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Report on

2015 Inspection of BDO USA, LLP
(Headquartered in Chicago, IL)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

PORTIONS OF THE COMPLETE REPORT ARE OMITTED FROM THIS DOCUMENT IN ORDER TO COMPLY WITH SECTIONS 104(g)(2) AND 105(b)(5)(A) OF THE SARBANES-OXLEY ACT OF 2002

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2015 INSPECTION OF BDO USA, LLP

Preface

In 2015, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm BDO USA, LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.D of this report (which also contains additional information concerning PCAOB inspections generally). The inspection included reviews of portions of selected issuer audits. These reviews were intended to identify whether deficiencies existed in the reviewed work, and whether such deficiencies indicated defects or potential defects in the Firm's system of quality control over audits. In addition, the inspection included a review of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, portions of Appendix B, Appendix C, and Appendix D. Appendix B consists of the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the Firm's system of quality control, those discussions also could eventually be made public, but only to the extent the Firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report. Appendix C presents the text of the paragraphs of the auditing standards that are referenced in Part I.A in relation to the description of auditing deficiencies there.

Note on this report's citations to auditing standards: On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization will be effective as of December 31, 2016, but the reorganized numbering system may be used before that date. In this report, citations to PCAOB auditing standards use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. A table cross-referencing the section numbers of those standards included in Part I of this report as reorganized is included at Appendix D.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from August 2015 to February 2016. The inspection team performed field work at the Firm's National Office and at 17 of its approximately 56 U.S. practice offices.[2]

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 23 issuer audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. Three of the deficiencies relate to auditing aspects of an issuer's financial statements that the issuer restated after the primary inspection procedures.[3] In addition, in three of the audits described below, after the primary inspection procedures, the Firm revised its opinion on the effectiveness of the issuer's internal control over financial reporting ("ICFR") to express an adverse opinion.

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1 For this purpose, the time span for "primary procedures" includes field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. The time span does not include (1) inspection planning, which may commence months before the primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

2 This represents the Firm's total number of practice offices; however, approximately 36 of the Firm's practice offices have primary responsibility for issuer audit clients.

3 The 2015 inspection did not include review of any additional audit work related to the restatements.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix C to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in the references to the auditing standards in this sub-Part, unless the lack of compliance with these standards is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

Certain of the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with the applicable financial reporting framework and/or its opinion about whether the issuer had maintained, in all material respects, effective internal control over financial reporting ("ICFR"). In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement and/or the issuer maintained effective ICFR.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are misstated or that there are undisclosed material weaknesses in ICFR. It is often not possible for the inspection team, based only on the information available from the auditor, to reach a conclusion on those points.

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.[4]

The audit deficiencies that reached this level of significance are described in Part I.A.1 through I.A.12, below.

Effects on Audit Opinions

Of the 12 issuer audits that appear in Part I.A, deficiencies in six audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in 12 audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the 12 audits in which substantive testing deficiencies were identified, four audits included deficiencies in substantive testing that the inspection team determined were caused by a reliance on controls that was excessive in light of deficiencies in the testing of controls.

	Number of Audits
Deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	6
Deficiencies included in Part I.A related to the financial statement audit only	6
Total	12

[4] Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

Most Frequently Identified Audit Deficiencies

The following table lists, in summary form, the types of deficiencies that are included most frequently in Part I.A of this report. A general description of each type is provided in the table; the description of each deficiency in Part I.A contains more specific information about the individual deficiency. The table includes only the four most frequently identified deficiencies that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Issue	Part I.A Audits
Failure to perform sufficient testing related to an account or significant portion of an account or to address an identified risk.	<u>10 Audits:</u> Issuers A, B, D, E, F, G, H, J, K, and L
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate.	<u>6 Audits:</u> Issuers A, B, D, F, G, and I
Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing.	<u>6 Audits:</u> Issuers A, B, E, G, I, and J
Failure to sufficiently test controls over, or sufficiently test, the accuracy and completeness of data or reports.	<u>5 Audits:</u> Issuers A, B, E, G, and J

Audit Deficiencies

A.1. <u>Issuer A</u>

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The issuer implemented a new information-technology ("IT") system in phases during the current and the prior year. This system processed revenue and inventory transactions and, in its testing of controls over the sales and inventory-management processes, the Firm selected a number of application controls that depended on this system. The Firm identified multiple deficiencies related to the IT general controls ("ITGCs") over this system, including issues related to segregation of duties, as well as deficiencies that meant that individuals could access and change underlying data.

- o The Firm failed to consider the potential effects of these deficiencies on the effectiveness of the application and IT-dependent manual controls on which the Firm relied when testing revenue and inventory. (AS No. 13, paragraph 34)

- o The Firm failed to perform sufficient procedures to evaluate the severity of the deficiencies, as follows –

  - ▪ With respect to revenue, the Firm identified four compensating controls, operating as of year end, but failed to sufficiently evaluate whether these controls would mitigate the risks related to revenue posed by the ITGC deficiencies. Specifically, (1) the Firm determined that one of these controls was not operating effectively and (2) as described below, the Firm failed to sufficiently test the other three controls, which consisted of (a) a review of order information entered into the system used to process revenue transactions, (b) the approval of both standard and non-standard pricing, and (c) reviews of the revenue disclosures in the financial statements. (AS No. 5, paragraph 68)

  - ▪ With respect to inventory, the Firm asserted that there were compensating controls in place, but failed to identify the specific compensating controls and evaluate whether those controls would operate at a level of precision that would prevent or detect a material misstatement. (AS No. 5, paragraph 68)

- The issuer recognized revenue from sales directly to end customers and from transactions involving distributors. The transactions involving distributors included both sales on a sell-in basis (for which revenue was recognized upon transfer of title to the distributor) and sales on a consignment basis (for which revenue was generally recognized upon subsequent transfer of title). The Firm failed to perform sufficient procedures related to revenue, for which the Firm identified a fraud risk, and net accounts receivable, as follows –

- The Firm selected for testing a number of controls over the entering of order information into, and processing of that information by, the system that was subject to the ITGC deficiencies described above. The Firm's procedures were insufficient. Specifically –

  - The Firm selected for testing a control that consisted of a review of the order information entered into the system. The Firm failed to sufficiently test an important aspect of the control that consisted of the review of the order coding entered into the system, which the system used to determine whether revenue was recognized or deferred. Specifically, the Firm's procedures were limited to obtaining a checklist evidencing the review without understanding and evaluating the procedures that the control owner performed to review the order coding. (AS No. 5, paragraphs 42 and 44)

  - The Firm failed to identify and test any controls that addressed whether the system would correctly recognize or defer revenue based on the order coding. (AS No. 5, paragraph 39)

  - For revenue transactions recognized either on the sale to end customers or on a sell-in basis to distributors, the Firm selected for testing a number of application controls that were based on the configuration of the system. The Firm's procedures were insufficient, as follows –

    - The Firm tested a control that generated an error message if the shipping and invoice date did not match in the system. The Firm, however, failed to identify and test any controls over the accuracy of the product shipment dates. (AS No. 5, paragraph 39)

- The Firm failed to identify and test any controls that addressed whether the quantity of product recognized as revenue agreed to the quantity of product shipped. (AS No. 5, paragraph 39)

▪ The Firm selected for testing a manual control that consisted of the approval of both standard and non-standard pricing. The sample that the Firm used to test this control was too small to provide sufficient evidence because it was limited to one customer with non-standard pricing and one invoice with standard pricing. (AS No. 5, paragraph 44)

o The Firm selected for testing a control consisting of reviews of the issuer's revenue disclosures. The Firm's procedures to test this control were limited to inquiring of one of the control owners and inspecting initials on the quarterly disclosure checklist as evidence that a review had occurred. The Firm also pointed to its testing of the accuracy of the issuer's disclosures, but these procedures did not directly test the control. The Firm's testing did not include ascertaining and evaluating the nature of the review procedures that the control owners performed. (AS No. 5, paragraphs 42, 44, and B9)

o The Firm designed certain of its substantive procedures – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the samples that the Firm used to test revenue and accounts receivable were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

o In addition to the fraud risk related to revenue, the Firm identified a fraud risk related to the potential for management override of controls due to a small accounting department and multiple persons with administrative rights to the accounting system. The Firm identified that the chief financial officer ("CFO") had the ability to create and post journal entries, and had created and posted multiple entries to the cash and accounts receivable sub-ledgers in the first half of the year. To address this fraud risk, the Firm tested only a small number of the journal entries created and posted by the CFO in the first half of the year. In addition, the Firm failed to sufficiently evaluate the appropriateness of the journal entries selected for testing because its procedures were limited to comparing the entries to the issuer's system without examining any supporting documentation. Further, the Firm failed to perform procedures, beyond inquiry, to test whether the CFO had created and posted journal entries during the last six months of the year. (AU 316, paragraph .61)

- The Firm failed to perform sufficient procedures related to the allowance for doubtful accounts, as follows –

  - The Firm's procedures to test the control that it selected, consisting of a review of the allowance for doubtful accounts, were limited to inquiring of management, tracing certain amounts to the general ledger, and inspecting emails as evidence that reviews had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

  - The Firm's substantive procedures to test the allowance for doubtful accounts were limited to testing the aging of a sample of invoices and inquiring of management. (AU 342, paragraph .07)

- The Firm failed to perform sufficient procedures to evaluate whether the issuer's accounting for revenue that was recognized on a sell-in basis was in conformity with GAAP, as follows –

