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Report on

2016 Inspection of BDO USA, LLP
(Headquartered in Chicago, IL)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

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(Includes portions of Part II and Appendix B of the full report that were not included in PCAOB Release No. 104-2018-111)

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2016 INSPECTION OF BDO USA, LLP

Preface

In 2016, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm BDO USA, LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

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

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

Note on this report's citations to auditing standards: On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization 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 BDO USA, LLP ("the Firm"). The inspection procedures included reviews of portions of 24 issuer audits performed by the Firm. Twenty of the 24 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 16 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 16 issuer audits that appear in Part I.A, deficiencies in 11 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in 14 audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the 14 audits in which substantive testing deficiencies were identified, five 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	9 Audits: Issuers A, B, C, D, G, H, I, J, and M
Audits for which deficiencies included in Part I.A related to the ICFR audit only	2 Audits: Issuers O and P
Audits for which deficiencies included in Part I.A related to the financial statement audit only	5 Audits: Issuers E, F, K, L, and N
Total	16

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	10 Audits: Issuers A, B, C, D, G, I, J, M, O, and P
Failure to sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate	9 Audits: Issuers A, C, F, I, J, K, L, M, and N
Failure to sufficiently test controls over or sufficiently test the accuracy and completeness of data or reports	5 Audits: Issuers A, B, M, O, and P

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
Revenue, including accounts receivable, deferred revenue, and allowances	6 Audits: Issuers B, C, D, E, H, and N
Inventory and related reserves	4 Audits: Issuers D, E, O, and P
Loans, including the allowance for loan losses	4 Audits: Issuers C, F, G, and H

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from June 2016 to June 2017. The inspection team performed field work at the Firm's National Office and inspected issuer audits performed by 18 of the Firm's approximately 42 U.S. practice offices.[2]

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 24 issuer audits performed by the Firm.

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

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

2 This represents the Firm's total number of practice offices; however, approximately 38 of the Firm's practice offices have primary responsibility for issuer audit clients.

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 internal control over financial reporting ("ICFR"). In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement and/or the issuer maintained effective ICFR.

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

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.[3]

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[3] 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.15, below.

Audit Deficiencies

A.1. Issuer A

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

- The issuer calculated its unpaid loss and loss adjustment expense reserves ("loss reserves") based on internally produced data from multiple lines of business. The Firm failed to perform sufficient procedures related to the loss reserves, for which it identified a fraud risk. Specifically –

  - For certain lines of business, the Firm selected for testing three controls that consisted of (1) the review of the loss reserves by the issuer's actuarial group, (2) the review of the loss reserves by the issuer's Reserve Review Committee, and (3) the review of an external actuarial report by both the actuarial group and the Reserve Review Committee. The Firm's procedures were not sufficient, as follows –

    - The Firm's procedures to test these controls were limited to inquiring of control owners, obtaining Reserve Review Committee presentations and minutes, and the external actuarial report, and inspecting emails or signatures as evidence that reviews had occurred. The Firm failed to evaluate the nature of the specific review procedures that the various control owners performed, including the criteria used by those control owners to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

    - The Firm failed to sufficiently test controls over the accuracy and completeness of the system-generated data used in the performance of these controls, as follows –

- The Firm selected for testing a control over data from one system; this control consisted of reconciling this system's data to the general ledger. The Firm's procedures to test this control were limited to inquiring of the control owner, obtaining a sample of reconciliations, tracing certain balances to the general ledger, testing mathematical accuracy, and obtaining a memorandum documenting that the reconciliation was completed. The Firm failed to (1) evaluate whether this control addressed the accuracy of the specific data used in the performance of the three controls over the loss reserves and (2) obtain an understanding of, and evaluate, the nature of reconciling items. (AS 2201.42 and .44)

- With respect to another system, which processed insurance claim information and generated underlying data used in these controls, the Firm identified a significant deficiency related to an individual having administrator access. The Firm tested certain compensating controls that it considered to mitigate the identified deficiency. Two of these compensating controls were directly relevant to the accuracy and completeness of the underlying data used in these controls. The Firm's testing of these two controls was not sufficient, as follows –

    - The first control consisted of the review and approval of changes to certain data in this system. The Firm failed to sufficiently test this control, as the Firm's procedures were limited to inquiring of management and inspecting one email as evidence that reviews had occurred. The Firm failed to evaluate the nature of the specific review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.68)

- o The second control consisted of the calculation by this system of certain loss reserves related to individual claims. The Firm failed to sufficiently test this control, as the Firm's procedures were limited to inquiring of management and testing one selection from the first month of the year, which was insufficient given the access-related deficiency. (AS 2201.68)

- o To estimate the year-end loss reserves, the issuer's internal actuaries began by using historical data obtained as of the end of the third quarter. The issuer's internal actuaries then applied loss ratios to the fourth-quarter data and made adjustments for certain other factors. The Firm failed to identify and test any controls over the issuer's process for identifying and evaluating any significant loss events that occurred in the fourth quarter, which the issuer should have considered when estimating the year-end loss reserves. (AS 2201.39)

- o The Firm designed certain of its substantive procedures, including its sample size, to test a significant input into the estimate of the loss reserves based on a level of control reliance that was not supported due to certain of the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample that the Firm used to test this input was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- o The Firm failed to identify and test any controls over the estimate of the loss reserves at certain lines of business for which the total loss reserves was multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement. (AS 2201.39)

- The Firm failed to perform sufficient substantive procedures to test the issuer's recorded loss reserves. The issuer internally developed its loss reserves estimates and engaged an external actuary to evaluate these estimates. This external actuary developed a range of possible estimates for the loss reserves. As part of its audit procedures, the Firm engaged an actuary to evaluate certain of the issuer's external actuary's loss reserves estimates. The Firm's procedures to test the loss reserves were insufficient in the following respects –

    - The Firm failed to obtain an understanding of the methods and assumptions that the issuer's internal actuaries used to develop the loss reserves estimate. (AS 1210.12)

    - In determining that the issuer's loss reserves estimate was reasonable, the Firm failed to consider (1) that the recorded loss reserves for certain lines of business were outside the range developed by the issuer's external actuary and (2) the significant movement of the issuer's aggregate recorded loss reserves within the external actuary's reserves range from period to period. (AS 1210.12; AS 2810.03 and .27)

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

    - To address the valuation of available-for-sale ("AFS") securities, the Firm selected for testing a control that consisted of a quarterly review involving a comparison of current-period AFS security prices to those for the prior quarter. The Firm failed to sufficiently test whether this control was designed effectively to detect misstatements that could be material, as it did not evaluate whether the prior-quarter price was an appropriate expectation for the current-period valuation and whether the threshold that the control owner used to identify matters for investigation was appropriate. (AS 2201.42)

    - To address the valuation of AFS securities related to other-than temporary-impairments ("OTTI"), the Firm selected for testing a control that consisted of a review of AFS securities identified as potentially impaired. The Firm's procedures to test this control were limited to inquiring of the control owner, reading issuer-prepared memoranda, and inspecting emails or signatures as evidence that reviews had occurred. These procedures were not sufficient. Specifically, the Firm failed to evaluate the nature of the specific review procedures that the control owner performed, including whether the control owner evaluated the completeness of the list of potentially impaired securities, the criteria used by the control owner to identify matters for follow up, and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- The Firm failed to identify and test any controls over the issuer's identification and evaluation of AFS securities with contractual cash flows that were other than high credit quality, which involve specific accounting considerations. (AS 2201.39)

- To address the existence and completeness of investments, the Firm selected for testing three controls that consisted of reviews of quarterly and monthly reconciliations of investments. The Firm, however, failed to evaluate the nature of the procedures that the control owners applied to evaluate the identification and resolution of reconciling items. (AS 2201.42 and .44)

- To address the presentation and disclosure of investments, the Firm selected for testing a control that consisted of the preparation of a schedule to classify investments according to the fair value hierarchy as set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurement*. The Firm's procedures were limited to inquiring of the control owner, obtaining the issuer's fair value hierarchy schedule, and inspecting signatures or emails as evidence that the schedule preparation had occurred. The Firm failed to obtain an understanding of, and evaluate, the procedures the control owner performed to determine the fair value hierarchy classification of investments, including whether these procedures considered the inputs used in the estimation of the fair value of the investments. (AS 2201.42 and .44)

- The Firm failed to identify and test any controls that addressed the evaluation of whether the issuer's equity investments in unconsolidated limited partnerships were variable interest entities that should be consolidated, even though there were indicators of a risk of material misstatement due to unconsolidated VIEs. (AS 2201.39)

- The Firm failed to identify and test any controls over the accounting for securities sold under agreements to repurchase. (AS 2201.39)

- The Firm failed to perform sufficient substantive procedures to test the valuation of investments, for which the Firm identified a fraud risk. Specifically –

  - The Firm's audit approach for testing the valuation of the issuer's AFS securities was to make an independent estimate of the fair values of the AFS securities. The Firm obtained prices for each of the issuer's AFS securities from external pricing sources, compared these prices to the recorded values, and established a threshold for investigation of differences. The Firm's testing was not sufficient, as –

    - The Firm established a single threshold for investigation, regardless of the types of securities within the issuer's portfolio, and the threshold the Firm used was not sufficiently precise to identify and investigate potential material misstatements. (AS 2502.40)

    - The Firm's procedures to evaluate the differences that it identified were not sufficient, as it limited its procedures to aggregating the net difference and comparing this difference to its established level of materiality without considering whether a combination of individual differences could have aggregated to a material misstatement. (AS 2502.40)

        - The Firm failed to evaluate whether the prices it obtained were from different pricing sources than those the issuer used. (AS 2502.40)

