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Report on

2016 Inspection of Deloitte & Touche LLP

(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

November 28, 2017

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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PCAOB

Public Company Accounting Oversight Board

2016 INSPECTION OF DELOITTE & TOUCHE LLP

Preface

In 2016, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Deloitte & Touche 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 A and Appendix B. Appendix A 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 B 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 became effective as of December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

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EXECUTIVE SUMMARY

This summary sets out certain key information from the 2016 inspection of Deloitte & Touche LLP ("the Firm"). The inspection procedures included reviews of portions of 54 issuer audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. Fifty-three of the 55 engagements were integrated audits of both internal control and the financial statements. Part I.C of this report provides certain demographic information about the audits inspected and Part I.D describes the general procedures applied in the PCAOB's 2016 inspections of annually inspected registered firms.

The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In 13 audits, 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 conformity 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"). These deficiencies are described in Part I.A of the report.

Effects of Audit Deficiencies on Audit Opinions

Of the 13 issuer audits that appear in Part I.A, deficiencies in 12 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in seven audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the seven audits in which substantive testing deficiencies were identified, two 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
Audits for which deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	<u>6 Audits</u>: Issuers A, B, C, D, E, and F
Audits for which deficiencies included in Part I.A related to the ICFR audit only	<u>6 Audits</u>: Issuers G, H, I, K, L, and M

	Number of Audits
Audits for which deficiencies included in Part I.A related to the financial statement audit only	1 Audit: Issuer J
Total	13

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 three 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 sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing	9 Audits: Issuers A, B, C, E, F, G, H, I, and M
Failure to sufficiently evaluate significant assumptions that the issuer used in developing an estimate	5 Audits: Issuers A, B, C, D, and F
Failure to sufficiently test controls over or sufficiently test the accuracy and completeness of issuer-produced data or reports	4 Audits: Issuers A, F, G, and L

Areas in which Audit Deficiencies Were Most Frequently Identified

The following table lists, in summary form, the financial statement accounts or auditing areas in which the deficiencies that are included in Part I.A of this report most frequently occurred. The table includes only the three most frequently identified areas that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Area	Part I.A Audits
Investment securities, including derivatives	5 Audits: Issuers A, B, G, H, and I
Loans, including the allowance for loan losses	3 Audits: Issuers A, B, and G

Area	Part I.A Audits
Revenue, including deferred revenue	3 Audits: Issuers F, L, and M

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from November 2015 to February 2017. The inspection team performed field work at the Firm's National Office and at 29 of its approximately 64 U.S. practice offices.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 54 issuer audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In one 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.

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 B 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

[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.

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 conformity with the applicable financial reporting framework and/or its opinion about whether the issuer had maintained, in all material respects, effective 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.[2]

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[2] 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.

The audit deficiencies that reached this level of significance are described in Parts I.A.1 through I.A.13, below.

Audit Deficiencies

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

In this audit of an issuer in the financial services industry, 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 procedures related to the allowance for loan losses ("ALL") were insufficient, as follows –

    - The Firm identified 17 sub-components within the three components that constituted the issuer's ALL and performed risk assessment procedures for each of the 17 sub-components; these procedures included identifying the risks of misstatement associated with each sub-component and concluding whether those risks individually represented a risk of material misstatement. For eight sub-components, the Firm concluded that the risks did not represent a risk of material misstatement for any of these sub-components individually. These eight sub-components, when combined, represented a significant portion of the issuer's total ALL. The Firm failed to perform any procedures for these sub-components, which in the aggregate presented a reasonable possibility of material misstatement. (AS 2110.59; AS 2301.08)

    - The Firm's testing of controls over the ALL for commercial loans was insufficient. The issuer assigned a risk rating for each commercial loan when it was initiated, and it reviewed each risk rating once during the year, based on its assessment of the borrower's credit quality and other characteristics. This information was retained in systems for which the Firm identified multiple deficiencies in controls over user access. The issuer used the assigned risk rating to develop a probability of default for each loan, which was a significant assumption used in the determination of a component of this ALL that represented a significant portion of the ALL. Regarding the Firm's testing of controls over this component –

  - The Firm selected for testing a control that consisted of a review of the risk rating assigned to the related loans, but the Firm's testing was insufficient. The Firm's procedures to test this control consisted of inquiring of the control owners, reading the issuer's internal policy, and inspecting certain information that the issuer used in the performance of the control. In addition, in its evaluation of this control, the Firm considered the results of a substantive procedure that consisted of evaluating whether the risk rating assigned by the issuer was appropriate in accordance with the issuer's policy. The Firm, however, failed to ascertain and evaluate the specific criteria that the control owners used to assess the reasonableness of the risk rating assigned to each loan. (AS 2201.42 and .44)

  - The Firm failed to identify and test any controls to address the risk that it identified that an assigned risk rating could be rendered inaccurate due to events or changes to loan data that occurred after the date of the loan risk-rating review. (AS 2201.39)

- When developing the qualitative component of the ALL, the issuer assigned an individual score to each qualitative factor it identified and grouped these factors into four categories that were then weighted using certain judgmental assumptions. The Firm's procedures to test the qualitative component of the ALL, which represented a significant portion of the issuer's total ALL, consisted of (1) obtaining an understanding of the issuer's rationale for each of the qualitative factors; (2) comparing the assigned score for each qualitative factor in the current period to the related score in prior periods; (3) inquiring of management regarding the reason for changes from prior periods; (4) inspecting supporting documentation for one change; and (5) evaluating, based on the Firm's knowledge of the issuer and economic factors, trends in the total ALL balance and certain metrics related to the ALL. The Firm failed to sufficiently evaluate the reasonableness of the qualitative component of the ALL because it did not evaluate the assigned score and weighting assumptions described above beyond performing a directional assessment of changes. (AS 2501.11)