  - The Firm's procedures to test this revenue were limited to obtaining the associated purchase orders, shipping evidence, invoices, and subsequent cash receipts. The Firm's testing did not include evaluating whether these sales should be recognized as revenue upon shipment rather than deferred until the product was sold by the distributor. (AS No. 14, paragraph 30)

  - For one significant transaction, the Firm failed to identify and appropriately address what appeared to the inspection team to be an instance in which the financial statements were not presented fairly, in all material respects, in conformity with GAAP. Specifically, the Firm failed to identify that the issuer had incorrectly applied Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 605, *Revenue Recognition*, as the issuer recognized revenue for this transaction even though there was no persuasive evidence of an arrangement and collectibility was not reasonably assured. (AS No. 14, paragraph 30)

- The issuer recognized a significant amount of revenue from transactions involving consignments. The Firm failed to obtain an understanding of the issuer's process for recognizing this revenue, and the Firm also failed in the following respects to perform sufficient procedures related to revenue recognized from consignment transactions –

  - The Firm failed to identify and test any controls over whether revenue recognized from consignment transactions represented sales involving a transfer of title. (AS No. 5, paragraph 39)

  - The Firm failed to perform sufficient substantive procedures to test this revenue. The Firm's procedures consisted of obtaining the associated purchase orders, evidence that the product was shipped from the issuer to the consignment location, invoices, and subsequent cash receipts. The Firm's testing did not include an evaluation of whether the revenue represented transactions involving a transfer of title. (AS No. 14, paragraph 30)

▪ The Firm failed to identify and appropriately address inaccuracies in the issuer's disclosures related to consignment sales. (AS No. 14, paragraphs 30 and 31)

- The issuer held inventory at its locations and also reported inventory held at other locations that was subject to consignment arrangements. The Firm failed to obtain an understanding of the issuer's process for assessing the existence of inventory, both at its own locations and at external locations, and the Firm also failed in the following respects to perform sufficient procedures related to the existence of inventory –

  o The Firm failed to identify and test any controls over the existence of inventory held on consignment. (AS No. 5, paragraph 39)

  o The Firm failed to sufficiently test controls over the existence of inventory held at the issuer's locations, as follows –

    ▪ The Firm failed to identify and test any controls related to physical counts of the inventory held by the issuer. (AS No. 5, paragraph 39)

    ▪ The only two controls that the Firm selected related to the existence of this inventory consisted of scanning inventory items when they were received, modified, or shipped by the issuer and updating the inventory recorded in the IT system; the IT system was subject to the ITGC deficiencies described above. The Firm failed to sufficiently test these two controls, as its procedures consisted of inquiring of management and observing that the scanner indicated an error when an item was packed for shipment that was not ordered. In addition, in its evaluation of these controls, the

Firm considered the results of certain of its substantive procedures that consisted of obtaining the inventory detail and tracing the total to the general ledger and noting that products appeared reasonably classified among raw materials, work-in-process, and finished goods, but those procedures did not directly test the controls. (AS No. 5, paragraphs 42, 44, and B9)

- o The Firm did not obtain an understanding of or observe any of the issuer's count procedures; its primary substantive procedure to test the existence of inventory held at the issuer's locations consisted of performing an independent count of a judgmentally determined sample of items at year end. (AU 331, paragraph .12)

- The Firm failed to perform sufficient procedures related to the valuation of inventory. Specifically –

  - o The one control that the Firm selected over the valuation of inventory consisted of a review of the annual standard cost study, which the issuer used to allocate raw materials and overhead costs to each product. The Firm failed to sufficiently test this control, as its procedures were limited to inquiring of management, obtaining a copy of the standard cost study, and noting that costs appeared to be reasonably allocated to each product. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owner performed, including the criteria used by the control owner to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of this control. Further, the Firm failed to identify and test any controls that addressed whether the inventory costs that were the basis for the amount shown in the general ledger were the same as the costs generated in the annual standard cost study. (AS No. 5, paragraphs 39, 42, and 44)

  - o The Firm failed to perform sufficient substantive procedures to test the valuation of inventory. The Firm tested a sample of the finished goods inventory values in the annual standard cost study. The

Firm, however, did not compare the inventory costs that it had tested in the annual standard cost study to the inventory costs that were the basis for the amount shown in the general ledger. (AS No. 13, paragraph 8)

- The Firm failed to perform sufficient procedures related to investments. Specifically –

  - To address the valuation of investments, the Firm selected for testing two controls. These controls consisted of (1) reviews of investment balances and transactions for compliance with the issuer's investment policy and (2) the reconciliation of investment statements to the general ledger; however, the Firm failed to test any aspects of these controls, or any other controls, that addressed the risk related to whether the investments were recorded at fair value. (AS No. 5, paragraph 39)

  - To address the issuer's disclosure of investments in the financial statements, the Firm selected for testing a control consisting of reviews of the issuer's financial statements. The Firm's procedures to test this control were limited to tracing amounts in the financial statements to the general ledger, considering the accuracy of the disclosures based on the Firm's knowledge of events, and inspecting correspondence that indicated a review had occurred. The Firm's testing did not include ascertaining and evaluating the nature of the review procedures that the control owner performed, including how the control owner assessed whether disclosures were in conformity with GAAP. (AS No. 5, paragraphs 42 and 44)

  - The issuer classified certain securities as trading securities and entered into an amended purchase agreement related to these securities. The Firm failed to sufficiently test these securities, as follows –

    - The Firm failed to perform any procedures to test the existence of these securities. (AS No. 13, paragraph 8)

      - The Firm failed to identify and appropriately address that the issuer's disclosures regarding these securities omitted the fact that the purchase agreement had been amended and were inconsistent with the terms of the amended purchase agreement. (AS No. 14, paragraphs 30 and 31)

  - The Firm failed to perform sufficient substantive procedures to test the existence of available-for-sale ("AFS") securities. The Firm's procedures were limited to (1) requesting a confirmation of all AFS securities from the investment manager, who did not have custody of the securities, and (2) comparing the fair value of AFS securities from the returned confirmation in aggregate to a statement that the issuer had obtained from the custodian. The Firm, however, did not obtain that statement directly from the custodian. (AU 332, paragraph .21)

A.2. <u>Issuer B</u>

In this audit of a manufacturer of technology products, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The issuer entered into contracts involving multiple elements and allocated consideration to the deliverables using vendor-specific objective evidence ("VSOE") of fair value or the best estimate of selling price ("BESP"). The Firm identified a fraud risk related to the occurrence of revenue, but the Firm failed to perform sufficient procedures related to revenue, deferred revenue, and net accounts receivable, as follows –

  - The Firm failed in the following respects to sufficiently test controls –

      - The Firm failed to test the operating effectiveness of the control that it selected over the accuracy and completeness of sales order data that were input into the issuer's system. (AS No. 5, paragraph 44)

- The Firm identified and tested a control that included the internal audit department's ("IA") evaluation of the appropriateness of revenue recognition for a sample of transactions each quarter. The Firm noted that IA identified a number of exceptions in the sample of transactions that it had tested each quarter. The Firm, however, failed to (1) evaluate the effect of these exceptions on its conclusion related to the design effectiveness of this control or (2) identify and test any other controls that addressed the risk that revenue was not appropriately recognized. (AS No. 5, paragraph 48)

- The Firm selected for testing two controls to address the risk related to the amount of revenue allocated to each of the multiple elements; these controls consisted of (1) the review of the sales contracts, including the approval of any discounts, and (2) the analysis of VSOE and BESP. The Firm's procedures to test these controls were limited to, for the first control, inspecting approvals as evidence that the actions performed as part of the control had occurred and, for the second control, obtaining the issuer's VSOE and BESP memoranda and analyses. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of these controls. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed to identify and test any controls over the accuracy and completeness of the accounts receivable aging report, which was used in the issuer's control over the allowance for doubtful accounts that the Firm selected for testing. (AS No. 5, paragraph 39)

- The Firm failed to perform sufficient substantive procedures to test revenue from contracts involving multiple elements, as follows –

    - The Firm failed to perform any procedures to evaluate whether third-party evidence existed for elements that the issuer valued using BESP. (AS No. 14, paragraph 30)

    - The Firm failed to sufficiently evaluate the appropriateness of the methodology and the reasonableness of the assumptions used in the issuer's VSOE and BESP analyses, as its procedures were limited to obtaining the issuer's VSOE and BESP memoranda. (AU 342, paragraph .11)

    - The Firm failed to perform sufficient procedures to test the accuracy and completeness of the data used in the issuer's VSOE and BESP analyses. Specifically, the Firm's procedures were limited to comparing five items from its revenue testing to the analyses for each of the first and second quarters; for the other two quarterly analyses, the Firm performed no testing. (AU 342, paragraph .11)

    - The Firm's procedures to test a significant adjustment that the issuer made to revenue were not sufficient. Specifically, the Firm obtained the issuer's memorandum and compared the posted adjustment to the general ledger, but it failed to perform any procedures to determine whether the amount of the adjustment was accurate. (AS No. 13, paragraph 8)

- The Firm tested the existence of accounts receivable as of an interim date. The Firm's procedures to extend its conclusion to year end were not sufficient. Specifically, these procedures were limited to obtaining schedules that rolled forward accounts receivable from the interim testing date to the year end and, for certain locations, testing (1) a very small sample of sales and (2) a sample of cash receipts related to sales tested as of the interim date. (AS No. 13, paragraph 45)