    - The Firm's procedures to test AFS securities for OTTI included obtaining the issuer's list of potentially OTTI securities, evaluating whether all AFS securities meeting certain criteria were included on the issuer's list, reading a selection of issuer-prepared memoranda for potentially OTTI AFS securities, and reviewing AFS security sales to determine whether any potentially OTTI AFS securities were sold after the issuer's year end. The Firm considered two impairment indicators in its analysis without considering whether the other impairment indicators described in FASB ASC Topic 320, *Investments - Debt and Equity Securities*, were present. (AS 2502.17)

- The Firm failed to perform sufficient substantive procedures to test the existence of investments. The Firm sent requests for positive confirmations to the investment custodians that held the issuer's AFS securities. The Firm failed to perform alternative procedures on the AFS securities for which a confirmation response was not received. (AS 2310.31)

- The Firm failed to perform sufficient substantive procedures to test the disclosure of investments within the fair value hierarchy as set forth in FASB ASC Topic 820. The Firm's procedures were limited to obtaining the issuer's description of each investment security and determining the fair value hierarchy classification based upon these descriptions. The Firm failed, however, to determine whether the inputs to the valuation of certain of these securities were observable, which is necessary to determine the fair value classification. (AS 2502.15)

- The Firm failed to perform sufficient substantive procedures to test equity investments in unconsolidated limited partnerships. Specifically, the Firm failed to evaluate whether any events occurred for these investments that may have required the issuer to reevaluate its initial conclusions regarding consolidation. (AS 2301.08)

- o The Firm failed to test the completeness and valuation of the liability associated with securities sold under agreements to repurchase. (AS 2301.08)

- During the year, the issuer completed certain significant acquisitions that it accounted for as business combinations. The Firm failed to perform sufficient procedures related to these acquisitions. Specifically –

  - o The Firm selected for testing one control over the initial valuation of assets acquired and liabilities assumed that consisted of a review of the external valuation report for each acquisition. The Firm's procedures to test this control were limited to inquiring of the control owner and, for one acquisition, obtaining the valuation report and inspecting a signature as evidence that a review had occurred. The Firm failed to evaluate the nature of the review procedures that the control owner performed, including the criteria used by the control owner to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

  - o The Firm failed to identify and test any controls over the (1) accuracy and completeness of the opening balance sheets and (2) projected financial information used to estimate the fair value of the intangible assets acquired. (AS 2201.39)

  - o The Firm failed to perform sufficient substantive procedures to test certain of the assets acquired and liabilities assumed. Specifically –

    - ▪ The Firm failed to sufficiently evaluate the reasonableness of the issuer's projected financial information and attrition rates, which were significant inputs used in estimating the fair value of the intangible assets acquired. Specifically, the Firm limited its procedures to performing inquiries; reading the projections; reading the issuer's analyses of customer retention for one acquisition; and, for another acquisition, calculating the historical revenue growth rate and tracing one year of historical performance to the acquired entity's audited financial statements. (AS 2502.26 and .28)

- The Firm failed to evaluate the reasonableness of a key assumption developed by the issuer and used to estimate the fair value of the acquired loss reserves for one acquisition. (AS 2502.26 and .28)

- The Firm failed to sufficiently test certain other assets acquired and liabilities assumed in the acquisitions, as the Firm's procedures were limited to tracing certain items to reports, schedules, or reconciliations that the Firm had not tested; and, for premium receivables, tracing a small selection of receivables to subsequent cash collections. (AS 2502.26, .28, and .39)

- The Firm failed to perform sufficient procedures to address the risk of management override of controls. The Firm identified a fraud risk related to individuals in the accounting department having administrator access to the general ledger. To address this fraud risk, the Firm identified the journal entries posted by these individuals, but it inspected the supporting documentation for only a small number of those journal entries, without having a basis for limiting this testing to these journal entries. For the remaining journal entries created by these individuals, the Firm limited its procedures to evaluating the journal entry descriptions. (AS 2401.61)

A.2. Issuer B

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

- The Firm tested the information-technology general controls ("ITGCs") for the issuer's general ledger system, which was also the system for revenue and property and equipment. The Firm identified multiple deficiencies in these ITGCs, including that certain accounting users had the ability to access all areas of the system ("user-access deficiency"). With respect to controls over revenue and property and equipment, the Firm identified three compensating controls, which consisted of the reviews of account reconciliations, bank reconciliations, and analyses of operating results. The Firm's procedures to test these controls were limited to inquiring of the preparers of the reconciliations and analyses; inspecting certain documents used in the operation of the controls; inspecting signatures as evidence that reviews had occurred; and, for two of these controls, comparing account balances to the general ledger. The Firm failed to sufficiently evaluate whether these controls would mitigate the risks related to revenue and property and equipment posed by the deficiencies in ITGCs over the system described above, as follows –

- o The Firm's testing of the operating effectiveness of all three of these compensating controls did not include evaluating the nature of the specific review procedures that the control owners performed, including the criteria the control owners used to identify matters for investigation and whether those matters were appropriately resolved. (AS 2201.68)

- o The Firm failed to identify that the control owners used data and information in the performance of two of these controls that were produced by the system that was subject to the ITGC deficiencies described above. (AS 2201.68)

- o The Firm failed to identify that certain of the reconciliations used in the operation of one of these controls were prepared by individuals identified in the user-access deficiency. (AS 2201.68)

- The issuer processed a majority of its revenue through two main billing systems. The Firm failed to perform sufficient procedures related to revenue processed through these billing systems, as follows –

  - o The Firm selected for testing a number of controls consisting of reviews or approvals of pricing, customer invoices, and the recording of revenue. The Firm's procedures to test these controls were insufficient. Specifically, the Firm's procedures were limited to inquiring of certain control owners, inspecting certain documents used in the operation of the controls, and inspecting evidence that reviews had occurred. The Firm failed to evaluate the nature of the specific procedures that the control owners performed, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the performance of these controls. (AS 2201.39, .42, and .44)

- The Firm failed to identify and test any controls related to (1) the set-up of new customers in both billing systems and (2) the assignment of billing rates to specific invoices and the calculation of invoice amounts in one of the billing systems. (AS 2201.39)

- To substantively test revenue processed through both billing systems, the Firm selected (1) a judgmental sample of revenue transactions from billing registers and (2) a sample of accounts receivable. The Firm's procedures to test these selections consisted of comparing the associated invoices to evidence of subsequent cash collections. The Firm failed to perform sufficient substantive procedures related to the revenue processed by these two billing systems, as follows –

  - The Firm designed certain of its procedures – including sample sizes – based on a level of control reliance and a risk assessment that were both not supported. Specifically –

    - As a result of the deficiencies in testing controls that are discussed above, the level of control reliance the Firm used to calculate the size of its accounts receivable sample that it used to test revenue was not supported, and, as a result, the combined sample that the Firm used to test revenue and accounts receivable was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- The risk assessment used to determine the sample size of accounts receivable for testing revenue transactions was based on the Firm's conclusion that improper revenue recognition was not a fraud risk. In reaching that conclusion, however, the Firm failed to consider certain relevant evidence, as described below. As a result, the Firm's risk assessment was not supported, and the sample that the Firm used to test revenue was too small to provide sufficient evidence. (AS 2301.08 and .37; AS 2315.19, .23, and .23A)

  - In its risk assessment, the Firm postulated that the average monthly customer billing amount was small and that there would need to be a significant number of fictitious customers to cause a risk of material misstatement. The Firm failed to consider that the selections in the Firm's sample for testing revenue and accounts receivable presented an average monthly customer billing amount that was more than 60 times the amount postulated in its risk assessment. (AS 2110.74)

  - The Firm's conclusion that improper revenue recognition was not a fraud risk was based, in part, on the Firm's understanding that revenue was recognized when services were provided on a monthly basis. The Firm, however, failed to identify that the issuer disclosed that many of the issuer's customers purchased a bundle of multiple services at a single price and that the services were delivered at different times. (AS 2110.68)

  - The Firm identified certain journal entries, consisting of entries crediting revenue and debiting accounts other than cash, accounts receivable, unbilled receivables, and other receivables, as potentially related to fraudulently recorded revenue. Some of these journal entries were posted by individuals included in the user-access deficiency. The Firm failed to sufficiently consider whether the identification that these individuals had posted journal entries to revenue should have affected its risk assessment, as its procedures to test the journal entries were limited to reading them and inquiring of management regarding the business purpose of these journal entries. (AS 2110.74)

- The Firm's judgmental sample of revenue transactions made to test revenue also was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider population size, tolerable misstatement, and the risk of incorrect acceptance. (AS 2315.23 and .23A)

- The Firm failed to test the completeness of the billing registers from which it selected the revenue samples for testing. (AS 2315.24)

- For the items in its samples, the Firm limited its testing to obtaining the invoice and evidence of subsequent cash collection. These procedures did not provide evidence that the transactions met all the criteria necessary to recognize revenue. (AS 2301.08)

- The Firm failed to perform sufficient procedures related to property and equipment, as follows –

  o With respect to the existence and completeness of property and equipment, the Firm selected four controls, which consisted of (1) reviews of reconciliations of fixed assets to the general ledger, (2) reviews of fixed asset journal entries, (3) reviews of capital expenditures compared to budget, and (4) approvals for asset purchases. The Firm failed to perform sufficient procedures to test three of these controls, as follows –

- For the first two controls, the Firm's procedures were limited to inquiring of the control owners, reading associated documents, and inspecting signatures as evidence that reviews had occurred. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the reports used in the performance of these controls. (AS 2201.39, .42, and .44)

