

# Investors in the Crypto Asset Markets Should Exercise Caution With Alternatives to Financial Statement Audits: Investor Bulletin

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*The SEC's Office of Investor Education and Advocacy, along with the Office of the Chief Accountant, is issuing this Investor Bulletin to alert investors in the crypto asset markets of the risk of relying on audits not conducted following SEC rules and Public Company Accounting Oversight Board ("PCAOB") standards.*

Amid recent turmoil in the crypto asset markets, some crypto asset trading platforms and issuers of so-called "stablecoin" crypto assets have issued "proof of reserves" reports in an effort to reassure investors and customers about the safety of their crypto assets. In some cases, these reports have been portrayed as either equivalent to, or even as more "precise" than, audited financial statements.

In reality, these reports and the reviews that underlie them are not equivalent to financial statement audits and lack important investor protections provided by financial statement audits. The same is true of "valuation" or "calculation" reports that may be used in other industries. For these reasons, investors should carefully consider these limitations and not place the same degree of reliance on these types of reports as they would on financial statements that have been audited by an independent auditor in accordance with SEC rules and PCAOB independence and auditing standards.

What is the role of financial statement audits?

Public companies and SEC-registered broker-dealers are required to file annual reports, which include audited financial statements, with the SEC. These financial statements are designed to provide investors with a complete and accurate picture of a company's financial health and risks. To promote the accuracy and reliability of these statements, they are required to be audited by an auditor that is independent of the audit client, conducts the audit in accordance with the rules and standards of the SEC and the PCAOB, and is subject to regulatory oversight by the SEC and PCAOB.

Contrary to how they have sometimes been portrayed, proof of reserves, valuation, and calculation reports are *not* audit reports as defined by the PCAOB and the SEC. Among other important differences:

- These services may have no specific requirements for the engagement or the information reported, allowing an entity full discretion to manage the terms of the engagement. For example, a proof of reserves report does not include a complete set of financial statements and does not tell investors the whole story about the entity's liabilities.
- Unlike financial statement audits, which can only be performed by registered accounting firms, proof of reserves, valuation, and calculation reports may be provided by either registered or unregistered accounting firms, or by another third party, and often provide no assurance as to the reliability of the information provided.
- Even when provided by a registered accounting firm, investors should be aware that these services may fall outside of PCAOB regulatory oversight, and may not be subject to, for example, PCAOB standards or inspections, or PCAOB enforcement proceedings. Investors should be aware that registered accounting firms may provide services that are *not* subject to PCAOB standards.

- Firms providing these services may not be subject to the same independence requirements as firms providing audits that are subject to SEC rules, which are designed to ensure that an auditor will exercise objective and impartial judgment with respect to the audit. Additionally, the service typically is not designed to provide any level of assurance on the related information.

#### How do the PCAOB and SEC help protect investors?

Congress established the PCAOB to oversee the audits of public companies and SEC-registered broker-dealers. The mission of the PCAOB is to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. It does so through four main activities:

- registration of public accounting firms;
- adoption of auditing and related attestation, quality control, ethics, and independence standards with which registered firms must comply in performing audits;
- regular inspection of registered public accounting firms' audits and quality control systems; and
- investigation and discipline of registered public accounting firms and their associated persons for violations of legal rules or standards.

The SEC has oversight authority over the PCAOB, which includes approval of PCAOB's rules and standards. In addition, the SEC's auditor independence rule governing audits helps to ensure that auditors are qualified and independent of their audit clients in both fact and appearance. The SEC can bring enforcement actions related to these audits.

#### How can I tell if a registered public accounting firm has conducted an audit under PCAOB standards?

An audit report on the financial statements of a public company or registered broker-dealer includes the registered public accounting firm's opinion on whether the company's financial statements fairly present its financial position, results of operations and cash flows (often referred to as a "pass/fail opinion").

The report must be titled "Report of Independent Registered Public Accounting Firm." Among other things, the report will clearly state whether the audit was conducted in accordance with PCAOB standards.

The audit report will also state whether the auditor is providing an unqualified opinion or a qualified opinion, in which the auditor expresses disagreement with some of the information in the financial statements.

Even if they are labeled as an "audit report" or "attestation report," **reports that do not clearly state that the audit was conducted in accordance with the standards of the PCAOB are *not* audit reports** under PCAOB standards.

Such non-audit reports—even if performed by a PCAOB-registered accounting firm—lack important investor protections offered by PCAOB and SEC oversight, as discussed above. Investors should carefully consider these limitations before placing reliance on such non-audit reports when making a decision to invest in, or use the services of, an entity.

It is a **red flag** if an entity portrays non-audit services, such as proof of reserves reports, as equivalent, or superior, to audits meeting PCAOB standards. Examples include using terms such as a "GAAP audit" or a "Valuation Audit" to describe the services. Additionally, entities and associated individuals may exacerbate confusion by touting "successful" audits. We strongly caution investors that such reports are different from, and should not be taken as a substitute for, audits conducted by registered public accounting firms under PCAOB standards.

Only audits performed by registered public accounting firms and conducted in accordance with PCAOB standards have all of the investor protections mandated by the PCAOB and SEC.

## Additional Resources

Investor Alert: "[Exercise Caution with Crypto Asset Securities](#)"

PCAOB Investor Advisory: "[Exercise Caution with Third-Party Verification/Proof of Reserve Reports](#)"

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