- The Firm failed to perform sufficient procedures related to inventory at certain of the issuer's locations, which held approximately 75 percent of the issuer's total inventory. Specifically –

    - The Firm failed to appropriately evaluate certain exceptions identified in its testing of ITGCs. Specifically, the Firm failed to evaluate the effect of these exceptions on the effectiveness of automated and IT-dependent manual controls over inventory that it had tested. (AS No. 5, paragraphs 47 and 48)

    - The issuer identified exceptions in its testing of a control over cash payments and concluded that the control was not operating effectively. The Firm failed to consider the effect of these exceptions on its own evaluation that this control was operating effectively. (AS No. 5, paragraph 48)

    - The Firm failed to evaluate, in combination with the other identified deficiencies, the severity of a deficiency that it identified in an inventory control that it tested. (AS No. 5, paragraph 62)

    - Although the Firm identified four compensating controls that it believed addressed the deficiencies that it had identified in controls over inventory and related ITGCs, the Firm failed to sufficiently test these controls. Specifically –

        - The Firm failed to test one of the compensating controls that it had identified. (AS No. 5, paragraph 39)

        - Another of the compensating controls that the Firm had identified was the control over cash payments that the issuer had determined was not operating effectively, as discussed above. (AS No. 5, paragraph 68)

        - The Firm's procedures to test the other two compensating controls – consisting of reviews of balance sheet reconciliations and the review of a comparison of the financial statements by region to prior periods – were limited to inquiring of management, inspecting signatures as evidence that reviews had occurred, inspecting a list of the general review procedures to be performed for a reconciliation, tracing the balance of a reconciliation to the general ledger, and reading the explanations for significant differences identified through the financial statement comparison. The Firm's testing did not include ascertaining and evaluating the nature of the specific review procedures that the control owners performed, including the criteria used by the control owners to identify matters for investigation and whether those matters were appropriately investigated and resolved. (AS No. 5, paragraph 68)

- The Firm failed to sufficiently test controls over the existence of inventory. The Firm selected for testing a control that related to the physical inventory count procedures; an aspect of this control consisted of management's evaluation of all physical count variances to determine the adjustment to be recorded. The Firm failed to test this aspect of the control. In addition, the Firm failed to identify and test any controls over the report used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed in the following respects to sufficiently test controls over the valuation of inventory –

  - The Firm failed to identify and test any controls over the determination of standard costs, including the capitalization of labor and overhead costs into inventory. (AS No. 5, paragraph 39)

  - The Firm failed to test the operating effectiveness of certain controls that it selected for testing, which consisted of the approval of changes to standard costs and the review of manufacturing variances. (AS No. 5, paragraph 44)

  - The Firm selected for testing a control that consisted of a review of inventory allowances and other valuation adjustments. The Firm's procedures to test this control were limited to inquiring of the control owners regarding the nature of the review procedures performed, comparing certain balances to the general ledger, and inspecting signatures as evidence that the reviews had occurred. The Firm's testing did not include evaluating the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

- o The Firm failed to perform sufficient substantive procedures to test the existence of inventory. In performing test counts of the issuer's inventory, the Firm identified differences between its counts and management's counts. For certain of these differences, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the reasons for these differences or otherwise performed procedures to address the implications of the differences. In addition, for certain of the test counts, the Firm failed to trace the quantities that it had counted to the quantities recorded in the issuer's system. (AU 331, paragraph .09)

- o The Firm failed to perform sufficient substantive procedures to test the valuation of inventory, as follows –

  - ▪ The Firm failed to test any of the labor and overhead costs that were capitalized into inventory. (AS No. 13, paragraph 8)

  - ▪ To test inventory pricing for manufactured goods, the Firm selected a sample of five items. The Firm tested only a very small number of the raw materials that were included in these five manufactured goods. (AS No. 13, paragraph 8)

  - ▪ The Firm failed to investigate significant variances that it identified between the bill of materials, which was intended to be used to determine the inventory's recorded cost, and the cost recorded in the inventory subsidiary ledger. In addition, the Firm failed to sufficiently evaluate significant variances that it identified between the standard and actual costs, as it failed to evaluate whether these variances were included in the purchase-price variance detail. (AS No. 15, paragraph 29)

- The Firm failed to perform sufficient procedures to test the inventory allowance, which consisted of six separate components. To test these components, the Firm obtained an understanding of how the issuer determined the components; inspected supporting worksheets for certain of the components; tested the mathematical accuracy of certain calculations; considered changes in the balance for certain of the components as compared to previous periods; considered recent sales activity for one component; and, for another component, considered total write-offs during the year as compared to the component balance. The Firm, however, failed to evaluate the reasonableness of certain significant underlying assumptions for each of the components. (AU 342, paragraph .11)

- The Firm failed to sufficiently test the accuracy and completeness of data and reports used in calculating the components of the inventory allowance. Specifically, the Firm failed to test the underlying data used for four of the six components. For one of the remaining components, the Firm's procedures were limited to testing one item on one of the supporting schedules. For the last component, the Firm's procedures were limited to, for one of the supporting schedules, (1) tracing a small number of items to the inventory subsidiary ledger and prior-year schedule and (2) tracing a small number of items from the prior-year schedule to the current-year schedule. (AU 342, paragraph .11)

- The Firm failed to sufficiently test the accuracy and completeness of a report prepared by the issuer that the Firm used to test the net realizable value of inventory, as the Firm's procedures were limited to comparing one invoice from its revenue test of details to the report. (AS No. 15, paragraph 10)

- The Firm designed certain of its substantive procedures – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the samples that the Firm used to test revenue, deferred revenue, accounts receivable, and the cost of inventory were too small to provide sufficient evidence. In addition, the Firm's sample to test the net realizable value of inventory was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessments. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .23 and .23A)

- During the year, the issuer completed a number of significant acquisitions, and it accounted for these acquisitions as business combinations. The Firm identified a fraud risk related to these business combinations. The Firm failed to perform sufficient procedures to test controls over the valuation of the assets acquired and liabilities assumed in these business combinations. The Firm selected three controls for testing: these controls included a review of the valuation report and the checklist for each acquisition, the preparation of technical accounting memoranda, and the approval of the business combination by the board of directors. The Firm's procedures to test these controls were limited to verifying that the acquisition checklists were completed for a sample of the business combinations; inspecting signatures as evidence that reviews had occurred; reading issuer-prepared technical accounting memoranda; reading minutes of meetings of the board of directors; and, for one acquisition, reading emails from an external valuation specialist. The Firm failed to evaluate whether these controls were designed and operated at a level of precision that would prevent or detect material misstatements, as it failed to ascertain the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. (AS No. 5, paragraphs 42 and 44)

A.3. Issuer C

In this audit, the Firm failed to identify and appropriately address what appeared to the inspection team to be an instance in which the financial statements were not presented fairly, in all material respects, in conformity with GAAP. Specifically, the Firm failed to identify that (1) the issuer had incorrectly applied GAAP when it recorded a change in estimate on a prospective basis and (2) the issuer had omitted required disclosures regarding the change. (AS No. 14, paragraphs 30 and 31)

A.4. Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The issuer recognized certain revenue using the percentage-of-completion ("POC") method. The Firm identified a significant risk related to the use of estimates in calculating revenue to be recognized using the POC method and a fraud risk related to revenue. The Firm failed to perform sufficient procedures related to the POC revenue as follows –

    - The Firm selected a sample of 14 contracts for which to perform the majority of its substantive testing. Twelve of these contracts were selected for testing based on contract size and risk criteria, and these contracts represented approximately 50 percent of the total POC revenue. The other two contracts were selected from the remaining population. The Firm's sample for that remaining population was too small to provide sufficient evidence, given the identified significant risks and the amount of the POC revenue related to the remaining contracts, which was many times the Firm's established level of materiality. (AS No. 13, paragraphs 8 and 42; AU 350, paragraphs .23 and .23A)

    - The Firm failed to sufficiently evaluate the reasonableness of the estimated costs to complete the contracts that were open as of year end, as the procedures it designed and performed to address this estimate were limited to, as described more specifically below, inquiries, procedures that did not address the estimated costs, and observations at the project site for one contract. (AU 342, paragraph .07) The Firm's procedures consisted of –

- testing the total costs incurred for one item on one contract;
- inquiring of management related to the status of the project for the sample of contracts described above, as well as for certain additional contracts that exceeded a monetary threshold, including inquiring about the reasons for certain changes in estimated costs and gross margins that the Firm identified when performing comparisons of those items to prior or subsequent periods;
- for the sample of contracts described above, confirming certain terms – which did not include costs – with the customers and performing alternative procedures when the requested confirmations were not returned; and
- for one contract, inquiring of the project team, observing the progress at the project site, tracing the names of certain employees observed onsite to the payroll records, and inspecting for any uninstalled materials.

o The Firm failed to sufficiently test the change orders that were included in the POC calculations but had not yet been approved by the customer as of year end. In determining the population of change orders from which to select its sample for testing, the Firm included only those change orders that were unapproved at year end but had been approved by the customer by the later testing date. As a result, the Firm failed to select any of its sample from change orders that remained unapproved at the testing date. (AU 350, paragraph .17)