- The Firm's procedures related to derivatives were insufficient, as follows –

    - The Firm selected for testing a control to address an identified risk related to the completeness of derivatives with one type of counterparty; these derivatives represented a significant portion of the total derivatives. This control consisted of (1) a review of the issuer's net collateral position with its counterparties to determine the amount of collateral required and (2) a comparison of the net collateral position by counterparty to the issuer's derivative valuation systems. The Firm failed to identify that this control was not designed to address, and failed to identify and test any other controls that addressed, the risk that individual derivative transactions were not recorded in the issuer's systems. (AS 2201.39)

    - The Firm's substantive procedures to test the completeness of these derivatives were insufficient, as they were limited to comparing the terms of one derivative contract to the issuer's derivative valuation system, inquiring of management, and reading board minutes to identify any changes in management policy or strategy related to derivatives. (AS 2503.22-.23)

    - To address the risks related to the valuation of the majority of derivatives, the Firm selected a control in which the issuer used a mark-to-market report to review the value of the derivatives. Interest rate curves were an important input to the mark-to-market report, but the Firm failed to identify and test any controls over the accuracy and completeness of the interest rate curves within the system from which the report was generated. (AS 2201.39)

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

In this audit of an issuer in the financial services industry, 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 –

- For loans that the issuer assessed collectively for impairment, the issuer estimated the ALL using a model that consisted of quantitative and qualitative components. The issuer developed the qualitative component of the ALL, which represented a significant portion of the total ALL, by applying certain internal and external factors ("qualitative loss factors") to each of its classes of loans and determining the amount of the adjustments for these factors. The Firm's procedures related to the qualitative component of the ALL were insufficient, as follows –

    - o The Firm selected for testing a control that consisted of management's review of the qualitative loss factors and the related adjustments. The Firm's procedures to test this control consisted of inquiring of management, observing certain meetings, and inspecting the documents that management reviewed during these meetings. The Firm's testing did not include ascertaining and evaluating the nature of the specific steps that the reviewers took in the performance of their reviews, including the criteria used to identify matters for follow up and whether the matters identified for follow up were appropriately resolved. (AS 2201.42 and .44)

    - o The Firm failed to perform sufficient procedures to evaluate the reasonableness of the adjustments made for the qualitative loss factors. Specifically, the Firm limited its procedures to obtaining an understanding of the quarterly changes in the amount of the adjustments, comparing these quarterly changes to internal and external information for directional consistency, inquiring of management, and reading certain issuer-prepared presentations. (AS 2501.11)

- The Firm's procedures to test the valuation of one of the issuer's types of derivatives were insufficient in the following respects –

    - o These derivatives were created in relation to individual loan arrangements that the issuer expected to enter into. When such a derivative was created, the issuer entered the loan type and certain other information related to the derivative into an information-technology system, for which a deficiency in controls over user access had been identified. If data that met certain established parameters were entered, the system automatically calculated the fair value of the derivative. The Firm selected for testing an automated control that was designed to ensure that the data that were entered into the system met the applicable parameters, which were specific to the various loan types. The Firm failed to sufficiently test this control, as it limited its testing to only one transaction that represented only one of the issuer's many loan types. In addition, the Firm performed its testing after the year end, without performing any procedures to determine whether there had been changes in the design or operation of the control since the year end. (AS 2201.03, .42, and .44)

- The Firm designed its procedures to test the valuation of this type of derivative – including its sample size – 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 size that the Firm used to test this type of derivative was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- During the year, the issuer acquired a significant business. The Firm selected for testing a control over the valuation of acquired loans; this control consisted of management's review of the credit quality of these loans. The Firm failed to sufficiently test the aspects of this control that related to one of the two types of acquired loans. Specifically, the Firm's testing of these aspects consisted of inquiring of management and reading a memorandum that was prepared as part of the operation of the control, without ascertaining and evaluating the nature of the specific procedures performed by the control owners, including the criteria used to identify matters for follow up and whether the matters identified for follow up were appropriately resolved. (AS 2201.42 and .44)

A.3. Issuer C

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. For one type of its long-lived assets, the issuer identified an indicator of potential impairment due to a significant decline in the market value of these assets. As a result, the issuer developed undiscounted cash-flow analyses to assess the carrying value of each asset of this type for recoverability. One of the significant assumptions in each of these analyses was the rate that the issuer would receive when renting out the asset. Generally, the issuer estimated the rental rate for each asset using an average of historical rental rates over an established number of years ("historical average rate"). For those assets with a remaining useful life that was shorter than the established number of years used in developing the historical average rate, however, the issuer considered whether it would still be appropriate to use the historical average rate, and, if not, the issuer used the historical rental rates to estimate a lower rental rate ("adjusted rental rate"). The Firm's procedures related to the valuation of these assets with shorter remaining useful lives were insufficient. Specifically –

- The Firm selected for testing a control that included a review of the reasonableness of any adjusted rental rates used in the analyses for these assets. The Firm's procedures to test this control consisted of inquiring of the control owner, reperforming the control owner's test of the mathematical accuracy of the calculation of each adjusted rental rate, reading board minutes to obtain evidence about whether the issuer planned to dispose of any of these assets, and inspecting documents with signatures and notations that indicated the reviews had occurred. The Firm failed to ascertain and evaluate the specific procedures that the control owner performed to assess the reasonableness of the adjusted rental rates. (AS 2201.42 and .44)