- The Firm also failed to sufficiently test the third control. The Firm selected for testing the reviews of capital expenditures compared to budget for the first and second quarters. These reviews consisted of the comparison of year-to-date expenditures as of the end of each quarter to the annual budget; therefore, no items were identified as being over the budget and requiring further investigation. As a result of selecting only the first and second quarter reviews, the Firm failed to evaluate whether the control operated at a level of precision to prevent or detect a material misstatement. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the reports used in the performance of this control. (AS 2201.39, .42, and .44)

o The Firm failed to identify and test any controls that addressed whether expenditures were appropriately expensed or capitalized to property and equipment. (AS 2201.39)

o The Firm designed certain of its substantive procedures to test the existence and completeness of property and equipment – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the samples that the Firm used to test property and equipment additions and disposals were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- With respect to the valuation of property and equipment, the Firm tested a control consisting of the review of a quarterly impairment analysis for property and equipment, which included an evaluation of impairment indicators. The Firm failed to sufficiently test this control, as its procedures were limited to inquiring of the preparer of the analysis and inspecting a copy of the analysis for a signature indicating that a review had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owner performed, including the criteria the control owner used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

A.3. Issuer C

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

- The issuer evaluated the collectability of certain loans receivable by determining the estimated collections for each group of loans receivable; these estimated collections were important inputs in determining the amount of revenue that the issuer recorded for each group. The Firm identified a fraud risk related to the allocation of this revenue and the valuation of the related loans receivable. The Firm's testing related to this revenue and these loans receivable was insufficient in the following respects –

    - The Firm selected for testing two controls that consisted of (1) quarterly reviews of memoranda and related analyses documenting the changes to the estimated collections for each group of loans receivable and (2) additional reviews of variances in the estimated collections from period to period that exceeded certain thresholds. The Firm's procedures to test these controls were limited to (1) inquiring of management, (2) obtaining the documentation related to the estimated collections and the variances between periods and verifying that the variances above the established thresholds were explained and that the results were directionally consistent with the results of certain of the Firm's substantive procedures, (3) verifying that all groups of loans receivable were subject to review by reading the memoranda and related analyses and that any changes to the estimated collections were recorded by tracing each group of loans receivable to the general ledger, and (4) inspecting signatures and explanations as evidence that the reviews had occurred. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- For groups of loans receivable aged less than a specified number of years, the issuer applied a standard, predetermined adjustment to the estimated collection rates used to calculate revenue, which had the effect of reducing the recorded revenue during the applicable time period. The Firm noted that, during the year, the actual amounts that the issuer collected significantly exceeded the recorded revenue and that this had occurred in prior periods. The Firm failed to sufficiently evaluate the reasonableness of these adjustments, as its procedures were limited to recalculating the significant difference between the recorded revenue and the actual collections for each quarter and determining that the recorded revenue would have been significantly higher if the predetermined adjustments had not been applied. (AS 2501.11)

- The Firm selected for testing a control that consisted of the review of the issuer's analysis of the possible impairment of goodwill. The Firm's procedures to test this control were limited to reading the issuer's impairment memorandum for two quarters, inquiring of the preparer of the memorandum, tracing certain amounts to supporting documentation, and inspecting a signature as evidence that the review had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owner performed, including the criteria the control owner used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

A.4. Issuer D

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

- The issuer initiated and processed revenue transactions at numerous business units. The Firm failed to perform sufficient procedures related to revenue at certain of the issuer's business units as described below; the total revenue at these business units was multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement.

    - With respect to controls for these business units, the Firm relied on its testing of two entity-level controls over revenue; these controls included the review of each of these business units' (1) trial balances, percentage-of-completion ("POC") revenue schedules, and balance sheet variance analyses and (2) income statement variance analyses. The Firm's procedures to test these controls were limited to (1) for the first control, obtaining, and testing the mathematical accuracy of, the trial balance and supporting schedules and tracing the POC revenue schedule to the trial balance for each of the business units selected and (2) for the second control, confirming that the issuer had reviewed income statement variance analyses for all business units by inspecting signatures and checkmarks as evidence that the reviews had occurred. The Firm failed to evaluate whether these controls operated at a level of precision that would prevent or detect material misstatements, as it failed to evaluate the nature of the review procedures that the control owners performed, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

   - The Firm inappropriately limited its substantive procedures to test revenue for the above-noted business units to obtaining a sample of variance analyses prepared by the issuer for certain of these business units and verifying that the issuer documented explanations for changes in revenue and gross margin that exceeded certain thresholds. (AS 2301.08)

- The Firm failed to perform sufficient procedures related to two types of service revenue, with which the Firm associated a fraud risk, as well as the related deferred revenue and accounts receivable for two of the issuer's business units; this revenue was multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement.

   - For both of these business units, the Firm failed to identify and test any controls over revenue recognition for one type of service revenue and over the related accounts receivable. (AS No. 2201.39)

   - For one of these business units, the Firm –

      - Failed to identify and test any controls over the input of service-contract data into the system that automatically calculated and recorded the other type of service revenue and the related deferred revenue and accounts receivable. (AS 2201.39)

      - Designed certain of its substantive procedures – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the samples that the Firm used to test these types of service revenue and the related accounts receivable were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- The Firm failed to perform sufficient procedures to test controls over the existence of inventory that was subject to periodic cycle counts.

Specifically, in testing whether the cycle-count procedures that the issuer used for this inventory were sufficiently reliable, the Firm failed to consider whether the issuer's controls included monitoring the extent of the inventory items counted, the frequency of the counts, and the deviations identified in the counts. (AS 2201.42 and .44)

A.5. Issuer E

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

- The issuer generated a significant portion of its revenue from medical sales at numerous locations. The Firm failed to perform sufficient procedures to test these sales throughout the year, as its procedures were limited to (1) tracing sales amounts from the medical sales processing system that calculated the amounts due from insurers to the general ledger for one day for a sample of locations, (2) requesting confirmations for a sample of insurance receivables at year end and performing alternative procedures when the requested confirmations were not returned, and (3) performing analytical procedures, which consisted of a comparison of total current-year medical sales to total prior-year medical sales. These analytical procedures, however, provided little to no substantive assurance, as the Firm failed to (1) design its procedures at a level of disaggregation that was precise enough to identify misstatements that could be material, (2) obtain evidence as to why the prior-year sales amounts could be predictive of the current-year sales amounts, and (3) sufficiently evaluate the significant unexpected difference identified, as the only procedure the Firm performed was to document its own understanding of a "likely" reason for part of the difference without obtaining corroboration of its understanding. (AS 2301.08; AS 2305.13-.14, .17, and .21)

- The Firm's procedures to test the existence of inventory that the issuer held at numerous locations were insufficient. The Firm selected a sample of locations and observed physical inventory counts performed as of various interim dates in the second and third quarters. The Firm, however, failed to perform any procedures to extend its conclusions on the existence of inventory for the periods between this interim testing and year end. (AS 2301.45; AS 2510.12)

A.6. Issuer F

In this audit of a financial institution, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as it failed to perform sufficient procedures to test the allowance for loan losses ("ALL"). Specifically –

- The issuer assigned a risk rating to each loan and reviewed these risk ratings on a semi-annual basis. The risk rating was an important input in determining whether the loan would be individually evaluated for impairment or considered as part of the general reserve. The Firm evaluated the loan risk ratings by testing the issuer's review of the ratings; the Firm performed this testing as of a date six months before the year end and performed procedures to extend its conclusions to year end. The Firm's procedures were insufficient in the following respects –

    - The Firm's sample for testing as of the interim date was too small to provide sufficient evidence because, in determining its sample size, the Firm did not appropriately consider relevant factors, including the characteristics of the population and the Firm's risk assessment. In addition, the Firm failed to test the completeness of the population from which it selected its sample of items for testing. (AS 2315.23, .23A, and .24)

    - The Firm's procedures to extend its conclusions to year end were limited to reading the issuer's year-end draft report on the review of loan risk ratings and inquiring of management. (AS 2301.45)

- The Firm failed to perform sufficient procedures to test the valuation of the loans that the issuer deemed to be impaired. Specifically –

    - The Firm failed to test the accuracy and completeness of the underlying loan data used to estimate the component of the ALL related to these loans. (AS 2501.11)

- The Firm failed to evaluate the reasonableness of the methods and the appropriateness of the significant assumptions used in the valuation of collateral for these loans. (AS 2502.26 and .28)

- The Firm failed to evaluate the reasonableness of a significant judgmental input to the future cash-flow analyses that the issuer used to value certain of these loans. (AS 2501.11)

- The Firm failed to perform any procedures to test the valuation of loans that the issuer individually evaluated for impairment but did not deem to be impaired. (AS 2501.11)

A.7. Issuer G

In this audit of a financial institution, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to the ALL. Specifically –

- The Firm selected for testing a control that consisted of reviews of the issuer's loan risk-rating process; the risk ratings were an important input to the estimation of the general reserve component of the ALL. The control included two aspects: (1) the issuer's internal review of certain loans and (2) an external specialist's review of a selection of loans. The Firm failed to sufficiently test this control. Specifically –

  - The Firm failed to sufficiently test the design effectiveness of both aspects of the control, as it failed to evaluate whether the types and number of loans subjected to each review were appropriate to sufficiently evaluate the issuer's loan risk-rating process. (AS 2201.42)

  - To test the operating effectiveness of the control, the Firm selected three samples of loans in order to evaluate the reviewers' risk-rating conclusions. One sample was intended to test both aspects of the control, and the other two samples were each intended to test only one aspect of the control. For each aspect of the control, however, the Firm made its selection of one of the two samples from a population that was not confined to the loans that were reviewed as part of that aspect. As a result, many of the loans in the combined samples that the Firm tested for each of the two aspects had not been subjected to that aspect, so the Firm did not test enough operations of each aspect of the control to support a conclusion on the control's effectiveness. (AS 2201.44)

- The Firm designed certain of its substantive procedures to test the ALL – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's control testing that are discussed above. As a result, certain of the samples that the Firm used to test the ALL were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.8. Issuer H

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. The Firm's testing related to one type of loans receivable and the related revenue, which represented a significant portion of total revenue and for which the Firm identified a fraud risk, was insufficient in the following respects –

- Loan-agreement information was manually entered into and processed by the issuer's information-technology ("IT") system; this system recorded the loans receivable and automatically calculated the loan-related revenue based on the information entered. The Firm failed to identify and test any controls over the accuracy and completeness of the loan-agreement information entered into the system. (AS 2201.39)

- The Firm identified multiple significant deficiencies in ITGCs over the issuer's IT systems, including the system discussed above. In its testing of controls over loan-related revenue, the Firm selected for testing an automated control related to this system's recording of this revenue. To test this control, the Firm selected only one transaction, which was insufficient to support its controls reliance approach given the ITGC significant deficiencies. While the Firm identified certain controls, which consisted of various reconciliations, that it considered to mitigate the significant deficiencies, it failed to obtain evidence that the identified controls would prevent or detect material misstatements related to this revenue that could result from the ITGC significant deficiencies.