- During the year, the issuer acquired a significant business. The Firm failed to sufficiently evaluate the reasonableness of the estimated costs to complete related to the contracts of this business; these costs were used to calculate the value of the assets acquired and liabilities assumed that represented the differences between the revenue that the acquiree had previously recognized under the POC method and the billings per the contractual terms. Specifically, the Firm's procedures related to these estimated costs were limited to (1) reviewing the predecessor auditor's work papers for the prior-year audit, (2) inquiring of management about the reasons for certain changes in estimated costs and gross margins, and (3) performing the procedures that the Firm intended to test the estimated costs to complete for specific contracts that are described above. (AU 342, paragraph .07)

- The Firm failed to identify and evaluate the significance to the financial statements of the issuer having accounted for an acquisition other than in conformity with FASB ASC 805, *Business Combinations*. (AS No. 14, paragraph 30)

A.5. <u>Issuer E</u>

In this audit of a pharmaceutical company, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The issuer initially recorded sales net of estimated rebates, expected returns, chargebacks, and other sales adjustments, and recorded these amounts on the balance sheet, either as a reduction to accounts receivable (a sales allowance) or as a liability (a price-concession reserve or sales return reserve). The issuer updated its sales allowance and reserve accounts quarterly if actual results differed from previous expectations. The Firm identified a fraud risk related to the occurrence of revenue, but failed to perform sufficient procedures to test net sales, net accounts receivable, and price-concession and sales return reserves for one subsidiary, as follows –

    - The Firm failed to identify and test any controls over the identification and consideration of contract terms that would affect revenue recognition. (AS No. 5, paragraph 39)

    - The Firm selected for testing controls that consisted of (1) a monthly review of the accounts receivable aging schedule in order to assess collectibility and (2) a quarterly review of sales allowances and reserves, as well as certain of the reductions recorded when revenue was recognized, and the supporting schedules. The Firm's procedures to test these controls were limited to inquiring of management and inspecting signatures or emails as evidence that a review had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the report used in the performance of the sales allowance and reserve control. (AS No. 5, paragraphs 39, 42, and 44)

- o The Firm designed certain of its substantive procedures to test net sales – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample that the Firm used to test net sales was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

- o The Firm's sample to test accounts receivable was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population being tested and the Firm's risk assessments. (AU 350, paragraphs .23 and .23A)

- o The Firm failed to perform any substantive procedures to test certain significant reductions recorded when revenue was recognized. (AS No. 13, paragraph 8)

- o The Firm failed to sufficiently test the sales return reserve. Specifically, the Firm failed to perform any procedures to test the accuracy and completeness of the unprocessed returns schedule provided to the issuer by an external administrator; the issuer used this schedule in calculating the sales return reserve. (AU 342, paragraph .11)

- The Firm failed to perform sufficient procedures to test controls over income taxes. The Firm selected for testing two controls that consisted of reviews of the income tax provision and the effective tax rate reconciliation, as well as their supporting schedules. The Firm's procedures to test these controls were limited to inquiring of management, obtaining the schedules that were reviewed as part of the controls, and inspecting emails as evidence that the reviews had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of these controls. (AS No. 5, paragraphs 39, 42, and 44)

A.6. Issuer F

In this audit of a financial institution, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The Firm identified a fraud risk related to the valuation of the allowance for loan losses ("ALL"). The Firm's procedures to test the specific component of the ALL were insufficient, as they were limited to (1) for one significant impaired loan, obtaining corroboration of its classification and payment status, (2) for a small sample of impaired loans, examining documentation supporting the issuer's impairment assessment, and (3) for three other impaired loans, testing the loan grades, examining documentation supporting the loans' classification, and documenting that the recorded carrying value and accrual status appeared appropriate. The Firm failed to evaluate the significant assumptions used in the issuer's impairment assessments and to test the related calculation of the specific component. (AU 342, paragraph .11)

- The Firm tested the existence of loans receivable as of an interim date and performed procedures to extend its conclusions to the year end. The Firm's procedures for testing the existence of loans were insufficient in the following respects –

- o The Firm's sample for testing at the interim date was too small to provide sufficient evidence because the Firm increased the tolerable misstatement that it used to develop the sample to an amount that was multiple times the tolerable misstatement that was based on the Firm's established level of materiality. (AU 350, paragraphs .16, .18, .18A, and .23)

- o The Firm's roll-forward procedures were limited to obtaining, for a sub-set of the loans receivable tested at the interim date, the transactions related to those loans from the issuer's records for the period between the interim testing date and the year end without performing any procedures to test those transactions. (AS No. 13, paragraph 45)

- The issuer acquired a business during the year and accounted for this acquisition as a business combination. The Firm failed to perform sufficient procedures to test certain assets acquired and liabilities assumed in this acquisition. Specifically, the Firm's procedures to test the loans receivable acquired and deposits assumed were limited to selecting a small sample from the population of loans and deposits outstanding as of a date approximately four months after the acquisition date, confirming these amounts, and rolling the amounts of those individual loan and deposit accounts back to the acquisition date. The Firm failed to perform any procedures to address changes in the populations of loans and deposits between the acquisition date and the date of its testing procedures. (AU 350, paragraph .17)

A.7. <u>Issuer G</u>

In this audit of a financial institution, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures related to the ALL, as follows –

- o The Firm selected for testing three controls that consisted of reviews of the ALL by management and the audit committee. The Firm's procedures to test these controls were limited to inquiring of management; obtaining certain documents and inspecting signatures as evidence that reviews had occurred; comparing certain amounts used in the calculation of the ALL to internally generated supporting documents or the general ledger; reading the minutes of the review committees, including the audit committee; and attending audit committee meetings. The Firm failed to ascertain and evaluate the nature of the specific review procedures that the various control owners performed, including the criteria used by those control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to test the aspects of these controls related to the accuracy and completeness of the data and reports used in the performance of these controls. (AS No. 5, paragraphs 42 and 44)

- o The Firm failed to perform sufficient substantive procedures to test the specific component of the ALL, as the Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions used in the calculation of this component. Specifically, with respect to impaired collateral-dependent loans included in the specific component, the Firm evaluated the significant assumptions used by appraisers in valuing the loan collateral based only on its general experience and knowledge of the banking industry and the real estate environment, without considering whether those assumptions reflected, or were not inconsistent with, existing market information relevant to those assets. (AU 328, paragraphs .26 and .28)

- o The Firm decreased its sample size to test the impaired loans included in the specific component of the ALL based on the assurance it obtained from certain other substantive procedures; these procedures, however, related to the quantitative and qualitative components of the ALL, and did not address the impaired loans or the specific component. As a result, the sample that the Firm used to test impaired loans receivable was too small to provide sufficient evidence. (AU 350, paragraphs .19, .23, and .23A)

- The Firm tested the existence of loans receivable as of an interim date and performed additional procedures to test loans originated in the period between the interim testing date and the year end. Both the interim procedures and the additional procedures were insufficient. Specifically –

  - o The Firm's sample to test loans receivable as of the interim date was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessments. (AU 350, paragraphs .23 and .23A)

  - o The Firm selected key items that exceeded a monetary threshold to test the loans that originated in the period between its interim testing date and year end. For the loans originated in this period that were not covered by the Firm's testing of key items, which totaled multiple times the Firm's established level of materiality, the Firm failed to perform any procedures. (AS No. 15, paragraph 27)

- The Firm's samples to test the loans receivable for which the issuer owned only a portion of the loan were too small to provide sufficient evidence because the Firm increased the tolerable misstatement that it used to develop the sample to an amount that was multiple times the tolerable misstatement that was based on the Firm's established level of materiality. (AU 350, paragraphs .16, .18, .18A, and .23)

A.8. Issuer H

In this audit of a retailer of consumer products, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The issuer acquired a significant business during the year, but the Firm failed to perform sufficient testing related to the inventory and revenue for this acquired component –

- The Firm failed to perform sufficient procedures to test the quantity of inventory acquired in the business combination at the acquisition date and the quantity of inventory held by this component at year end. The Firm's procedures to test this inventory consisted of (1) reading the issuer's cycle-count instructions, (2) observing the issuer's cycle counts and performing independent counts for a selection of the inventory at both the acquisition date and a date close to the year end, and (3) for its year-end testing, performing procedures to extend its conclusions from the date of its independent counts to year end. In determining that the cycle-count procedures that the issuer used for this inventory were sufficiently reliable, the Firm failed to consider the extent of the inventory items counted, the frequency of the counts, and the deviations identified in the counts. (AU 328, paragraph .39; AU 331, paragraph .11)

- The Firm failed to perform sufficient procedures to test the occurrence of one type of revenue, for which the Firm identified a fraud risk. The Firm determined its sample size for testing the occurrence of this revenue based on the assurance it had obtained from certain other substantive procedures. These other procedures consisted of performing an analytical procedure related to revenue cut-off, testing four journal entries related to revenue or the deferred revenue liability, testing subsequent aggregated cash collections for accounts receivable outstanding as of year end, and testing the deferred revenue liability. As these procedures were focused on the year end, they did not provide sufficient assurance about the occurrence of revenue throughout the period since the acquisition date and, as a result, the sample that the Firm used to test this revenue was too small to provide sufficient evidence. (AU 350, paragraphs .19, .23, and .23A)

A.9. Issuer I

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The Firm's testing of the fair value assigned to the intangible assets resulting from a business combination during the year was insufficient.