- At year end, actual rental rates were significantly lower than historical rental rates, and the issuer noted that these lower rental rates could persist for some time. To evaluate the reasonableness of the issuer's assertion that the carrying value of all but one of the assets with a shorter remaining useful life was recoverable, the Firm tested the mathematical accuracy of the calculation used to determine the issuer's adjusted rental rate and analyzed whether the carrying value of these assets would be recoverable based on alternative rental-rate assumptions. The Firm's procedures were insufficient, as described below. (AS 2501.07)

    - To develop its first alternative rental-rate assumption, the Firm used the actual year-end rental rate for the first two years of the forecast, percentages of the historical average rate for the next two years, and the historical average rate for the remaining years. The Firm concluded that the undiscounted cash flows calculated using this alternative rental-rate assumption exceeded the carrying values for all but one of these assets. The Firm was aware that the historical average rate that it used to develop this assumption was significantly higher than each adjusted rental rate used by the issuer, but concluded that the issuer's assertion that the carrying value of all but one of these assets was recoverable was reasonable without performing any additional procedures to support its use of the historical average rate in later years. In addition, the Firm failed to obtain any evidence to support the percentages that it applied to the historical average rate in the third and fourth years of each analysis.

- In developing its second alternative rental-rate assumption, the Firm used the actual rental rate, which was lower than all of the issuer's adjusted rental rates, for the first two years of the forecast and then calculated the rate for the remaining years that would result in the undiscounted cash flows being equal to the carrying value of the asset ("break-even" rate). The Firm was aware that these "break-even" rates exceeded the issuer's adjusted rental rate for a significant portion of these assets. The Firm also determined that, for each asset, the "break-even" rate was lower than the historical average rate. Nevertheless, without performing any additional procedures, the Firm concluded that the issuer's assertion that the carrying value of all but one of these assets was recoverable was reasonable.

A.4. Issuer D

In this audit, 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 its procedures related to the valuation of inventory were insufficient. Specifically –

- The Firm selected for testing a control that consisted of the review of the allowance for excess and obsolete inventory. The Firm's procedures to test this control consisted of inquiring of the control owner, obtaining a checklist as evidence of approval, reading industry information used in the review, reading the control owner's explanations for changes in the allowance by inventory aging category as compared to prior periods, inspecting the control owner's testing of the mathematical accuracy of the allowance calculation, and inspecting the control owner's comparison of the inventory balances to the inventory sub-ledger. The Firm failed to identify that this control did not address the reasonableness of the percentages that the issuer applied to each of the inventory aging categories in determining the allowance, and it did not identify and test any other control that addressed the risk related to the percentages applied. (AS 2201.39)

- The Firm failed to perform sufficient procedures to evaluate the reasonableness of the percentages that the issuer applied to each of the inventory aging categories in determining the allowance for excess and obsolete inventory. The Firm's procedures to evaluate the reasonableness of these percentages were limited to reading the issuer's methodology and inquiring of management regarding any changes in methodology; reading industry information; noting that the same percentages were used at the prior year end, an interim date, and the current year end; and comparing the total allowance as a percentage of gross inventory at an interim date to those percentages for the last three year ends. (AS 2501.11)

A.5. Issuer E

In this audit of a manufacturer, 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 its procedures related to property, plant, and equipment ("PPE") were insufficient. Specifically –

- The Firm selected for testing a control that included the review of PPE for recoverability; an aspect of this control consisted of a review for events or changes in circumstances that the control owner considered to indicate that a test of the recoverability of PPE needed to be performed. The Firm's procedures to test this aspect of the control consisted of inquiring of management, reading certain long-term supply contracts and certain issuer communications, reading minutes of meetings of the board of directors and the audit committee, observing a meeting of the audit committee, and observing that one production facility was operating. The Firm, however, failed to evaluate whether the criteria that the control owner used in the operation of this aspect of the control were sufficient to identify all events or changes in circumstances contemplated in Financial

Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") Subtopic 360-10, *Property, Plant, and Equipment – Overall*. (AS 2201.42)

- For two production facilities, the Firm failed to sufficiently evaluate the issuer's assertion that there were no events or changes in circumstances that would require a test for recoverability. The Firm identified that both of these production facilities (1) had curtailed production by at least 50 percent during the last half of the year and (2) had an operating loss for the year, as well as a projected operating loss for the following year. Despite these circumstances that, under generally accepted accounting principles, appeared to be events or changes in circumstances that indicated that the facilities' carrying value might not have been recoverable, the Firm's procedures to evaluate the issuer's assertion that there were no such events or changes in circumstances were limited to inquiring of management; noting the existence of certain labor and long-term supply agreements for the facilities; noting that historical market prices had been volatile; and considering that the facilities had had positive operating results in the first half of the year, before they recorded the operating losses. (AS 2301.08)

A.6. <u>Issuer F</u>

In this audit of a government contractor, 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 procedures related to revenue were insufficient in the following respects –

  - Three of the controls related to revenue that the Firm identified and tested consisted of (1) a review of new and modified contracts to determine the appropriate method for recognizing revenue on each contract and to verify the terms and assumptions entered into the issuer's accounting system, (2) the automated calculation of revenue based on formulas that were specific to each of the issuer's six contract types, and (3) a review of invoices for consistency with the underlying contract information and for accuracy. The Firm failed to sufficiently test these controls. Specifically –

- For the first control, the Firm failed to sufficiently test the aspect of the control related to determining the appropriate method for recognizing revenue because its procedures to test this aspect were limited to inquiring of management. (AS 2201.42 and .44)

- For the second control, the Firm's procedures consisted of inquiring of management and, for one contract, comparing information in the issuer's accounting system to the contract and recalculating the revenue recognized. These procedures were insufficient to support a conclusion that the control was designed and operating effectively with respect to all of the issuer's contract types, as the Firm tested only one contract type. (AS 2201.42 and .44)