Due to the control testing failure and the deficiency in the Firm's testing of other controls discussed above, the Firm designed certain of its substantive procedures to test these loans receivable and the related revenue – including sample sizes – based on a level of control reliance that was not supported. As a result, the samples that the Firm used to test these loans receivable and the allocation of this revenue were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.9. Issuer I

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 it failed to perform sufficient procedures related to goodwill. Specifically –

- The Firm selected for testing a control that included reviews of the issuer's annual analysis of the possible impairment of goodwill. The Firm failed to sufficiently test this aspect of the control, as its procedures were limited to (1) obtaining the issuer's impairment memorandum, (2) inquiring of the control owners, (3) obtaining an email as evidence that a review had occurred, and (4) attending a meeting in which the two reviewers discussed the approach for and results of the issuer's annual goodwill impairment analysis. The Firm, however, failed to evaluate the nature of the procedures that the control owners performed to review the forecasts underlying the impairment analysis, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- The issuer used forecasted revenue and forecasted earnings before interest, taxes, depreciation, and amortization ("EBITDA") in its assessment of the possible impairment of goodwill for one of its reporting units. The issuer forecasted growth in both revenue and EBITDA despite having had declining revenue for this reporting unit over the previous several years. The Firm failed to sufficiently evaluate the reasonableness of the issuer's forecasted revenue and EBITDA. Specifically, the Firm's procedures to test these forecasts were limited to (1) reading the issuer's impairment memorandum and related supporting schedules, (2) inquiring of management, (3) comparing the book value of the issuer's net assets to its market capitalization, and (4) performing a sensitivity analysis that only assumed no growth in revenue or EBITDA and did not consider the possibility of continued declining revenue. These procedures provided little to no substantive assurance about the significant assumptions underlying the forecasted revenue and EBITDA. In addition, the Firm compared the issuer's actual current-year revenue for this business unit to the revenue the issuer had previously forecast for the year; this comparison showed that the actual current-year revenue was significantly less than what had been forecast. The Firm failed to take these results into account in its evaluation of the forecasted revenue, including the forecasted revenue growth in future years. (AS 2502.26, .28, .31, and .36; AS 2810.03)

A.10. Issuer J

In this audit, the Firm failed in the respects described below to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The issuer consummated an acquisition during the year and valued the contingent consideration using projections of revenue; it valued the acquired intangible assets using projections of both revenue and expenses. The issuer revalued the contingent consideration for this and a previous acquisition at year end.

- The Firm failed to perform sufficient procedures to test controls over the initial valuation of the contingent consideration and acquired intangible assets and the year-end revaluation of the contingent consideration. The Firm selected for testing three controls that consisted of (1) a review of the purchase accounting memorandum and supporting documents; (2) a review of a list of acquired assets and assumed liabilities and supporting documents; and (3) a review of the contingent consideration balance and any activity, relevant events, and revisions to the projected revenue used in the revaluation. The Firm's procedures to test these controls consisted of (1) inquiring of the control owners, (2) attending calls between the control owners and the issuer's valuation specialist, (3) reading certain supporting documentation, (4) reading the contingent consideration memorandum and email correspondence between the control owners and the issuer's valuation specialist, and (5) inspecting signatures or emails as evidence that the reviews had occurred. The Firm failed to evaluate the procedures that the control owners performed to review the assumptions underlying the projections, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- The Firm failed to perform sufficient substantive procedures to test the initial valuation of the contingent consideration and acquired intangible assets and the revaluation of the contingent consideration.

    - The Firm's procedures to test the revenue projections used in the initial valuations were limited to obtaining an understanding of how the issuer prepared the projections, calculating the revenue growth rates used in the projections, and comparing the issuer's actual current-year revenue to the revenue that the issuer had projected for the year. The Firm, however, failed to evaluate the assumptions underlying the revenue projections. In addition, the Firm failed to perform any procedures to test the expense projections used in determining the fair value of the intangible assets. (AS 2502.26 and .28)

    - The Firm's procedures to test the revised revenue projections used in the revaluation of contingent consideration at year end were limited to obtaining an understanding of how the issuer prepared the projections, calculating the revenue growth rates used in the projections, and evaluating the first year of the projections for reasonableness by comparing those projections to the last month of the actual current-year revenue, annualized. The Firm, however, failed to evaluate the assumptions underlying the revenue projections for periods beyond the first year. (AS 2502.26 and .28)

A.11. Issuers K and L

In both of these audits, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements, as its procedures to test the valuation of the asset retirement obligations were insufficient. Specifically, the

Firm failed to sufficiently evaluate the estimated costs that the issuer expected to incur to fulfill its obligations, which were a significant assumption used in determining the asset retirement obligations. The Firm's procedures to test these estimated costs were limited to (1) obtaining an understanding of management's process to estimate the costs, (2) for all properties, tracing the estimated costs at the beginning of the year to the estimated costs at the end of the preceding year, and (3) for certain properties, comparing the current-year costs incurred to the prior-year estimate and inquiring of management regarding certain differences. (AS 2501.11)

A.12. Issuer M

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. The Firm's procedures related to the valuation of property and equipment were not sufficient. Specifically –

- The Firm selected for testing a control consisting of the evaluation of certain information, including historical and projected data at the individual property location level, and the preparation and reviews of a memorandum documenting the analysis of the possible impairment of property and equipment at the issuer's property locations. The Firm failed to sufficiently test this control, as its procedures were limited to reading the issuer's impairment memorandum for two quarters, inquiring of one of the control owners, and inspecting emails as evidence that the reviews had occurred. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm identified and tested certain controls over the accuracy and completeness of historical and projected data; however, these controls did not address the data at the individual property location level that were used in the performance of this control, and the Firm did not identify and test any other controls that did so. (AS 2201.39, .42, and .44)

- The Firm failed to perform sufficient substantive procedures to test the valuation of property and equipment. The Firm's procedures consisted of testing the analyses that the issuer used to identify indicators of possible impairment and to evaluate the recoverability of property and equipment at its property locations. The Firm, however, failed to test controls over the historical and projected data for the individual property locations included in these analyses, as described above, or, in the alternative, to test the accuracy and completeness of these data. (AS 2501.11)

A.13. Issuer N

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the valuation of accounts receivable were insufficient. The issuer determined the amount of the allowance for doubtful accounts by applying reserve percentages to past-due accounts receivable; the reserve percentages varied based on the age of the accounts receivable. The Firm's procedures to test the allowance for doubtful accounts were limited to (1) documenting the issuer's reserve policy; (2) recalculating the allowance for doubtful accounts based on the issuer's reserve policy; and (3) calculating certain metrics related to the total allowance for doubtful accounts, comparing these metrics to the same metrics in previous periods or to industry ranges, and inquiring about differences over a threshold. The Firm, however, failed to evaluate the reasonableness of the specific reserve percentages the issuer used to calculate the allowance for doubtful accounts. (AS 2501.11)

A.14. Issuer O

In this audit of a manufacturer, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to sufficiently test controls over the valuation of inventory held at certain of the issuer's business units that were significant in the aggregate. The Firm selected for testing controls consisting of (1) a periodic review and approval of changes to standard costs for these business units and (2) a review of a monthly analysis of variances in cost of goods sold for one of these business units. The Firm failed to sufficiently test these controls, as its procedures were limited to reading the schedule of changes to standard costs and the schedule showing the monthly analysis of variances in cost of goods sold, inquiring of the preparers of these schedules, and inspecting signatures or other notations that indicated that the reviews had occurred. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed, including the criteria the control owners used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the schedules used in the performance of these controls. (AS 2201.39, .42, and .44)

A.15. Issuer P

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 the valuation of inventory were insufficient. The Firm identified and tested a control that consisted of the preparation and review of an inventory valuation analysis. The Firm's procedures to test this control were limited to obtaining the analysis, inquiring of the preparer of the analysis, tracing certain amounts to supporting documentation, and inspecting a signature as evidence that the review had occurred. The Firm failed to evaluate the nature of the review procedures that the control owner performed, including the criteria the control owner used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of certain data used in the performance of the control. (AS 2201.39, .42, and .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 1210, *Using the Work of a Specialist*	Issuer A	2
AS 2110, *Identifying and Assessing Risks of Material Misstatement*	Issuer B	3
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 G Issuer H Issuer I Issuer J	15 9 2 4 2 1 1 1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer M Issuer O Issuer P	1 1 1
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer B Issuer D Issuer E Issuer F Issuer G Issuer H	3 4 2 2 1 1 1
AS 2305, *Substantive Analytical Procedures*	Issuer E	1
AS 2310, *The Confirmation Process*	Issuer A	1
AS 2315, *Audit Sampling*	Issuer A Issuer B Issuer D Issuer F Issuer G Issuer H	1 5 1 1 1 1
AS 2401, *Consideration of Fraud in a Financial Statement Audit*	Issuer A	1
AS 2501, *Auditing Accounting Estimates*	Issuer C Issuer F Issuer K Issuer L Issuer M Issuer N	1 3 1 1 1 1
AS 2502, *Auditing Fair Value Measurements*	Issuer A	8

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
and Disclosures	Issuer F Issuer I Issuer J	1 1 2
AS 2510, *Auditing Inventories*	Issuer E	1
AS 2810, *Evaluating Audit Results*	Issuer A Issuer I	1 1

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

The table below lists the financial statement accounts or auditing areas related to 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. The following standards were cited for only one issuer and are excluded from the table: AS 1210, AS 2110, AS 2305, AS 2310, AS 2401, and AS 2510.[4]

	AS 2201	**AS 2301**	**AS 2315**	**AS 2501**	**AS 2502**	**AS 2810**
Asset retirement obligations				K, L		
Business combinations, including contingent consideration	A, J				A, J	
Impairment of goodwill and intangible assets	C, I				I	I

[4] The AS 1210 issue for issuer A related to loss reserves. The AS 2110 issue for issuer B and the AS 2305 issue for issuer E related to revenue. The AS 2310 issue for issuer A related to investment securities. The AS 2401 issue for issuer A related to the risk of management override of controls. The AS 2510 issue for issuer E related to inventory.