Specifically, the Firm failed to sufficiently evaluate the reasonableness of the significant assumptions underlying the internally developed cash-flow forecast that the issuer used to determine the fair value of the assets, as its procedures were limited to (1) obtaining the forecast and related significant assumptions, (2) inquiring of management, and (3) testing the mathematical accuracy of the forecast. (AU 328, paragraphs .26 and .28)

- The Firm failed to perform sufficient procedures to test controls over the annual analyses of the possible impairment of goodwill and other intangible assets. The Firm selected for testing a control that consisted of an annual review of the impairment analyses; these analyses included the use of cash-flow forecasts. The Firm's procedures to test the aspect of this control related to the cash-flow forecasts were limited to (1) obtaining the issuer's impairment memorandum, cash-flow forecasts, and related supporting schedules; (2) inquiring of management; and (3) comparing certain amounts to data, reports, and schedules prepared by the issuer. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed related to this aspect of the control, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to perform sufficient procedures to test the cash-flow forecast that the issuer used when performing its analysis of the possible impairment of goodwill. Specifically, the Firm's procedures to evaluate the reasonableness of the significant assumptions used in this forecast were limited to (1) obtaining the issuer's impairment memorandum, cash-flow forecast, and related supporting schedules; (2) inquiring of management; (3) testing the mathematical accuracy of the cash-flow forecast; and (4) performing a sensitivity analysis. Through its sensitivity analysis, the Firm identified that numerous scenarios could result in the reporting unit's fair value being less than its carrying value, but the Firm concluded that the assumptions used in the forecast were reasonable without performing any additional procedures. (AU 328, paragraphs .26 and .28)

- The Firm failed to perform sufficient procedures to test the issuer's analysis of the possible impairment of intangible assets other than goodwill. Specifically, the Firm's procedures to evaluate the reasonableness of the significant assumptions in this analysis were limited to (1) obtaining the issuer's memorandum, (2) inquiring of management, and (3) comparing certain amounts to data, reports, or schedules prepared by the issuer. (AU 328, paragraphs .26 and .28)

A.10. Issuer J

In this audit of a manufacturer of consumer products, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to sufficiently test inventory for one of the issuer's significant geographic regions, as follows –

- This inventory was subject to daily cycle counts, and the issuer maintained a manual spreadsheet that summarized which items were counted each day. The Firm's procedures to test the existence of, and the controls over the existence of, this inventory were insufficient. Specifically, in testing whether the cycle-count procedures that the issuer used for this inventory were sufficiently reliable, the Firm failed to consider the extent of the inventory items counted, the frequency of the counts, and the deviations identified in the counts. (AS No. 5, paragraphs 42 and 44; AU 331, paragraph .11)

- The Firm's approach for testing the valuation of this inventory included testing ITGCs over certain inventory applications to support the Firm's conclusions regarding transaction-level controls that were part of, or depended on, these applications. The Firm identified a control deficiency related to users having inappropriate developer-level access to these applications. The Firm tested certain compensating controls that it considered to mitigate the deficiency; these controls consisted of (1) the review of program changes made to the inventory applications, (2) the review of certain account balances that involved judgment, and (3) the comparison of the recorded results for each business unit to its budget. The Firm, however, failed to obtain sufficient evidence to support its conclusion that the compensating controls would prevent or detect material misstatements resulting from the ITGC access deficiency. Specifically –

- o The Firm failed to identify and test any controls that addressed the completeness of the population of changes that was actually reviewed pursuant to the control over program changes. (AS No. 5, paragraph 39)

- o The Firm's procedures to test the second and third compensating controls were limited to inquiring of management, ascertaining the thresholds that were used by the control owners to identify matters for investigation, and inspecting signatures and notes as evidence that reviews had occurred. The Firm's testing did not include evaluating whether the thresholds used by the control owners to identify matters for investigation were consistently applied or whether the matters identified for investigation were appropriately investigated and resolved. (AS No. 5, paragraph 68)

- o The Firm failed to identify and test any controls over the accuracy and completeness of the data used in the comparison of the recorded results to the budget. (AS No. 5, paragraph 39)

- The Firm selected for testing a control that included the review of inventory reserves. The Firm's procedures to test this review aspect of the control consisted of inquiring of management and inspecting signatures as evidence that reviews had occurred. In addition, the Firm stated that certain of its substantive tests were dual-purpose in nature and provided evidence of the effectiveness of this aspect of the control. The Firm failed to test, however, through any of its procedures, whether this aspect of the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and B9)

- The Firm designed certain of its substantive procedures to test the valuation of raw materials and work-in-process inventory – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the samples that the Firm used to test the valuation of this inventory were too small to provide sufficient evidence. In addition, the Firm's sample to test the valuation of finished goods inventory was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessments. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

A.11. Issuer K

In this audit of a financial institution, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as the Firm failed to perform sufficient procedures to test loans receivable. Specifically, the Firm's sample to test the existence of loans receivable was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessments. (AU 350, paragraphs .23 and .23A)

A.12. Issuer L

In this audit of a financial institution, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as the Firm failed to perform sufficient procedures to test loans receivable. Specifically, the Firm's sample to test the existence of loans receivable was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessments. (AU 350, paragraphs .23 and .23A)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also may relate, however, to other paragraphs of those standards and to other auditing standards, including those concerning due professional care, responses to risk assessments, and audit evidence.

Many audit deficiencies involve a lack of due professional care. AU 230, *Due Professional Care in the Performance of Work*, paragraphs .02, .05, and .06, requires the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AU 230, paragraphs .07 through .09, and AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, paragraph 7, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement. AS No. 15, *Audit Evidence*, paragraph 4, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of ICFR) and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in providing support for the related conclusions.

The paragraphs of the standards that are described immediately above are not cited in Part I.A, unless those paragraphs are the most directly related to the relevant deficiency.

B.1. List of Specific Auditing Standards Referenced in Part I.A

The table below lists the specific auditing standards that are referenced in Part I.A of this report, cross-referenced to the issuer audits for which each standard is cited. For each auditing standard, the table also provides the number of distinct deficiencies for which the standard is cited for each of the relevant issuer audits. This information identifies only the number of times that the standard is referenced, regardless of whether the reference includes multiple paragraphs or relates to multiple financial statement accounts.

PCAOB Auditing Standards	**Audits**	**Number of Deficiencies per Audit**
AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	Issuer A Issuer B Issuer E Issuer G	16 15 3 1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer I Issuer J	1 5
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer B Issuer D Issuer E Issuer F Issuer J	4 5 1 2 1 1
AS No. 14, *Evaluating Audit Results*	Issuer A Issuer B Issuer C Issuer D	5 1 1 1
AS No. 15, *Audit Evidence*	Issuer B Issuer G	2 1
AU 316, *Consideration of Fraud in a Financial Statement Audit*	Issuer A	1
AU 328, *Auditing Fair Value Measurements and Disclosures*	Issuer G Issuer H Issuer I	1 1 3
AU 331, *Inventories*	Issuer A Issuer B Issuer H Issuer J	1 1 1 1
AU 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*	Issuer A	1
AU 342, *Auditing Accounting Estimates*	Issuer A Issuer B Issuer D	1 4 2

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer E Issuer F	1 1
AU 350, *Audit Sampling*	Issuer A Issuer B Issuer D Issuer E Issuer F Issuer G Issuer H Issuer J Issuer K Issuer L	1 1 2 2 2 3 1 1 1 1

B.2. Financial Statement Accounts or Auditing Areas Related to Identified Audit Deficiencies

The table below lists the financial statement accounts or auditing areas related to each deficiency included in Part I.A of this report and identifies the audits described in Part I.A where deficiencies relating to the respective areas were observed.[5] The following standards were cited for only one issuer and are excluded from the table: AU 316 and AU 332.[6]

5 Certain deficiencies that affect multiple accounts or areas, such as those related to the evaluation of control deficiencies, are excluded from this table, but are included in Appendix D.

6 The AU 316 issue for issuer A related to revenue. The AU 332 issue for issuer A related to investment securities.

	AS No. 5	AS No. 13	AS No. 14	AS No. 15	AU 328	AU 331	AU 342	AU 350
Business combinations, including contingent consideration	B		D		H, I		D	F
Impairment of goodwill and intangible assets	I				I			
Income taxes	E							
Inventory and related reserves	A, B, J	A, B, J	C	B		A, B, H, J	B	B, J
Investment securities	A	A	A					
IT-related	A, B, J	A						
Loans, including ALL	G	F		G	G		F	F, G, K, L
Revenue, including accounts receivable, deferred revenue, and allowances	A, B, E	A, B, D, E	A, B				A, B, D, E	A, B, D, E, H

B.3. Audit Deficiencies by Industry

The table below lists the industries[7] of the issuers for which audit deficiencies were discussed in Part I.A of this report, and cross-references the issuer the specific auditing standards related to the deficiencies.[8]

	AS No. 5	AS No. 13	AS No. 14	AS No. 15	AU 316	AU 328	AU 331	AU 332	AU 342	AU 350
Consumer Discretionary	I		C			H, I	H			H
Financial Services	G	F		G		G			F	F, G, K, L