- For the third control, the Firm failed to sufficiently test the operating effectiveness of the aspect of the control related to the comparison of invoices to the underlying contract information. Specifically, the Firm inspected evidence of review of the comparison for a sample of invoices, but reperformed this aspect of this manual control for only one invoice. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the project-cost information that the issuer used in the performance of this control. (AS 2201.39 and .44)

o The Firm's substantive procedures to test revenue included (1) selecting a small number of specific contracts for testing and (2) performing a substantive analytical procedure using an expectation that was based on the prior-year consolidated gross margin, which was adjusted based on the results of the Firm's testing of the specific contracts. The adjustment that the Firm made to its expectation of revenue represented the actual amount of the gross margin fluctuations for the small number of specific contracts selected for testing. As the selection of specific contracts for testing was not designed to be representative of the population, the Firm's use of the results of this testing to develop its expectation for total revenue was not supported. In addition, gross margins varied significantly across the issuer's contracts, but the Firm developed its analytical procedures using a consolidated gross margin. Further, the Firm established its threshold for investigating differences based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are described above. As a result, the expectation that the Firm developed and the thresholds that the Firm used to investigate differences from those expectations were not precise enough to provide the necessary degree of assurance that misstatements that could have been material would be identified. (AS 1105.27; AS 2301.16, .18, and .37; AS 2305.17 and .20)

- The issuer performed an analysis of the possible impairment of goodwill for both of its reporting units; the analyses included cash-flow forecasts that were developed based on individual contracts. The Firm's procedures related to the valuation of goodwill for one of the issuer's reporting units were insufficient in the following respects –

    - The Firm selected for testing a control that consisted of reviews of the issuer's cash-flow forecasts. The Firm's procedures to test the operating effectiveness of the control consisted of: (1) inquiring of the control owners, (2) for one contract, inspecting the specific cash-flow forecast and supporting documents, and (3) inspecting the reporting unit's cash-flow forecast for evidence of review and approval by management. The Firm, however, failed to evaluate whether matters identified for follow up were appropriately investigated and resolved. (AS 2201.44)

    - The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions underlying the cash-flow forecasts that the issuer used in its analysis of the possible impairment of goodwill for this reporting unit. Three of the significant assumptions that the issuer used to develop its cash-flow forecasts were: (1) the likelihood that the unfunded contract value for existing contracts would be awarded in the future; (2) the likelihood of securing new contracts and extending existing contracts; and (3) the projected profit margin for new contracts. The Firm's procedures to evaluate the reasonableness of these assumptions were insufficient, as those procedures were limited to inquiring of management. (AS 2502.26 and .28)

A.7. Issuer G

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

- For certain investments without readily determinable fair values, the issuer elected the fair value option of accounting. The issuer determined the reported fair values of these investments using one of the following pricing methods: (1) trades and other information observed by the issuer's internal trading desk, (2) external broker quotes, or (3) internal models. The Firm selected for testing a control over the valuation of these investments, but failed to sufficiently test this control. The control consisted of the review of an analysis of fair value by the issuer's pricing committee and the resolution of certain matters identified by the pricing committee for follow-up. The Firm's procedures to test this control consisted of inquiring of management, inspecting meeting invitations, and inspecting documentation evidencing management's approval of the recorded fair values. The Firm failed to ascertain and evaluate the nature of the procedures that the control owners performed to address the matters identified by the pricing committee for follow-up. (AS 2201.42 and .44)

- The Firm's procedures to test controls over the valuation of loans were insufficient. With respect to substantially all of the issuer's loans, the Firm selected for testing a control that consisted of management's review of loan information, including loan risk-ratings, to identify potentially impaired loans. The Firm, however, failed to identify and test any controls over the accuracy and completeness of the information used in the performance of the control. (AS 2201.39)

A.8. Issuer H

In this audit of an investment company, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its procedures to test controls over the valuation of investments were insufficient. The Firm selected for testing three controls that addressed the recording of investments at fair value. Two of these controls consisted of (1) the quarterly review of investment valuations by the issuer's chief financial officer and (2) for investments categorized as level 3 within the hierarchy set forth in FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* the quarterly comparison of the issuer's fair values to the values determined by an external valuation specialist. The Firm's procedures to test these two controls consisted of inquiring of the control owner, obtaining the issuer's and external valuation specialist's fair value determinations and a summary of the differences between the values, and inspecting documents and emails that indicated the reviews and certain other actions performed as a result of the reviews had occurred. For the first control, the Firm failed to evaluate the criteria used to identify matters for follow up and, for both controls, the Firm failed to evaluate whether the matters identified for follow up were appropriately resolved. The Firm concluded that the third control was dependent on the first of these two controls and, therefore, its testing of the third control was also affected by the deficiencies in the testing of the first control. (AS 2201.42 and .44)

A.9. Issuer I

In this audit of an investment company, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its procedures to test controls over the valuation of securities without readily determinable fair values, which represented over 40 percent of the issuer's investments, were insufficient. The issuer valued these securities using an income approach and a market approach; in certain circumstances, the issuer also requested an external valuation using the same approaches. The assumptions used in these approaches included (1) assumptions underlying cash-flow forecasts and underlying the discount rate applied to the forecasts and (2) assumptions related to the selection of the companies and transactions that would be appropriate to use for comparison. The Firm selected for testing three controls that consisted of quarterly reviews of the issuer's valuation of these securities, including the review of the underlying assumptions. The Firm's procedures to test the aspect of these controls that involved the review of these assumptions consisted of (1) inquiring of the control owners; (2) for a selection of the issuer's valuation analyses, comparing assumptions to the underlying support and to the assumptions underlying the prior-quarter valuation analyses; and (3) inspecting emails and documents that indicated the reviews and certain other actions performed as a result of the reviews had occurred. For a selection of securities for which an external valuation had been performed, the Firm also compared the assumptions underlying the issuer's internal valuation analyses to those underlying the external valuations. In addition, for one of the controls, the Firm attended certain meetings held as part of the control. With respect to the control owners' reviews of the cash-flow forecasts, discount rates, and the selection of comparable companies and transactions, the Firm failed to evaluate (1) the specific steps performed by the control owners to review the related assumptions, (2) the criteria used to identify matters for follow up, and (3) whether the matters identified for follow up were appropriately resolved. (AS 2201.42 and .44)