	AS 2201	AS 2301	AS 2315	AS 2501	AS 2502	AS 2810
Information technology	B					
Inventory and related reserves	D, O, P	E				
Investment securities	A	A			A	
Loans, including ALL	C, G, H	F, G, H	F, G, H	C, F	F	
Loss reserves	A	A	A			A
Property and equipment	B, M	B	B	M		
Revenue, including accounts receivable, deferred revenue, and allowance	B, C, D, H	B, D, E, H	B, D, H	C, N		

B.3. Audit Deficiencies by Industry

The table below lists the industries[5] 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.[6]

	AS 1210	AS 2110	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2401	AS 2501	AS 2502	AS 2510	AS 2810
Consumer Discretionary			M	E	E				M		E	
Energy			P						K, L			

[5] 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.

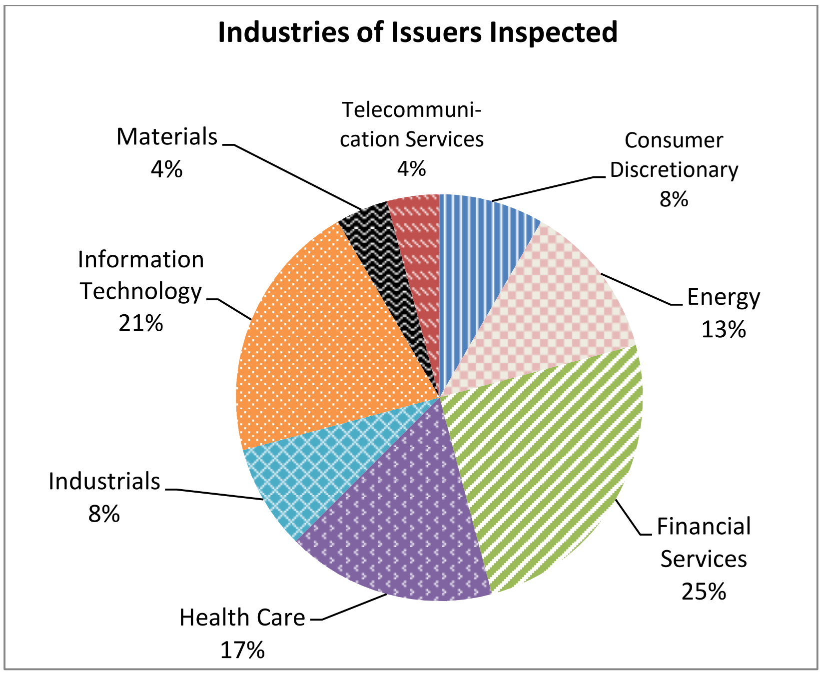
[6] Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

	AS 1210	AS 2110	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2401	AS 2501	AS 2502	AS 2510	AS 2810
Financial Services	A		A, C, G, H	A, F, G, H		A	A, F, G, H	A	C, F	A, F		A
Health Care			J						N	J		
Information Technology			D, I	D			D			I		I
Materials			O									
Telecommu-nication Services		B	B	B			B					

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

The chart below categorizes the 24 issuers whose audits were inspected in 2016, based on the issuer's industry.[7]

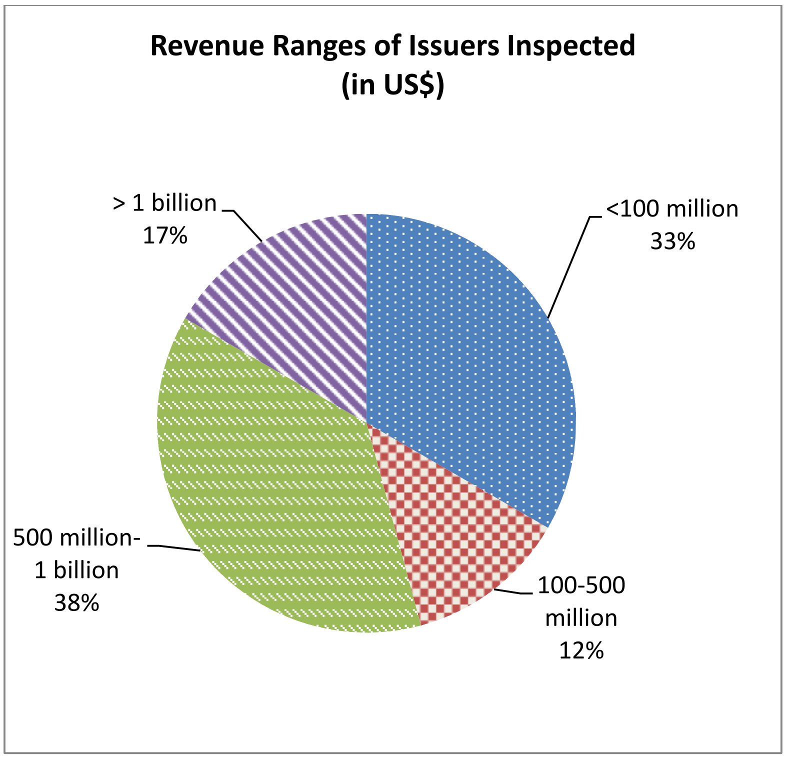


Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	2	8%
Energy	3	13%
Financial Services	6	25%
Health Care	4	17%
Industrials	2	8%
Information Technology	5	21%
Materials	1	4%
Telecommu-nication Services	1	4%

7 See Footnote 5 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 24 issuers whose audits were inspected in 2016.[8] 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	8	33%
100-500 million	3	12%
500 million -1 billion	9	38%
>1 billion	4	17%

8 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.[9]

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,[10] 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,

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[9] 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.

[10] 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.

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 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 may indicate a defect or potential defect in a firm's quality control system.[11] If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;[12] 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

[11] 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.

[12] 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.

policies and procedures, and processes for responding to defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

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

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

PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

PART II

ISSUES RELATED TO QUALITY CONTROLS

This Part II contains a discussion of criticisms of and potential defects in the Firm's quality control system.[13] As described below, an analysis of the inspection results reported by the inspection team, including the results of the reviews of individual audits,[14] indicates that the Firm's system of quality control requires remedial action in order to provide sufficient assurance that the Firm's audit work will meet applicable standards and requirements.

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Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism

The inspection results indicate that the Firm's system of quality control does not provide the reasonable assurance described in QC 20.03 and .17 that the Firm's personnel will appropriately exercise the professional skepticism required by AS 1015, AS 2301, and AS 2810 in the performance of issuer audits. The application of professional skepticism is essential to the performance of effective audits under PCAOB standards, and a lack of professional skepticism can have a pervasive effect on an audit. The inspection team identified 10 audits[15] in which deficiencies appeared to be caused, at least in part, by the failure to appropriately apply professional skepticism;

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13 This report's description of quality control issues is generally based on the inspection team's observations that occurred during the primary inspection procedures. Any changes or improvements that the Firm may have made in its system of quality control since that time * * * * [have been] taken into account by the Board during its assessment of whether the Firm has satisfactorily addressed the quality control criticisms or defects within the twelve months after the issuance of this report.

14 * * * *

15 Issuers A, B, C, D, E, F, G, I, M, and O

certain of these deficiencies in nine of these audits are included in Part I.A.[16] These deficiencies occurred even in areas where the Firm had identified a risk of fraud.[17]

The specific deficiencies that were identified are described below –

- In six audits,[18] the Firm failed to sufficiently evaluate contradictory or potentially inconsistent information that was included in its work papers or disclosed by the issuer, including information that may have indicated management bias.
- In six audits,[19] the Firm's procedures to test certain controls that included a review component were focused on inquiring of management, determining whether a review had occurred, and performing additional procedures that did not include evaluating the nature of the review procedures.
- In four audits,[20] a significant aspect or portion of an account was subject to a significant risk or was multiple times the Firm's established level of materiality. Without establishing a basis for doing so, however, the Firm concluded in three of these audits[21] that it did not need to perform any procedures to test that aspect or portion of the account, and, in the fourth audit,[22] it limited its procedures to obtaining issuer-developed schedules.

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16 Issuers A, B, C, D, E, F, I, M, and O

17 Issuers A, C, and D

18 Issuers A, B, C, E, G, and I

19 Issuers A, B, D, I, M, and O

20 Issuers A, B, F, and G

21 Issuers A, B, and F

22 Issuer G

- In three audits,[23] the Firm failed to sufficiently test journal entries that it had identified as having fraud risk characteristics.

- In two ICFR audits,[24] the Firm failed to identify and test any controls over transactions related to, or portions of, accounts identified as significant risks by the Firm.

