Dealer is or will be year 2000 compliant, that its year 2000 remediation plan will be successful in whole or in part, or that parties with which the ABC Broker-Dealer does business will be year 2000 compliant.

This report is intended solely for the information and use of the Board of Directors and Management of ABC Broker-Dealer and the Securities and Exchange Commission and is not intended to be and should not be used by anyone other than the specified parties.