[7] The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

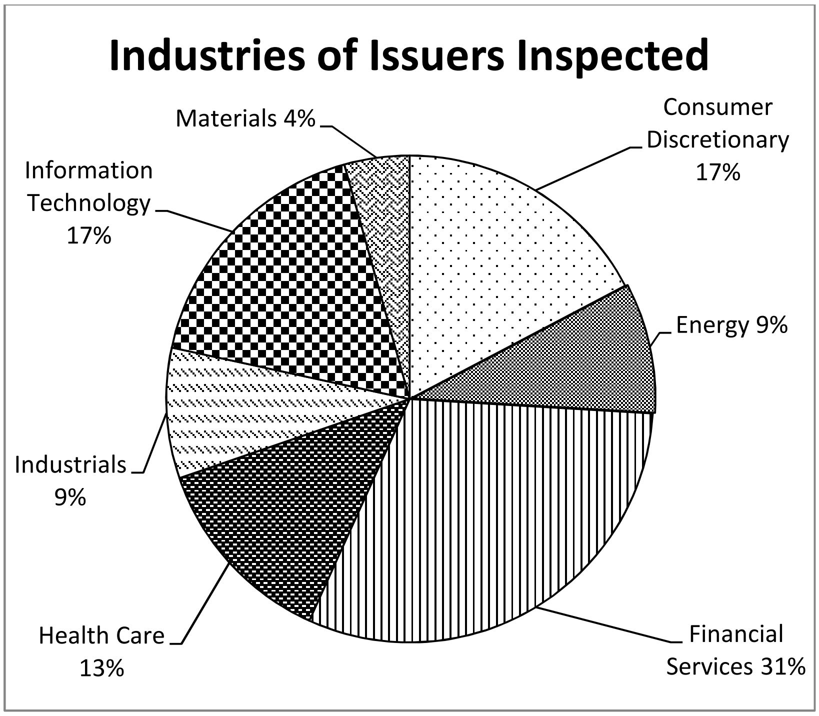
[8] Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

	AS No. 5	AS No. 13	AS No. 14	AS No. 15	AU 316	AU 328	AU 331	AU 332	AU 342	AU 350
Health Care	A, E	A, E	A		A		A	A	A, E	A, E
Industrials	J	D, J	D				J		D	D, J
Information Technology	B	B	B	B			B		B	B

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

The chart below categorizes the 23 issuers whose audits were inspected in 2015, based on the issuer's industry.[9]

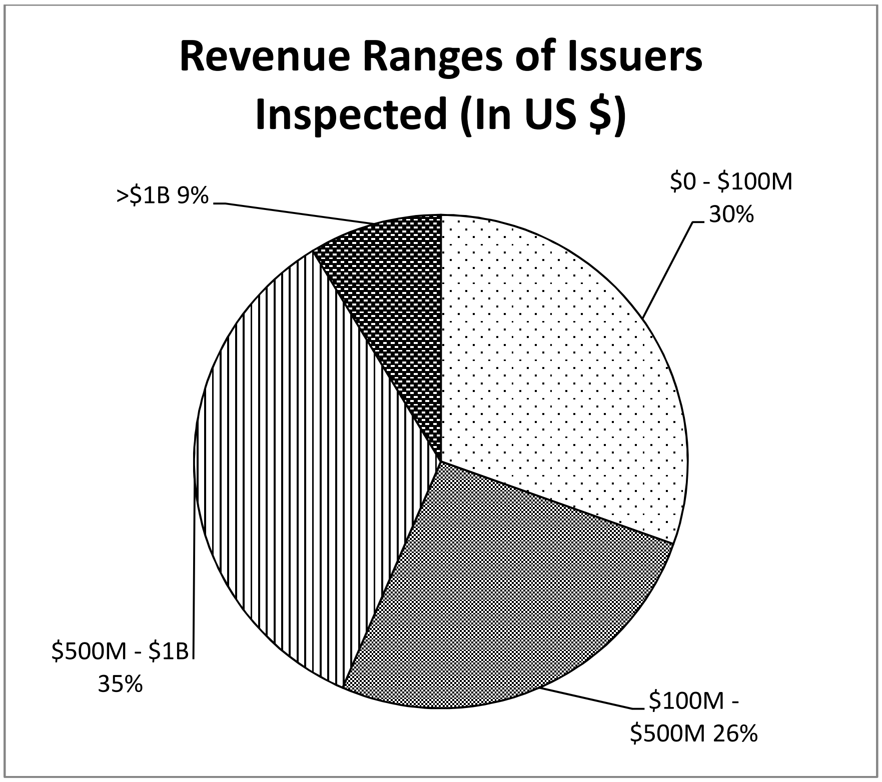


Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	4	17%
Energy	2	9%
Financial Services	7	31%
Health Care	3	13%
Industrials	2	9%
Information Technology	4	17%
Materials	1	4%

[9] See Footnote 7 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 23 issuers whose audits were inspected in 2015.[10] This presentation of revenue data is intended to provide information about the size of issuer audits that were inspected and is not indicative of whether the inspection included a review of the Firm's auditing of revenue in the issuer audits selected for review.



Revenue (in US$)	Number of Audits inspected	Percentage
<100 million	7	30%
100-500 million	6	26%
500 million -1 billion	8	35%
>1 billion	2	9%

[10] The revenue amounts reflected in the chart are for the issuer's fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.

D. Information Concerning PCAOB Inspections that is Generally Applicable to Annually Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. For these audits, the inspection team selects certain portions of the audits for inspection, and it reviews the engagement team's work papers and interviews engagement personnel regarding those portions. If the inspection team identifies a potential issue that it is unable to resolve through discussion with the firm and any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report.

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[11] as well as a firm's failure to perform, or to perform sufficiently, certain necessary audit procedures. An inspection of an annually inspected firm does not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS No. 3, *Audit Documentation,* provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. In reaching its conclusions, an inspection team considers whether audit documentation or any other evidence that a firm might provide to the inspection team supports the firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

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[11] When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with the applicable financial reporting framework, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.[12]

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

D.2. Review of a Firm's Quality Control System

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice,* provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable

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[12] The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system.[13] If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;[14] related firm methodology, guidance, and practices; and possible root causes.

Inspections also include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining issuer audit engagements, including the application of the firm's risk-rating system; (4) processes related to the firm's use of audit work that the firm's foreign affiliates perform on the foreign operations of the firm's U.S. issuer audits; and

[13] Not every audit deficiency suggests a defect or potential defect in a firm's quality control system, and this report does not discuss every audit deficiency the inspection team identified.

[14] An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.

(5) the firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

D.2.a. Review of Management Structure and Processes, Including the Tone at the Top

Procedures in this area are designed to focus on (1) how management is structured and operates the firm's business, and the implications that the management structure and processes have on audit performance and (2) whether actions and communications by the firm's leadership – the tone at the top – demonstrate a commitment to audit quality. To assess this area, the inspection team may interview members of the firm's leadership and review significant management reports and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.

D.2.b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area are designed to focus on (1) whether the firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as distinct from marketing or other activities of the firm; (2) the firm's processes for allocating its partner resources; and (3) the accountability and responsibilities of the different levels of firm management with respect to partner management. The inspection team may interview members of the firm's management and review documentation related to certain of these topics. In addition, the inspection team's evaluation may include the results of interviews of audit partners regarding their responsibilities and allocation of time. Further, the inspection team may review a sample of partners' personnel files.

D.2.c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Issuer Audit Engagements, Including the Application of the Firm's Risk-Rating System

The inspection team may consider the firm's documented policies and procedures in this area. In addition, the inspection team may select certain issuer audits to (1) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the issuer audit engagements and (2) observe whether the audit procedures were responsive to the risks identified during the firm's process.

D.2.d. Review of Processes Related to a Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audits

The inspection team may review the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the firm's U.S. issuer audits, review available information relating to the most recent internal inspections of foreign affiliated firms, interview members of the firm's leadership, and review the U.S. engagement teams' supervision concerning, and procedures for control of, the audit work that the firm's foreign affiliates performed on a sample of audits.

D.2.e. Review of a Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Defects or Potential Defects in Quality Control

D.2.e.i. Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area are designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team may interview members of the firm's management and review documents relating to the firm's identification and evaluation of, and response to, possible indicators of deficiencies in audit performance. In addition, the inspection team may review documents related to the design, operation, and evaluation of findings of the firm's internal inspection program, and may compare the results of its review of audit work to those from the internal inspection's review of the same audit work.

D.2.e.ii. Review of Response to Defects or Potential Defects in Quality Control

The inspection team may review steps the firm has taken to address possible quality control deficiencies and assess the design and effectiveness of the underlying processes. In addition, the inspection team may inspect audits of issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies have improved.

D.2.e.iii. Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team may assess policies, procedures, and guidance related to aspects of independence requirements and the firm's consultation processes, as well as the firm's compliance with these requirements and processes. In addition, the inspection team may review documents, including certain newly issued policies and procedures, and interview firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

END OF PART I

PART II, PART III, AND APPENDIX A OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX B

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[15]

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[15] The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

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December 14, 2016

Ms. Helen A. Munter
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Re: Response to Part I of the Draft Report on the 2015 Inspection of BDO USA, LLP

Dear Ms. Munter:

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2015 inspection of BDO USA, LLP.

We have evaluated each of the matters described in Part I of the Draft Report and have taken appropriate actions under both PCAOB standards and our policies, including steps we considered necessary to comply with AU 390, *Consideration of Omitted Procedures After the Report Date*, and where applicable, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.*

We remain committed in making audit quality our top priority. The PCAOB's inspection process assists us in improving our audit performance and our underlying quality control systems. We look forward to continuing to work with the PCAOB on the most effective means of achieving this objective.