In many of these audits, it appeared that the engagement teams focused on obtaining evidence that would support management's position or approach related to significant management judgments or assumptions, rather than critically assessing the reasonableness of those judgments or assumptions, even when, as in certain of these audits, there was information in the Firm's work papers that was potentially inconsistent with management's position. For many of the deficiencies discussed above, the Firm's evidential support for significant judgments or assumptions consisted of management's calculations or memoranda and responses to Firm inquiries, with minimal corroborating evidence or independent analysis by the engagement team. This suggests that certain of the Firm's personnel are overly focused on rationalizing or supporting management's perspective.

The inspection team also continued to observe that the Firm's consultation process may not sufficiently eliminate potential bias towards supporting the issuer's position. For example, the inspection team identified an instance in which the individual consulted supported the issuer's position without sufficiently evaluating the engagement team's assessment of, and audit responses to, certain assumptions that were necessary to conclude that the position was appropriate.[25]

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[23] Issuers A, C, and D

[24] Issuers A and D

[25] In addition, in 2015, the inspection team identified two instances in which the individuals consulted supported the issuers' accounting positions despite significant evidence indicating that the positions were inappropriate. In both of these instances, the issuers subsequently restated their financial statements to change the accounting treatment with respect to these matters.

Audit deficiencies in this area have been identified in each of the last five inspections. In response to these deficiencies, the Firm has implemented certain remedial actions, including enhancing templates, establishing audit milestones, and providing coaching and additional training. The Firm should continue to perform its analysis of the root causes of identified deficiencies in this area, including by evaluating why previously implemented actions were not effective in addressing the deficiencies. Based on this analysis, the Firm should determine whether additional, or adjustments to existing, remedial actions are necessary, and it should timely implement any additional remedial actions that are needed.

Deficiencies in the System of Quality Control Related to Testing and Evaluating Internal Control

The inspection results indicate that the Firm's system of quality control does not provide the reasonable assurance described in QC 20.03 and .17 that the work performed by the Firm's personnel with respect to testing and evaluating internal control in financial statement audits and audits of ICFR will meet the requirements of AS 2201 and AS 2301.[26] The inspection team identified deficiencies in the Firm's testing of internal control in 12 audits,[27] 11 of which are included in Part I.A of this report,[28] that support this concern.

Taking action to address the concerns regarding testing and evaluating internal control and monitoring the effects of those actions are critical, in part because this testing is used in some audits both to support the Firm's opinion on the effectiveness of ICFR and to modify the nature, timing, and extent of substantive testing in the financial statement audit. The inspection team identified five audits,[29] all of which are included in Part I.A, in which the substantive procedures to test certain significant accounts were

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[26] As noted within this section, issues related to compliance with AS 1201.05-.06 appear to have been among the potential causes of some of the identified audit deficiencies.

[27] Issuers A, B, C, D, G, H, I, J, M, O, P, and Q

[28] Issuers A, B, C, D, G, H, I, J, M, O, and P

[29] Issuers A, B, D, G, and H

insufficient, at least in part because the Firm designed those procedures based on a level of control reliance that was not supported due to deficiencies in its testing of controls.

Concerns related to testing and evaluating internal control were in the areas of * * * * identifying and testing controls that addressed the risks that were present, * * * * testing controls that included a review element, * * * * and * * * * identifying and testing controls over the accuracy and completeness of data and reports.

Failures to Identify and Test Controls That Addressed the Risks That Were Present

In four audits,[30] the Firm failed to identify and test controls that addressed the risks of material misstatement that were present for relevant assertions of significant accounts. In addition, in one of these audits,[31] the Firm identified and tested controls to address certain risks of material misstatement, but failed to test specific aspects of those controls that would have addressed certain of those risks or, in the alternative, identify and test other controls that would have done so.

Failures to Sufficiently Test Controls That Included a Review Element

In 11 audits,[32] the Firm failed to sufficiently test the design or operating effectiveness of certain controls that included a review element. With respect to many of these controls, the Firm's procedures were focused on inquiring of management and determining whether a review had occurred, often by obtaining evidence of reviewer sign-off. In all of these audits, the Firm failed to evaluate whether certain controls that it selected for testing operated at a level of precision that would prevent or detect material misstatements, as its procedures to test these controls did not include evaluating the effectiveness of the review process, which would generally include determining and evaluating (1) the specific actions

30 Issuers A, B, D, and H

31 Issuer D

32 Issuers A, B, C, D, G, I, J, M, O, P, and Q

taken by the control owners, (2) the criteria the control owners used to identify matters for investigation, and (3) the manner in which identified issues were investigated and resolved.

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Failures to Identify and Test Controls Over the Accuracy and Completeness of Data and Reports

In eight audits,[33] the Firm failed to identify and test any controls over the accuracy and/or completeness of data and reports, including those generated by IT systems, that the issuer used in the performance of controls that the Firm tested, including controls with a review element.

The identified deficiencies suggest that some of the Firm's professionals, including the partners and managers who are responsible for supervising issuer audits, lack a sufficient knowledge of the specific requirements of PCAOB standards in order to plan and perform tests of controls and evaluate the results of that testing. For example, some professionals appear not to understand that testing controls that include a review element necessarily entails understanding and evaluating the procedures performed by the control owners. The identified deficiencies also suggest that some of the Firm's professionals failed to perform sufficient procedures to obtain an understanding of the flow of transactions, including how transactions are initiated, authorized, processed, and recorded, even though this is critical to identifying (1) the points within an issuer's processes at which a misstatement could arise that, individually or in combination with other misstatements, would be material and (2) the controls that management has implemented to address these potential misstatements.

The deficiencies also suggest that the Firm's guidance, tools, or training on the requirements for identifying, testing, and evaluating controls have not been effective enough in assisting engagement teams in designing and executing appropriate procedures that sufficiently identify and respond to the risks presented. For example, the Firm's guidance on walkthroughs indicates that a walkthrough may be achieved through inquiry, observation of the application of control activities and inspection of

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33 Issuers A, B, D, G, M, O, P, and Q

relevant documents, or tracing transactions through the system. While inquiry, observation, and inspection are procedures that are often used in the performance of walkthroughs, the walkthrough is described in AS 2201 as following a transaction from origination through the company's processes to the financial statements. By stating in its guidance that tracing transactions through the system is only one of the possible procedures rather than the purpose of a walkthrough, the Firm's guidance may confuse engagement teams and may lead engagement teams to fail to obtain an appropriate understanding of the flow of transactions.

Further, some partners and managers may not be placing sufficient emphasis on planning and executing tests of controls, and therefore may not be giving sufficient attention to the supervision, including review, of those procedures.

The inspection team also observed that an apparent lack of sufficient integration of ISA personnel throughout the audit may have contributed to certain of the Firm's failures involving identifying, testing, and evaluating relevant controls. Specifically, while ISA personnel were largely responsible for the testing of ITGCs in the Firm's audits, the financial statement audit personnel generally did not draw on the ISA personnel's specialized knowledge of the relationships among the ITGCs, the issuer's various IT applications, and related automated and manual controls when the financial statement audit personnel were identifying the points at which a misstatement could arise, performing walkthroughs, selecting controls to test, testing those controls, or evaluating the effects of IT-related deficiencies. For example, in four audits,[34] the Firm failed to identify and test, or to sufficiently test, automated controls or automated aspects of IT-dependent manual controls; in all four of these audits, the financial statement auditors performed the identification and testing of the automated controls without ISA assistance. This may be a consequence of the small number of ISA PPDs who are responsible for providing oversight of the IT-related procedures performed on issuer audits. The inspection team observed that four ISA PPDs were each responsible for providing oversight on between 33 and 65 issuer audits, in addition to serving as Regional IT Leaders.

In response to the identification of numerous audit deficiencies in testing controls in this and each of the past five inspections, the Firm has taken a number of actions, including requiring engagement teams to include business process flowcharts in the

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[34] Issuers B, D, H, and Q

audit documentation, mandating that ISA auditors review and approve the planned audit procedures related to testing complex systems and automated controls, revising existing templates and practice aids, issuing new templates, establishing audit milestones, and providing coaching and additional training. Given the high rate of deficiencies identified by the inspection team in 2016 and the similarities between the types of deficiencies identified in this inspection and those identified in the previous inspections, continued monitoring of the effects of these remedial actions is critical. As part of its monitoring activities, the Firm should determine whether engagement teams are (1) using the audit tools as intended and (2) appropriately applying the Firm's guidance in this area. In addition, the Firm should determine whether any of its audit tools or guidance needs to be modified, clarified, or expanded. Further, the Firm should continue to analyze the root causes of the deficiencies in testing and evaluating internal control and should develop and implement additional remedial actions as appropriate.

Deficiencies in the System of Quality Control Related to Engagement Supervision and Review

The inspection results indicate that the Firm's system of quality control does not provide the reasonable assurance described in QC 20.03 and .17 and QC 40.08 that the supervision and reviews of audit work by the Firm's partners will meet the applicable requirements of AS 1201 and AS 1220.[35] Many of the audit deficiencies that the inspection team identified appear to have been the result, at least in part, of inadequate supervision, including review, of the audit work by the engagement partner, and the fact that many of these deficiencies were not detected and appropriately addressed was apparently due, at least in part, to inadequate review of the work by the EQR partner.

<u>Engagement Partner Supervision, Including Review</u>

The 2016 inspection results indicate deficiencies in the supervision of audits, including the review of the audit work, by the Firm's engagement partners. In 13 audits,[36] all of which are included in Part I.A of this report, the inspection

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35 As noted within this section, issues related to compliance with AS 1015.07 and AS 2301.07 appear to have been among the potential causes of some of the identified audit deficiencies.