A.10. Issuer J

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 Firm's procedures to test the existence of work-in-progress and finished goods inventory at the issuer's production facilities were insufficient. Specifically, the Firm's physical inventory observation procedures for this inventory included inquiring of management and comparing the quantities noted by the issuer on a selection of inventory packages to the quantities recorded in the issuer's inventory records, without performing any procedures to address whether the quantities shown were accurate. (AS 2510.09)

- During the year, the issuer announced that it would indefinitely suspend the use of a significant long-lived asset. Following the announcement and before the year end, the issuer terminated the majority of the employees associated with the asset and received bids for the asset in amounts that were significantly below the asset's carrying value. When performing its impairment analysis for the asset group that included this asset, the issuer forecasted no future production from this specific asset, but determined there was no impairment charge to be recorded for the asset group as a whole. After the year end and before the issuance of the financial statements, the issuer announced it would not resume use of this asset. The Firm failed to sufficiently evaluate the issuer's assertion that it did not cease to use the asset until after the year end and that, therefore, the asset should be reported at its carrying value, rather than its salvage value, as of the year end. Specifically, the Firm's procedures to determine whether the facts noted above indicated that the conditions constituting the cessation of the use of the asset existed as of the year end were limited to obtaining a representation from management and documenting the Firm's conclusion. (AS 2801.03 and .07)

A.11. Issuer K

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its testing of controls related to the presentation of the consolidated statement of cash flows was insufficient. The issuer prepared its consolidated statement of cash flows by compiling and translating financial information from numerous subsidiaries, denominated in various currencies, and recording numerous manual adjustments in the process. The Firm identified that the issuer had not implemented a control that directly addressed the presentation of its consolidated statement of cash flows. The Firm selected for testing a control that it asserted mitigated this control deficiency; this control consisted of a comparison of information in the financial statements to supporting schedules and a review of certain of the supporting schedules for accuracy and completeness. The Firm failed to test any aspects of this control that addressed the presentation of the consolidated statement of cash flows. (AS 2201.68)

A.12. Issuer L

In this audit of a healthcare provider, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm identified control deficiencies related to the control owners' failure to compare billing rates and authorizations to provide services to supporting documentation. These deficiencies related to the majority of revenue and affected all of the controls that the Firm tested that directly addressed the occurrence and allocation of that revenue. In response to these deficiencies, the Firm identified and tested a control that it asserted mitigated the deficiencies; this control consisted of a comparison of budgeted revenue by service type and geographic location to actual revenue. The Firm, however, failed to identify and test any controls over the accuracy and completeness of significant data that the issuer used in developing and periodically updating the budgeted revenue. (AS 2201.39)

A.13. Issuer M

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its procedures to test controls over revenue were insufficient. The issuer maintained thousands of price lists, including separate price lists for individual customers and, for many customers, separate price lists for individual locations. The control that the Firm selected to directly address the pricing of revenue transactions consisted of a comparison of the prices on each customer's purchase order to the relevant price list that the issuer maintained for that customer. The Firm's procedures to test the operating effectiveness of this control did not include testing the control objective of verifying whether the prices on the customer's purchase order were consistent with those on the relevant price lists for the specific customer; instead, the Firm's testing consisted of comparing the prices on a sample of customers' purchase orders to invoice prices and determining that any differences were approved. (AS 2201.44)

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. Paragraphs .02, .05, and .06 of AS 1015, *Due Professional Care in the Performance of Work*, require the independent auditor to plan and perform his or her work with due professional care and set forth aspects of that requirement. AS 1015.07-.09, and paragraph .07 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, 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 2301.03, .05, and .08 require the auditor to design and implement audit responses that address the risks of material misstatement. Paragraph .04 of AS 1105, *Audit Evidence*, 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 1105, *Audit Evidence*	Issuer F	1
AS 2110, *Identifying and Assessing Risks of Material Misstatement*	Issuer A	1
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	Issuer A Issuer B Issuer C Issuer D Issuer E Issuer F Issuer G Issuer H Issuer I Issuer K Issuer L Issuer M	4 3 1 1 1 4 2 1 1 1 1 1
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer B Issuer E Issuer F	1 1 1 1
AS 2305, *Substantive Analytical Procedures*	Issuer F	1
AS 2315, *Audit Sampling*	Issuer B	1
AS 2501, *Auditing Accounting Estimates*	Issuer A	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
AS 2501, *Auditing Accounting Estimates (continued)*	Issuer B Issuer C Issuer D	1 1 1
AS 2502, *Auditing Fair Value Measurements and Disclosures*	Issuer F	1
AS 2503, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*	Issuer A	1
AS 2510, *Auditing Inventories*	Issuer J	1
AS 2801, *Subsequent Events*	Issuer J	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 the deficiencies 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.