Respectfully submitted,

BDO USA, LLP

APPENDIX C

AUDITING STANDARDS REFERENCED IN PART I

This appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this appendix, and any other Notes, are from the original auditing standards that are referenced. While this appendix contains the specific portions of the relevant standards cited with respect to the deficiencies in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS No. 5.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, B, E, and J
TESTING CONTROLS		
Testing Design Effectiveness		
AS No. 5.42	The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.	Issuers A, B, E, G, I, and J

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
Testing Operating Effectiveness		
AS No. 5.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. Note: In some situations, particularly in smaller companies, a company might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for a company's financial reporting and associated controls, the auditor may take into account the combined competence of company personnel and other parties that assist with functions related to financial reporting.	Issuers A, B, E, G, I, and J
Relationship of Risk to the Evidence to be Obtained		
AS No. 5.47	Factors that affect the risk associated with a control include – • The nature and materiality of misstatements that the control is intended to prevent or detect; • The inherent risk associated with the related account(s) and assertion(s); • Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness; • Whether the account has a history of errors; • The effectiveness of entity-level controls, especially controls that monitor other controls; • The nature of the control and the frequency with which it operates; • The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information	Issuer B

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	technology general controls); • The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; • Whether the control relies on performance by an individual or is automated (i.e., an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and Note: A less complex company or business unit with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of information technology controls might focus on the application controls built into the pre-packaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls. • The complexity of the control and the significance of the judgments that must be made in connection with its operation. Note: Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.	
AS No. 5.48	When the auditor identifies deviations from the company's controls, he or she should determine the effect of the deviations on his or her assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control. Note: Because effective internal control over financial reporting cannot, and does not, provide absolute assurance of achieving the company's control objectives, an individual control does not necessarily have to operate without any deviation	Issuer B

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	to be considered effective.	
EVALUATING IDENTIFIED DEFICIENCIES		
AS No. 5.62	The auditor must evaluate the severity of each control **deficiency** that comes to his or her attention to determine whether the deficiencies, individually or in combination, are material weaknesses as of the date of management's assessment. In planning and performing the audit, however, the auditor is not required to search for deficiencies that, individually or in combination, are less severe than a material weakness.	Issuer B
AS No. 5.68	The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.	Issuers A, B, and J
APPENDIX B - Special Topics		
INTEGRATION OF AUDITS		
AS No. 5.B9	To obtain evidence about whether a selected control is effective, the control must be tested directly; the effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, should inform the auditor's risk assessments in determining the testing necessary to conclude on the effectiveness of a control.	Issuers A and J

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
Responses Involving the Nature, Timing, and Extent of Audit Procedures		
AS No. 13.8	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuers A, B, D, and E

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
Testing Controls		
TESTING CONTROLS IN AN AUDIT OF FINANCIAL STATEMENTS		
AS No. 13.16	*Controls to be Tested.* If the auditor plans to assess control risk at less than the maximum by relying on controls,[12/] and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire **period of reliance**.[13/] However, the auditor is not required to assess control risk at less than the maximum for *all* relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	Issuers A, B, E, and J
Footnotes to AS No. 13.16 12/ Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures. 13/ Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.		
AS No. 13.18	*Evidence about the Effectiveness of Controls in the Audit of Financial Statements*. In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers A, B, E, and J
ASSESSING CONTROL RISK		
AS No. 13.34	When deficiencies affecting the controls on which the auditor intends to rely are detected, the auditor should evaluate the severity of the deficiencies and the effect on	Issuer A

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	the auditor's control risk assessments. If the auditor plans to rely on controls relating to an assertion but the controls that the auditor tests are ineffective because of control deficiencies, the auditor should: a. Perform tests of other controls related to the same assertion as the ineffective controls, or b. Revise the control risk assessment and modify the planned substantive procedures as necessary in light of the increased assessment of risk. Note: Auditing Standard No. 5 establishes requirements for evaluating the severity of a control deficiency and communicating identified control deficiencies to management and the audit committee in an integrated audit. AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* establishes requirements for communicating significant deficiencies and material weaknesses in an audit of financial statements only.	
Substantive Procedures		
AS No. 13.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	Issuers A, B, E, and J
EXTENT OF SUBSTANTIVE PROCEDURES		
AS No. 13.42	The more extensively a substantive procedure is performed, the greater the evidence obtained from the procedure. The necessary extent of a substantive audit procedure depends on the materiality of the account or disclosure, the assessed risk of material misstatement, and the necessary degree of assurance from the procedure. However, increasing the extent of an audit procedure cannot adequately address an assessed risk of material misstatement unless the evidence to be obtained from the procedure is reliable and relevant.	Issuer D

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
TIMING OF SUBSTANTIVE PROCEDURES		
AS No. 13.45	When substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. Such procedures should include (a) comparing relevant information about the account balance at the interim date with comparable information at the end of the period to identify amounts that appear unusual and investigating such amounts and (b) performing audit procedures to test the remaining period.	Issuers B and F

AS No. 14, *Evaluating Audit Results*		
Evaluating the Results of the Audit of Financial Statements		
EVALUATING THE PRESENTATION OF THE FINANCIAL STATEMENTS, INCLUDING THE DISCLOSURES		
AS No. 14.30	The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Note: AU sec. 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles,* establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, *Evaluating Consistency of Financial Statements,* establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements. Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the	Issuers A, B, C, and D

AS No. 14, *Evaluating Audit Results*		
	accounting principles applicable to that company.	
AS No. 14.31	As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework. Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. Note: According to AU sec. 508, if the financial statements, including the accompanying notes, fail to disclose information that is required by the applicable financial reporting framework, the auditor should express a qualified or adverse opinion and should provide the information in the report, if practicable, unless its omission from the report is recognized as appropriate by a specific auditing standard.[18/]	Issuers A and C
Footnote to AS No. 14.31 [18/] AU secs. 508.41-.44.		

AS No. 15, *Audit Evidence*		
Sufficient Appropriate Audit Evidence		
USING INFORMATION PRODUCED BY THE COMPANY		
AS No. 15.10	When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:[3/] • Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and • Evaluate whether the information is sufficiently precise and detailed for purposes of the audit.	Issuer B

AS No. 15, *Audit Evidence*		
Footnote to AS No. 15.10 [3] When using the work of a specialist engaged or employed by management, see AU sec. 336, *Using the Work of a Specialist.* When using information produced by a service organization or a service auditor's report as audit evidence, see AU sec. 324, *Service Organizations*, and for integrated audits, see Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.		
Selecting Items for Testing to Obtain Audit Evidence		
SELECTING SPECIFIC ITEMS		
AS No. 15.27	The application of audit procedures to items that are selected as described in paragraphs 25-26 of this standard does not constitute audit sampling, and the results of those audit procedures cannot be projected to the entire population.[12]	Issuer G
Footnote to AS No. 15.27 [12] If misstatements are identified in the selected items, see paragraphs 12-13 and paragraphs 17-19 of Auditing Standard No. 14.		
Inconsistency in, or Doubts about the Reliability of, Audit Evidence		
AS No. 15.29	If audit evidence obtained from one source is inconsistent with that obtained from another, or if the auditor has doubts about the reliability of information to be used as audit evidence, the auditor should perform the audit procedures necessary to resolve the matter and should determine the effect, if any, on other aspects of the audit.	Issuer B

AU 316, *Consideration of Fraud in a Financial Statement Audit*		
Responding to Assessed Fraud Risks		
Audit Procedures Performed to Specifically		

AU 316, *Consideration of Fraud in a Financial Statement Audit*		
Address the Risk of Management Override of Controls		
AU 316.61	The auditor should use professional judgment in determining the nature, timing, and extent of the testing of journal entries and other adjustments. For purposes of identifying and selecting specific entries and other adjustments for testing, and determining the appropriate method of examining the underlying support for the items selected, the auditor should consider: • *The auditor's assessment of the fraud risk.* The presence of fraud risk factors or other conditions may help the auditor to identify specific classes of journal entries for testing and indicate the extent of testing necessary. • *The effectiveness of controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and adjustments may affect the extent of substantive testing necessary, provided that the auditor has tested the controls. However, even though controls might be implemented and operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items. • *The entity's financial reporting process and the nature of the evidence that can be examined.* The auditor's procedures for testing journal entries and other adjustments will vary based on the nature of the financial reporting process. For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments might involve both manual and automated procedures and controls. Regardless of the method, the auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items. In addition, the auditor should be aware that journal entries and other adjustments might exist in either electronic or paper form. When	Issuer A

AU 316, *Consideration of Fraud in a Financial Statement Audit*		
	information technology (IT) is used in the financial reporting process, journal entries and other adjustments might exist only in electronic form. Electronic evidence often requires extraction of the desired data by an auditor with IT knowledge and skills or the use of an IT specialist. In an IT environment, it may be necessary for the auditor to employ computer-assisted audit techniques (for example, report writers, software or data extraction tools, or other systems-based techniques) to identify the journal entries and other adjustments to be tested. • *The characteristics of fraudulent entries or adjustments.* Inappropriate journal entries and other adjustments often have certain unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or a consistent ending number. • *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to errors in the past, (d) have not been reconciled on a timely basis or contain unreconciled differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified fraud risk. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations based on factors set forth in paragraphs 11 through 14 of Auditing Standard No. 9, *Audit Planning.* • *Journal entries or other adjustments processed outside the normal course of*	

AU 316, *Consideration of Fraud in a Financial Statement Audit*		
	business. Standard journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements, or to record recurring periodic accounting estimates generally are subject to the entity's internal controls. Nonstandard entries (for example, entries used to record nonrecurring transactions, such as a business combination, or entries used to record a nonrecurring estimate, such as an asset impairment) might not be subject to the same level of internal control. In addition, other adjustments such as consolidating adjustments, report combinations, and reclassifications generally are not reflected in formal journal entries and might not be subject to the entity's internal controls. Accordingly, the auditor should consider placing additional emphasis on identifying and testing items processed outside of the normal course of business.	