36 Issuers A, B, C, D, E, F, G, H, I, J, K, L, and N

team identified deficiencies that the engagement partner should have identified and appropriately addressed but did not. In 11 of these audits,[37] certain of these deficiencies occurred in areas in which the engagement team had identified a significant risk, including a fraud risk in four of these audits.[38]

Engagement Quality Review

AS 1220, *Engagement Quality Review*, requires the EQR partner to evaluate certain significant judgments made by the engagement team, including the engagement team's assessment of, and audit responses to, significant risks identified by the engagement team. In 11 of the audits included in Part I.A of this report,[39] the inspection team noted instances in which the EQR process did not result in the identification of certain deficiencies related to significant judgments made by the engagement team, even though the area had been reviewed by the EQR partner during the audit. In one additional audit included in Part I.A of this report,[40] the EQR partner did not review the audit work papers related to an area that the engagement team had assessed as a significant risk, and the inspection team identified a deficiency in that area. These instances included failures by the EQR partners to identify or appropriately evaluate deficiencies related to:

- significant judgments and conclusions made by the engagement team with respect to the control and/or substantive testing related to certain accounts for which the engagement team had identified a significant risk,[41] including a fraud risk in four of these audits;[42]

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37 Issuers A, C, D, E, F, G, H, J, K, L, and N

38 Issuers A, C, D, and H

39 Issuers A, B, C, D, E, F, G, H, J, K, and L

40 Issuer N

41 Issuers A, C, D, E, F, G, H, J, K, L, and N

42 Issuers A, C, D, and H

- significant judgments made by the engagement team related to the scope of the audit as part of audit planning;[43] and

- significant judgments made by the engagement team about the severity of control deficiencies that were based on whether identified compensating controls addressed the risks intended to be addressed by the controls that were deficient.[44]

These deficiencies indicate that (1) certain of the Firm's engagement partners did not appropriately supervise their audits and (2) certain of the Firm's engagement partners and EQR partners did not perform their reviews as thoroughly as necessary, possess the requisite skills, or devote sufficient time and attention to these responsibilities. In addition, these deficiencies suggest that certain partners may not be approaching their responsibilities with professional skepticism. For example, (1) certain engagement partners may not be performing a critical assessment of the planned audit approach, the execution of that audit approach, and the audit evidence obtained; and (2) certain EQR partners may not be performing a sufficient evaluation of the significant judgments that relate to engagement planning and of the engagement teams' assessment of, and responses to, the significant risks identified.

In 2016, the Firm implemented certain remedial actions related to supervision and review, including enhancing Firm processes and templates, providing training, and establishing mandatory audit milestones. The Firm should evaluate the effectiveness of these remedial actions. In addition, the Firm should continue to assess the root causes of the deficiencies in this area, including by analyzing whether inappropriate engagement partner and EQR partner assignments may be contributing to the inadequate supervision and review. The Firm should develop and implement additional remedial actions in response to its root cause assessment as appropriate.

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[43] Issuer D

[44] Issuer B

PCAOB Standards and Rules

The table below lists the specific PCAOB standards and rules that are primarily related to the descriptions of defects in, or criticisms of, the Firm's system of quality control included in this Part of the report.[45]

PCAOB Standards and Rules	Part II Section
AS 1015, *Due Professional Care in the Performance of Work*	* * * * Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism * * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review * * * *
AS 1201, *Supervision of the Audit Engagement*	* * * * Deficiencies in the System of Quality Control Related to Testing and Evaluating Internal Control * * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review * * * *
AS 1220, *Engagement Quality Review*	* * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review

45 This table does not necessarily include reference to every standard that may have been related to the criticisms or potential defects that are included in Part II.

PCAOB Standards and Rules	Part II Section
* * * *	
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	* * * * Deficiencies in the System of Quality Control Related to Testing and Evaluating Internal Control
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	* * * *Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism * * * * Deficiencies in the System of Quality Control Related to Testing and Evaluating Internal Control * * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review * * * *
* * * *	
AS 2810, *Evaluating Audit Results*	* * * * Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism * * * *
QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*	* * * * Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism

PCAOB Standards and Rules	Part II Section
	* * * * Deficiencies in the System of Quality Control Related to Testing and Evaluating Internal Control * * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review * * * *
* * * *	
QC 40, *The Personnel Management Element of a Firm's System of Quality Control-Competencies Required by a Practitioner-in-Charge of an Attest Engagement*	* * * * Deficiencies in the System of Quality Control Related to Engagement Supervision and Review
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The table below provides a cross-reference to the issuer audits that were included in Part II of this report.

Part II Section	PCAOB Standards and Rules	Issuers
*** * * ***		
Deficiencies in the System of Quality Control Related to the Application of Professional Skepticism	• AS 1015, *Due Professional Care in the Performance of Work* • AS 2301, *The Auditor's Responses to the Risks of Material Misstatement* • AS 2810, *Evaluating Audit Results* • QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*	Issuers A, B, C, D, E, F, G, I, M, and O
Deficiencies in the System of Quality Control Related to Testing and Evaluating	• AS 1201, *Supervision of the Audit Engagement* • AS 2201, *An Audit of Internal Control Over*	Issuers A, B, C, D, G, H, I, J,

Part II Section	PCAOB Standards and Rules	Issuers
Internal Control	*Financial Reporting That Is Integrated with An Audit of Financial Statements* • AS 2301, *The Auditor's Responses to the Risks of Material Misstatement* • QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*	M, O, P, and Q
Deficiencies in the System of Quality Control Related to Engagement Supervision and Review	• AS 1015, *Due Professional Care in the Performance of Work* • AS 1201, *Supervision of the Audit Engagement* • AS 1220, *Engagement Quality Review* • AS 2301, *The Auditor's Responses to the Risks of Material Misstatement* • QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* • QC 40, *The Personnel Management Element of a Firm's System of Quality Control-Competencies Required by a Practitioner-in-Charge of an Attest Engagement*	Issuers A, B, C, D, E, F, G, H, I, J, K, L, and N
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APPENDIX B

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[46]

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

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June 11, 2018

Mr. George Botic
Acting Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Re: Response to Part I of the Draft Report on the 2016 Inspection of BDO USA, LLP

Dear Mr. Botic:

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2016 inspection of BDO USA, LLP.

We have evaluated each of the matters described in Part I of the Draft Report and have taken appropriate actions under both PCAOB standards and our policies, including steps we considered necessary to comply with AS 2901, *Consideration of Omitted Procedures After the Report Date*, and where applicable, AS 2905, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

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

Respectfully submitted,

BDO USA, LLP

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100 Park Avenue
New York, NY 10017

June 11, 2018

Mr. George Botic
Acting Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Re: Response to the Non-public Portion of the Draft Report on the 2016 Inspection of BDO USA, LLP

Dear Mr. Botic:

We appreciate this opportunity to provide our response to Part II of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2016 inspection of BDO USA, LLP. We have separately provided our response to Part I of the Draft Report as of the same date.

We wish to emphasize the seriousness with which we take the matters described in Part II of the Draft Report. In that regard, we will re-evaluate actions previously taken, as well as undertake any new measures we consider necessary to address these matters.

Our remediation action plans relative to the specific matters discussed in Part II of the Draft Report will be submitted to the PCAOB at a subsequent date and will contain the actions already implemented as well as future plans for each of the matters covered by the Draft Report. Firm leadership will continue to endorse and support the efforts to improve audit quality and make it our top priority.

We look forward to our continuing dialogue with your staff in order to ensure that our actions are fully responsive to the Board's expectations and, if not, that we take additional timely actions to achieve that goal.

Respectfully submitted,

BDO USA, LLP

APPENDIX C

AUDITING STANDARDS REFERENCED IN PART I

This appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this appendix, and any other Notes, are from the original auditing standards that are referenced. While this appendix contains the specific portions of the relevant standards cited with respect to the deficiencies in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.[47]

AS 1210, *Using the Work of a Specialist*		
USING THE FINDINGS OF THE SPECIALIST		
AS 1210.12	The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (*a*) obtain an understanding of the methods and assumptions used by the specialist, (*b*) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (*c*) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.	Issuer A

AS 2110, *Identifying and Assessing Risks of Material Misstatement*		
Factors Relevant to Identifying Fraud Risks		
AS 2110.68	Presumption of Fraud Risk Involving Improper Revenue Recognition. The auditor should presume that there	Issuer B

[47] The text presented in this appendix represents the standards as in effect during the applicable audit period.

AS 2110, *Identifying and Assessing Risks of Material Misstatement*		
	is a fraud risk involving improper revenue recognition and evaluate which types of revenue, revenue transactions, or assertions may give rise to such risks.	
Revision of Risk Assessment		
AS 2110.74	The auditor's assessment of the risks of material misstatement, including fraud risks, should continue throughout the audit. When the auditor obtains audit evidence during the course of the audit that contradicts the audit evidence on which the auditor originally based his or her risk assessment, the auditor should revise the risk assessment and modify planned audit procedures or perform additional procedures in response to the revised risk assessments.[38]	Issuer B
Footnote to AS 2110.74 38 *See also* AS 2301.46.		