	AS 1105	**AS 2110**	**AS 2201**	**AS 2301**	**AS 2305**	**AS 2315**	**AS 2501**	**AS 2502**	**AS 2503**	**AS 2510**	**AS 2801**
Business Combinations			B								
Cash Flows			K								
Long-lived assets, including amortization			C, E	E			C				J
Impairment of goodwill			F					F			
Inventory and related reserves			D				D			J	
Investment securities,			A, B, G,	B		B			A		

	AS 1105	AS 2110	AS 2201	AS 2301	AS 2305	AS 2315	AS 2501	AS 2502	AS 2503	AS 2510	AS 2801
including derivatives			H, I								
Loans, including ALL		A	A, B, G	A			A, B				
Revenue, including deferred revenue	F		F, L, M	F	F						

B.3. Audit Deficiencies by Industry

The table below lists the industries[3] of the issuers for which audit deficiencies were discussed in Part I.A of this report and cross references the issuers to the specific auditing standards related to the deficiencies.[4]

	AS 1105	AS 2110	AS 2201	AS 2301	AS 2305	AS 2315	AS 2501	AS 2502	AS 2503	AS 2510	AS 2801
Consumer Staples			M								
Financial Services		A	A, B, G, H, I	A, B		B	A, B		A		
Health Care			L								
Industrials			C, D				C, D				
Information Technology	F		F, K	F	F			F			
Materials			E	E						J	J

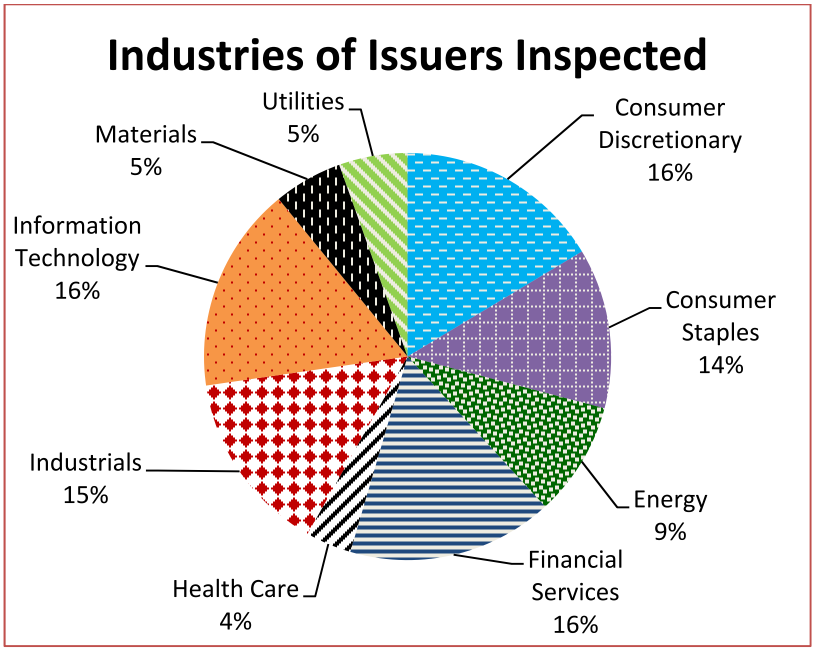
[3] The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

[4] 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.

C. Data Related to the Issuer Audits Selected for Inspection[5]

C.1. Industries of Issuers Inspected

The chart below categorizes the 55 issuers whose audits were inspected in 2016, based on the issuer's industry.[6]



Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	9	16%
Consumer Staples	7	14%
Energy	5	9%
Financial Services	9	16%
Health Care	2	4%
Industrials	8	15%
Information Technology	9	16%
Materials	3	5%
Utilities	3	5%

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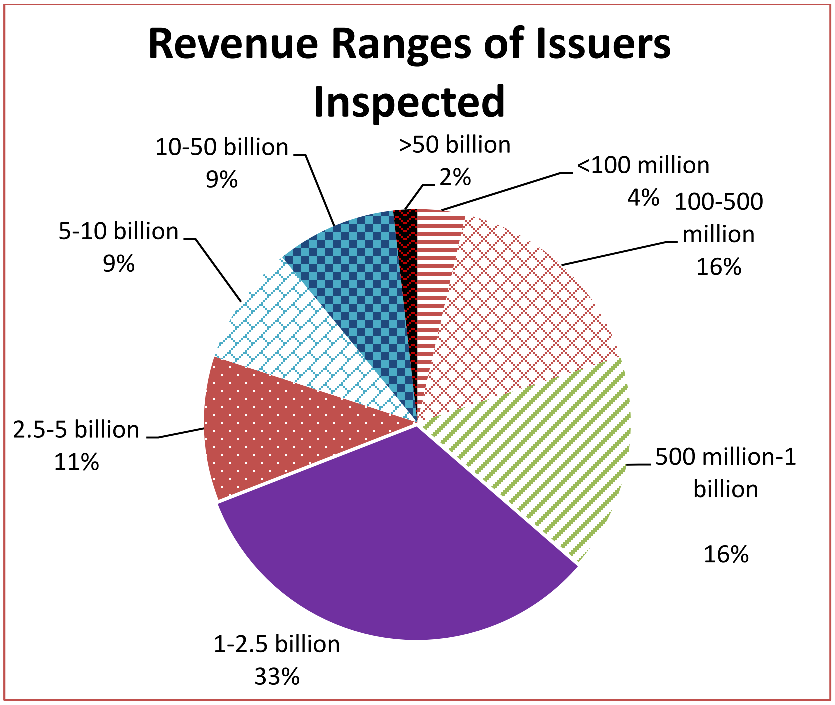
5 Where the audit work inspected related to an engagement in which the Firm played a role but was not the principal auditor, the industry and the revenue included in the tables and charts in this section are those of the entity for which an audit report was issued by the primary auditor. As discussed above, the inspection process included reviews of portions of 54 selected issuer audits completed by the Firm and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor.