AU 328, *Auditing Fair Value Measurements and Disclosures*		
Introduction		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AU 328.26	The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether: a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06). b. The fair value measurement was determined using an appropriate model, if applicable. c. Management used relevant information that was reasonably available at the time.	Issuers G and I
AU 328.28	Where applicable, the auditor should evaluate	Issuers G and

AU 328, *Auditing Fair Value Measurements and Disclosures*		
	whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.	I
AU 328.39	The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.	Issuer H

AU 331, *Inventories*		
Inventories		
AU 331.09	When inventory quantities are determined solely by means of a physical count, and all counts are made as of the balance-sheet date or as of a single date within a reasonable time before or after the balance-sheet date, it is ordinarily necessary for the independent auditor to be present at the time of count and, by suitable observation, tests, and inquiries, satisfy himself respecting the effectiveness of the methods of inventory-taking and the measure of reliance which may be placed upon the client's representations about the quantities and physical condition of the inventories.	Issuer B
AU 331.11	In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor	Issuers H and J

AU 331, *Inventories*		
	must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances. [Revised, June 1981, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 39.]	
AU 331.12	When the independent auditor has not satisfied himself as to inventories in the possession of the client through the procedures described in paragraphs .09 through .11, tests of the accounting records alone will not be sufficient for him to become satisfied as to quantities; it will always be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions. This should be coupled with inspection of the records of any client's counts and procedures relating to the physical inventory on which the balance-sheet inventory is based.	Issuer A

AU 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*		
Financial Statement Assertions		
Existence		
AU 332.21	Existence assertions address whether the derivatives and securities reported in the financial statements through recognition or disclosure exist at the date of the statement of financial position. Occurrence assertions address whether derivatives and securities transactions reported in the financial statements, as a part of earnings, other comprehensive income, or cash flows or through disclosure, occurred. Paragraph .19 provides guidance on the auditor's determination of the nature, timing, and extent of substantive procedures to be performed. Examples of substantive procedures for existence or occurrence assertions about derivatives and securities include— • Confirmation with the issuer of the security. • Confirmation with the holder of the security, including securities in electronic form, or with the	Issuer A

AU 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

	counterparty to the derivative.[fn 11] • Confirmation of settled transactions with the broker-dealer or counterparty. • Confirmation of unsettled transactions with the broker-dealer or counterparty. • Physical inspection of the security or derivative contract. • Reading executed partnership or similar agreements. • Inspecting underlying agreements and other forms of supporting documentation, in paper or electronic form, for the following: o Amounts reported o Evidence that would preclude the sales treatment of a transfer o Unrecorded repurchase agreements • Inspecting supporting documentation for subsequent realization or settlement after the end of the reporting period. • Performing analytical procedures.[fn 12] For example, the absence of a material difference from an expectation that interest income will be a fixed percentage of a debt security based on the effective interest rate determined when the entity purchased the security provides evidence about existence of the security.	

<u>Footnotes to AU 332.21</u>

[fn 11] Section 330, provides guidance to auditors in using confirmations as substantive tests of financial statement assertions. Confirmations may be used as a substantive test of various financial statement assertions about derivatives and securities. For example, a confirmation may be designed to—

- Obtain information about valuation assertions or assumptions underlying valuations.
- Determine whether there are any side agreements that affect assertions about the entity's rights and obligations associated with a transaction, such as an agreement to repurchase securities sold or an agreement to pledge securities as collateral for a loan.
- Determine whether the holder of the entity's securities agrees to deliver the securities reported or

AU 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*
their value when required by the entity. fn 12 Section 329, provides guidance to auditors in using analytical procedures as substantive tests.

AU 342, *Auditing Accounting Estimates*		
Evaluating Accounting Estimates		
AU 342.07	The auditor's objective when evaluating accounting estimates is to obtain sufficient appropriate evidential matter to provide reasonable assurance that— a. All accounting estimates that could be material to the financial statements have been developed. b. Those accounting estimates are reasonable in the circumstances. • The accounting estimates are presented in conformity with applicable accounting principles[fn2] and are properly disclosed.[fn 3]	Issuers A and D
Footnotes to AU 342.07 fn 2 Section 411, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, discusses the auditor's responsibility for evaluating conformity with generally accepted accounting principles. [Title of section 411 amended, effective for reports issued or reissued on or after June 30, 2001, by Statement on Auditing Standards No. 93.] fn 3 See paragraph 31 of Auditing Standard No. 14, *Evaluating Audit Results*.		
Evaluating Reasonableness		
AU 342.11	Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach: a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation.	Issuers B, E, and F

AU 342, *Auditing Accounting Estimates*		
	b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose. f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions. h. Consider using the work of a specialist regarding certain assumptions (section 336, Using the Work of a Specialist). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	

AU 350, *Audit Sampling*		
Sampling In Substantive Tests Of Details		
Planning Samples		
AU 350.16	When planning a particular sample for a substantive test of details, the auditor should consider • The relationship of the sample to the relevant audit objective. • Tolerable misstatement. (See paragraphs .18-.18A.)	Issuers F and G

AU 350, *Audit Sampling*		
	• The auditor's allowable risk of incorrect acceptance. Characteristics of the population, that is, the items comprising the account balance or class of transactions of interest.	
AU 350.17	When planning a particular sample, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures, to be applied will achieve that objective. The auditor should determine that the population from which he draws the sample is appropriate for the specific audit objective. For example, an auditor would not be able to detect understatements of an account due to omitted items by sampling the recorded items. An appropriate sampling plan for detecting such understatements would involve selecting from a source in which the omitted items are included. To illustrate, subsequent cash disbursements might be sampled to test recorded accounts payable for understatement because of omitted purchases, or shipping documents might be sampled for understatement of sales due to shipments made but not recorded as sales.	Issuers D and F
AU 350.18	Evaluation in monetary terms of the results of a sample for a substantive test of details contributes directly to the auditor's purpose, since such an evaluation can be related to his or her judgment of the monetary amount of misstatements that would be material. When planning a sample for a substantive test of details, the auditor should consider how much monetary misstatement in the related account balance or class of transactions may exist, in combination with other misstatements, without causing the financial statements to be materially misstated. This maximum monetary misstatement for the account balance or class of transactions is called *tolerable misstatement*.	Issuers F and G

AU 350, *Audit Sampling*		
AU 350.18A	Paragraphs 8 - 9 of Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*, describe the auditor's responsibilities for determining tolerable misstatement at the account or disclosure level. When the population to be sampled constitutes a portion of an account balance or transaction class, the auditor should determine tolerable misstatement for the population to be sampled for purposes of designing the sampling plan. Tolerable misstatement for the population to be sampled ordinarily should be less than tolerable misstatement for the account balance or transaction class to allow for the possibility that misstatement in the portion of the account or transaction class not subject to audit sampling, individually or in combination with other misstatements, would cause the financial statements to be materially misstated.	Issuers F and G
AU 350.19	The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed." After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details.[fn 3] Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuers A, E, G, H, and J
Footnote to AU 350.19 [fn 3] Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.		
AU 350.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the	Issuers A, B, D, E, F, G, H, J, K, and L

AU 350, *Audit Sampling*		
	population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	
AU 350.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.	Issuers A, B, D, E, G, H, J, K, and L

APPENDIX D

REORGANIZED STANDARDS REFERENCED IN PART I

On March 31, 2015, the PCAOB adopted the reorganization of its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). On September 17, 2015, the SEC approved the PCAOB's adoption of the reorganization. The reorganized standards will be effective as of December 31, 2016. The citations to PCAOB auditing standards included in this report use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. This table provides the section numbers of those standards included in Part I of this report as reorganized, as well as the titles of the standards both before and after the reorganization. The complete standards are available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.

Auditing Standards – before the reorganization		**Auditing Standards – as reorganized**	
AS No. 3	*Audit Documentation*	AS 1215	*Audit Documentation*
AS No. 5	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	AS 2201	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
AS No. 13	*The Auditor's Responses to the Risks of Material Misstatement*	AS 2301	*The Auditor's Responses to the Risks of Material Misstatement*
AS No. 14	*Evaluating Audit Results*	AS 2810	*Evaluating Audit Results*
AS No. 15	*Audit Evidence*	AS 1105	*Audit Evidence*
AU 230	*Due Professional Care in the Performance of Work*	AS 1015	*Due Professional Care in the Performance of Work*
AU 316	*Consideration of Fraud in a Financial Statement Audit*	AS 2401	*Consideration of Fraud in a Financial Statement Audit*
AU 328	*Auditing Fair Value Measurements and Disclosures*	AS 2502	*Auditing Fair Value Measurements and Disclosures*
AU 331	*Inventories*	AS 2510	*Auditing Inventories*
AU 332	*Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*	AS 2503	*Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*
AU 342	*Auditing Accounting Estimates*	AS 2501	*Auditing Accounting Estimates*
AU 350	*Audit Sampling*	AS 2315	*Audit Sampling*