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS 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, B, D, H, M, O, and P
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 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	Issuers A, B, C, D, G, I, J, M, O, and P

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	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, D, G, I, J, M, O, and P
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.	Issuers A and B

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, B, D, and E

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
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 A, B, D, G, and H
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 primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers A, B, D, G, and H
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,	Issuers A, B, D, G, and H

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
	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.	
Timing of Substantive Procedures		
AS 2301.45	When substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. Such procedures should include (a) comparing relevant information about the account balance at the interim date with comparable information at the end of the period to identify amounts that appear unusual and investigating such amounts and (b) performing audit procedures to test the remaining period.	Issuers E and F

AS 2305, *Substantive Analytical Procedures*		
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Plausibility and Predictability of the Relationship		
AS 2305.13	It is important for the auditor to understand the reasons that make relationships plausible because data sometimes appear to be related when they are not, which could lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship can provide important evidence when appropriately scrutinized.	Issuer E
AS 2305.14	As higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation. Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts since income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion are sometimes	Issuer E

AS 2305, *Substantive Analytical Procedures*		
	less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.	
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 E
Investigation and Evaluation of Significant Differences		
AS 2305.21	The auditor should evaluate significant unexpected differences. Reconsidering the methods and factors used in developing the expectation and inquiry of management may assist the auditor in this regard. Management responses, however, should ordinarily be corroborated with other evidential matter. In those cases when an explanation for the difference cannot be obtained, the auditor should obtain sufficient evidence about the assertion by performing other audit procedures to satisfy himself as to whether the difference is a misstatement. In designing such other procedures, the auditor should consider that unexplained differences may indicate an increased risk of material misstatement. (*See* AS 2810.)	Issuer E

AS 2310, *The Confirmation Process*		
ALTERNATIVE PROCEDURES		
AS 2310.31	When the auditor has not received replies to positive confirmation requests, he or she should apply alternative procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level.	Issuer A

AS 2310, *The Confirmation Process*		
	However, the omission of alternative procedures may be acceptable (*a*) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (*b*) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated.	

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.	Issuers A, B, D, G, and H
<u>Footnote to AS 2315.19</u> [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	Issuers A, B, D, F, G, and H

AS 2315, *Audit Sampling*		
	population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	
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.	Issuers A, B, D, F, G, and H
Sample Selection		
AS 2315.24	Sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. For example, haphazard and random-based selection of items represents two means of obtaining such samples.[4]	Issuers B and F
Footnote to AS 2315.24 4 Random-based selection includes, for example, random sampling, stratified random sampling, sampling with probability proportional to size, and systematic sampling (for example, every hundredth item) with one or more random starts.		

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
RESPONDING TO ASSESSED FRAUD RISKS		
Audit Procedures Performed to Specifically Address the Risk of Management Override of Controls		
AS 2401.61	The auditor should use professional judgment in determining the nature, timing, and extent of the testing of journal entries and other adjustments. For purposes of identifying and selecting specific entries and other adjustments for testing, and determining the appropriate method of examining the underlying support for the items selected, the	Issuer A

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
	auditor should consider: ▪ *The auditor's assessment of the fraud risk.* The presence of fraud risk factors or other conditions may help the auditor to identify specific classes of journal entries for testing and indicate the extent of testing necessary. ▪ *The effectiveness of controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and adjustments may affect the extent of substantive testing necessary, provided that the auditor has tested the controls. However, even though controls might be implemented and operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items. ▪ *The entity's financial reporting process and the nature of the evidence that can be examined.* The auditor's procedures for testing journal entries and other adjustments will vary based on the nature of the financial reporting process. For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments might involve both manual and automated procedures and controls. Regardless of the method, the auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items. In addition, the auditor should be aware that journal entries and other adjustments might exist in either electronic or paper form. When information technology (IT) is used in the financial reporting process, journal entries and other adjustments might exist only in electronic form. Electronic evidence often requires extraction of the desired data by an auditor with IT knowledge and skills or the use of an IT specialist. In an IT environment, it may be necessary for the auditor to employ computer-assisted audit techniques (for example, report writers, software or data extraction tools, or other systems-based techniques) to identify the journal entries and other adjustments to be tested. ▪ *The characteristics of fraudulent entries or adjustments.* Inappropriate journal entries and other	

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
	adjustments often have certain unique identifying characteristics. Such characteristics may include entries (*a*) made to unrelated, unusual, or seldom-used accounts, (*b*) made by individuals who typically do not make journal entries, (*c*) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (*d*) made either before or during the preparation of the financial statements that do not have account numbers, or (*e*) containing round numbers or a consistent ending number. ▪ *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (*a*) contain transactions that are complex or unusual in nature, (*b*) contain significant estimates and period-end adjustments, (*c*) have been prone to errors in the past, (*d*) have not been reconciled on a timely basis or contain unreconciled differences, (*e*) contain intercompany transactions, or (*f*) are otherwise associated with an identified fraud risk. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations based on factors set forth in paragraphs .11 through .14 of AS 2101, *Audit Planning.* ▪ *Journal entries or other adjustments processed outside the normal course of business.* Standard journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements, or to record recurring periodic accounting estimates generally are subject to the entity's internal controls. Nonstandard entries (for example, entries used to record nonrecurring transactions, such as a business combination, or entries used to record a nonrecurring estimate, such as an asset impairment) might not be subject to the same level of internal control. In addition, other adjustments such as consolidating adjustments, report combinations, and reclassifications generally are not reflected in formal journal entries and might not be subject to the entity's internal controls. Accordingly, the auditor should consider placing additional emphasis on identifying and testing items processed outside of the normal course of business.	

AS 2501, *Auditing Accounting Estimates*

AS 2501, *Auditing Accounting Estimates*		
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 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.	Issuers C, F, K, L, M, and N

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
EVALUATING CONFORMITY OF FAIR VALUE MEASUREMENTS AND DISCLOSURES WITH GAAP		
AS 2502.15	The auditor should evaluate whether the fair value measurements and disclosures in the financial statements are in conformity with GAAP. The auditor's understanding of the requirements of GAAP and knowledge of the business and industry, together with the results of other audit procedures, are used to evaluate the accounting for assets or liabilities requiring fair value measurements, and the disclosures about the basis for the fair value measurements and significant uncertainties related thereto.	Issuer A
AS 2502.17	The auditor should evaluate management's intent to carry out specific courses of action where intent is relevant to the use of fair value measurements, the related requirements involving presentation and disclosures, and how changes in fair values are reported in financial statements. The auditor also should evaluate management's ability to carry out those courses of action. Management often documents plans and intentions relevant to specific assets or liabilities and GAAP may require it to do so. While the extent of evidence to be obtained about management's intent and ability is a matter of professional judgment, the auditor's procedures ordinarily include inquiries of management, with appropriate corroboration of responses, for example, by: ▪ Considering management's past history of carrying out its stated intentions with respect to assets or liabilities. ▪ Reviewing written plans and other documentation, including, where applicable, budgets, minutes, and other such items. ▪ Considering management's stated reasons for choosing a particular course of action. ▪ Considering management's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its contractual commitments.	Issuer A
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AS 2502.26	The auditor's understanding of the reliability of the process used by management to determine fair value is an	Issuers A, F, I, and J

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
	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.	
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.	Issuers A, F, I, and J
AS 2502.31	Assumptions ordinarily are supported by differing types of evidence from internal and external sources that provide objective support for the assumptions used. The auditor evaluates the source and reliability of evidence supporting management's assumptions, including consideration of the assumptions in light of historical and market information.	Issuer I
AS 2502.36	To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows),[5] individually and taken as a whole, need to be realistic and consistent with: a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances; b. Existing market information; c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies; d. Assumptions made in prior periods, if appropriate; e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable; f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts	Issuer I

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
	other than those relating to fair value measurements and disclosures; and g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate. Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience.	
Footnote to AS 2502.36 5 The auditor also should consider requirements of GAAP that may influence the selection of assumptions (*see* FASB Concepts Statement No. 7).		
AS 2502.39	The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.	Issuer A
Developing Independent Fair Value Estimates for Corroborative Purposes		
AS 2502.40	The auditor may make an independent estimate of fair value (for example, by using an auditor-developed model) to corroborate the entity's fair value measurement.[6] When developing an independent estimate using management's assumptions, the auditor evaluates those assumptions as discussed in paragraphs .28 to .37. Instead of using management's assumptions, the auditor may develop his or her own assumptions to make a comparison with management's fair value measurements. In that situation, the auditor nevertheless understands management's assumptions. The auditor uses that understanding to ensure	Issuer A

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
	that his or her independent estimate takes into consideration all significant variables and to evaluate any significant difference from management's estimate. The auditor also should test the data used to develop the fair value measurements and disclosures as discussed in paragraph .39.	
Footnote to AS 2502.40 6 *See* AS 2305, *Substantive Analytical Procedures*.		

AS 2510, *Auditing Inventories*		
INVENTORIES		
AS 2510.12	When the independent auditor has not satisfied himself as to inventories in the possession of the client through the procedures described in paragraphs .09 through .11, tests of the accounting records alone will not be sufficient for him to become satisfied as to quantities; it will always be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions. This should be coupled with inspection of the records of any client's counts and procedures relating to the physical inventory on which the balance-sheet inventory is based.	Issuer E

AS 2810, *Evaluating Audit Results*		
EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS		
AS 2810.03	In forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.	Issuers A and I

AS 2810, *Evaluating Audit Results*		
Evaluating the Qualitative Aspects of the Company's Accounting Practices		
AS 2810.27	*Evaluating Bias in Accounting Estimates*. The auditor should evaluate whether the difference between estimates best supported by the audit evidence and estimates included in the financial statements, which are individually reasonable, indicate a possible bias on the part of the company's management. If each accounting estimate included in the financial statements was individually reasonable but the effect of the difference between each estimate and the estimate best supported by the audit evidence was to increase earnings or loss, the auditor should evaluate whether these circumstances indicate potential management bias in the estimates. Bias also can result from the cumulative effect of changes in multiple accounting estimates. If the estimates in the financial statements are grouped at one end of the range of reasonable estimates in the prior year and are grouped at the other end of the range of reasonable estimates in the current year, the auditor should evaluate whether management is using swings in estimates to achieve an expected or desired outcome, e.g., to offset higher or lower than expected earnings. Note: AS 2401.64-.65 establish requirements regarding performing a retrospective review of accounting estimates and evaluating the potential for fraud risks.	Issuer A