6 See Footnote 3 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 55 issuers whose audits were inspected in 2016.[7] 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	2	4%
100-500 million	9	16%
500 million -1 billion	9	16%
1-2.5 billion	18	33%
2.5-5 billion	6	11%
5-10 billion	5	9%
10-50 billion	5	9%
>50 billion	1	2%

7 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. 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. For each specific portion of the audit that is selected, the inspection team 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. 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.[8]

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[8] 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.

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,[9] as well as a firm's failure to perform, or to perform sufficiently, certain necessary tests of controls and substantive 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 reaching its conclusions about whether a deficiency exists, 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 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 1215, *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 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

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[9] 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.

available evidence does not support the contention that the firm sufficiently performed the necessary work.

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 assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion or a failure to obtain sufficient appropriate audit evidence to fulfill the objectives of the firm's role in an audit may indicate a defect or potential defect in a firm's quality control system.[10] 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

[10] 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.

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;[11] 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 (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.

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[11] 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.

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, communications, 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 of material misstatement 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

PARTS II AND III OF THIS REPORT ARE NONPUBLIC
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX A

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.[12]

[12] 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.

Deloitte.

30 Rockefeller Plaza
New York, NY 10112
USA

August 3, 2017

Mr. John Fiebig
Senior Deputy Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006

Re: Deloitte & Touche LLP – Response to Part I of Draft Report on 2016 Inspection

Dear Mr. Fiebig:

Deloitte & Touche LLP is pleased to submit this response to the draft Report on the 2016 Inspection of Deloitte & Touche LLP (the Draft Report) of the Public Company Accounting Oversight Board (the PCAOB or the Board). We believe that the PCAOB's inspection process serves an important role in the achievement of our shared objectives of improving audit quality and serving investors and the public interest. We are committed to continuing to work with the PCAOB to further strengthen trust in the integrity of the independent audit.

We have evaluated the matters identified by the Board's inspection team for each of the issuer audits described in Part I of the Draft Report and have taken actions as appropriate in accordance with PCAOB standards to comply with our professional responsibilities under AU 390, *Consideration of Omitted Procedures After the Report Date,* and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.*

Executing high quality audits is our number one priority. In order to drive continuous improvements in quality, we are transforming the audit to leverage innovative technologies, along with enhancing the skillsets of our talent to prepare them for a digitally driven future. We are confident that our ongoing digital transformation, along with the investments we continue to make in our audit processes, policies, and quality controls, are resulting in significant enhancements to our audit quality.

Sincerely,

Joseph B. Ucuzoglu
Chairman and Chief Executive Officer
Deloitte & Touche LLP

Catherine M Engelbert

Catherine M. Engelbert
Chief Executive Officer
Deloitte

APPENDIX B

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 1105, *Audit Evidence*		
Selecting Specific Items		
AS 1105.27	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 F
Footnote to AS 1105.27 [12] If misstatements are identified in the selected items, *see* AS 2810.12 - .13 and AS 2810.17 - .19.		

AS 2110, *Identifying and Assessing Risks of Material Misstatement*		
PERFORMING RISK ASSESSMENT PROCEDURES		
IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT		
AS 2110.59	The auditor should identify and assess the risks of material misstatement at the financial statement level and the assertion level. In identifying and assessing risks of material misstatement, the auditor should: a. Identify risks of misstatement using information obtained from performing risk assessment procedures (as discussed in paragraphs .04–.58) and considering the characteristics of the	Issuer A

AS 2110, *Identifying and Assessing Risks of Material Misstatement*

accounts and disclosures in the financial statements.

Note: Factors relevant to identifying fraud risks are discussed in paragraphs .65–.69 of this standard.

b. Evaluate whether the identified risks relate pervasively to the financial statements as a whole and potentially affect many assertions.

c. Evaluate the types of potential misstatements that could result from the identified risks and the accounts, disclosures, and assertions that could be affected.

Note: In identifying and assessing risks at the assertion level, the auditor should evaluate how risks at the financial statement level could affect risks of misstatement at the assertion level.

d. Assess the likelihood of misstatement, including the possibility of multiple misstatements, and the magnitude of potential misstatement to assess the possibility that the risk could result in material misstatement of the financial statements.

Note: In assessing the likelihood and magnitude of potential misstatement, the auditor may take into account the planned degree of reliance on controls selected to test.[32]

e. Identify significant accounts and disclosures[33] and their relevant assertions[34] (paragraphs .60–.64 of this standard).

Note: The determination of whether an account or disclosure is significant or whether an assertion is a relevant assertion is based on inherent risk, without regard to the effect of controls.

f. Determine whether any of the identified and assessed risks of material misstatement are **significant risks** (paragraphs .70–.71 of this standard).

Footnotes to AS 2110.59

32 AS 2301.16-.35.

33 AS 2201.A10 states:

An account or disclosure is a significant account or disclosure if there is a reasonable possibility that the account or disclosure could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements, considering the risks of both overstatement and understatement. The determination of whether an account or disclosure is significant is based on inherent risk, without regard to the effect of controls.

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[34] AS 2201.A9 states:

A relevant assertion is a financial statement assertion that has a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated. The determination of whether an assertion is a relevant assertion is based on inherent risk, without regard to the effect of controls.

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

INTRODUCTION		
AS 2201.03	The auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting. Because a company's internal control cannot be considered effective if one or more material weaknesses exist, to form a basis for expressing an opinion, the auditor must plan and perform the audit to obtain appropriate evidence that is sufficient to obtain reasonable assurance[5] about whether material weaknesses exist as of the date specified in management's assessment. A material weakness in internal control over financial reporting may exist even when financial statements are not materially misstated.	Issuer B

Footnote to AS 2201.03

[5] See AS 1015, *Due Professional Care in the Performance of Work*, for further discussion of the concept of reasonable assurance in an audit.

USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS 2201.39	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, D, F, G, and L
TESTING CONTROLS		
Testing Design Effectiveness		
AS 2201.42	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	Issuers A, B, C, E, F, G, H, and I

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	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.	
Testing Operating Effectiveness		
AS 2201.44	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, C, F, G, H, I, and M
EVALUATING IDENTIFIED DEFICIENCIES		
AS 2201.68	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.	Issuer K

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS 2301.08	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 and E
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS 2301.16	*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 B and F
Footnotes to AS 2301.16 [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 2301.18	*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	Issuers B and F

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
	primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	
SUBSTANTIVE PROCEDURES		
AS 2301.37	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 B and F

AS 2305, *Substantive Analytical Procedures*		
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Precision of the Expectation		
AS 2305.17	The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (*see* paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.	Issuer F
Investigation and Evaluation of Significant Differences		
AS 2305.20	In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without	Issuer F

AS 2305, *Substantive Analytical Procedures*		
	further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.	

AS 2315, *Audit Sampling*		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AS 2315.19	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.[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.	Issuer B
Footnote to AS 2315.19 [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.		
AS 2315.23	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 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	Issuer B

AS 2315, *Audit Sampling*		
	misstatements.	
AS 2315.23A	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.	Issuer B

AS 2501, *Auditing Accounting Estimates*		
EVALUATING ACCOUNTING ESTIMATES		
AS 2501.07	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. c. The accounting estimates are presented in conformity with applicable accounting principles[2] and are properly disclosed.[3]	Issuer C
Footnotes to AS 2501.07 2 AS 2815, *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. 3 *See* paragraph .31 of AS 2810, *Evaluating Audit Result*s.		
EVALUATING REASONABLENESS		
AS 2501.11	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	Issuers A, B, and D

AS 2501, *Auditing Accounting Estimates*		
	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. 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 (AS 1210, *Using the Work of a Specialist*). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
AS 2502.26	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.	Issuer F
AS 2502.28	Where applicable, the auditor should evaluate 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.	Issuer F

AS 2503, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities		
DESIGNING SUBSTANTIVE PROCEDURES BASED ON RISK ASSESSMENTS		
Financial Statement Assertions		
Completeness		
AS 2503.22	Completeness assertions address whether all of the entity's derivatives and securities are reported in the financial statements through recognition or disclosure. They also address whether all derivatives and securities transactions are reported in the financial statements as a part of earnings, other comprehensive income, or cash flows or through disclosure. The extent of substantive procedures for completeness may properly vary in relation to the assessed level of control risk. In addition, the auditor should consider that since derivatives may not involve an initial exchange of tangible consideration, it may be difficult to limit audit risk for assertions about the completeness of derivatives to an acceptable level with an assessed level of control risk at the maximum. Paragraph .19 provides guidance on the auditor's determination of the nature, timing, and extent of substantive	Issuer A

AS 2503, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities		
	procedures to be performed. Examples of substantive procedures for completeness assertions about derivatives and securities are— ▪ Requesting the counterparty to a derivative or the holder of a security to provide information about it, such as whether there are any side agreements or agreements to repurchase securities sold. ▪ Requesting counterparties or holders who are frequently used, but with whom the accounting records indicate there are presently no derivatives or securities, to state whether they are counterparties to derivatives with the entity or holders of its securities.[13] ▪ Inspecting financial instruments and other agreements to identify embedded derivatives. ▪ Inspecting documentation in paper or electronic form for activity subsequent to the end of the reporting period. ▪ Performing analytical procedures. For example, a difference from an expectation that interest expense is a fixed percentage of a note based on the interest provisions of the underlying agreement may indicate the existence of an interest rate swap agreement. ▪ Comparing previous and current account detail to identify assets that have been removed from the accounts and testing those items further to determine that the criteria for sales treatment have been met. ▪ Reading other information, such as minutes of meetings of the board of directors or finance, asset/liability, investment, or other committees.	
Footnote to AS 2503.22 [13] AS 2310.17 discusses the blank form of positive confirmation in which the auditor does not state the amount or other information but instead asks the respondent to provide information.		
AS 2503.23	One of the characteristics of derivatives is that they may involve only a commitment to perform under a contract and not an initial exchange of tangible consideration. Therefore, auditors designing tests related to the completeness assertion should not focus exclusively on evidence relating to cash receipts and disbursements. When testing for completeness, auditors should consider making inquiries, inspecting agreements, and reading other information, such as minutes of meetings of the board of directors or finance, asset/liability, investment, or other	Issuer A

AS 2503, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities		
	committees. Auditors should also consider making inquiries about aspects of operating activities that might present risks hedged using derivatives. For example, if the entity conducts business with foreign entities, the auditor should inquire about any arrangements the entity has made for purchasing foreign currency. Similarly, if an entity is in an industry in which commodity contracts are common, the auditor should inquire about any commodity contracts with fixed prices that run for unusual durations or involve unusually large quantities. The auditor also should consider inquiring as to whether the entity has converted interest-bearing debt from fixed to variable, or vice versa, using derivatives.	

AS 2510, *Auditing Inventories*		
INVENTORIES		
AS 2510.09	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 J

AS 2801, *Subsequent Events*		
AS 2801.03	The first type consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.	Issuer J
AS 2801.07	Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities ordinarily will require adjustment of the financial statements (*see* paragraph .03) because such events typically represent the culmination of	Issuer J

AS 2801, ***Subsequent Events***		
	conditions that existed over a relatively long period of time. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements (*see* paragraph .05) because such changes typically reflect a concurrent evaluation of new conditions.	