

Report on
2006 Inspection of PricewaterhouseCoopers LLP

Issued by the
Public Company Accounting Oversight Board
October 18, 2007

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**



Preface to Reports Concerning Annually Inspected Firms

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements and of internal control over financial reporting. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these 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 previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in different years.



During 2006, the Board's inspection process focused on how efficiently the annually inspected U.S. firms performed audits in the second year of implementation of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* ("AS No. 2"). As described in Appendix B to this report, the inspection process occurred at three levels: (1) meetings with senior firm leadership, (2) national office inspection procedures, and (3) inspection procedures for audits of accelerated filers. In general, the Board's inspection teams observed that the firms achieved increased efficiencies as compared to the first year of implementation of AS No. 2. Nonetheless, the Board's inspection teams believed that, in many of these engagements, there were additional opportunities for the auditors to achieve efficiencies in the implementation of AS No. 2. Those observations have been discussed with the firms, and the Board expects that those discussions are contributing to changes to methodology, additional firm training and guidance, and more rigorous discussions with issuers about ways in which firms and issuers can work together to make audits more efficient.



Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



2006 INSPECTION OF PRICEWATERHOUSECOOPERS LLP

In 2006, the Board conducted an inspection of PricewaterhouseCoopers LLP ("PwC" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix B, and portions of Appendix C. Appendix B provides an overview of the inspection process. Appendix C includes the Firm's comments, if any, on a draft of the report.^{1/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{2/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

^{1/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report. 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.

^{2/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") performed an inspection of the Firm from May 2006 through January 2007. The inspection team performed field work at the Firm's National Office and at 22 of its approximately 63 U.S. practice offices.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{3/} To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix B to this report provides a description of the steps the inspection team took with respect to the review of audits of financial statements and of internal control over financial reporting and the review of eight functional areas related to quality control.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{4/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

^{3/} This focus 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.

^{4/} When the Board becomes aware 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 GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits of financial statements and of internal control over financial reporting performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process. In most cases, the review of the audit of an accelerated filer included a review of aspects of both the Firm's audit of financial statements and its audit of internal control over financial reporting ("ICFR").

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies.^{5/} Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3") 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.^{6/} For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the

^{5/} 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.

^{6/} See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28.

deficiencies to the firm's present ability to support its previously expressed opinions,^{7/} and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers, and in some instances, follow-up between the Firm and the issuer led to a change in the issuer's accounting or disclosure practices or led to representations related to prospective changes.^{8/}

In some cases, 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 competent evidential matter to support its opinion on the issuer's financial statements. The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis.

Issuer A

As described below, in this audit, the Firm failed to adequately test mortgage servicing rights and their amortization.

- The Firm failed to appropriately test whether the issuer's impairment analysis regarding mortgage servicing rights complied with Statement of Financial Accounting Standards ("SFAS") No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS No. 140 requires that mortgage servicing rights be stratified according to their predominant risk characteristics for purposes of evaluating impairment. The issuer included over 90 percent of its mortgage servicing rights in one stratum (sub-prime loans). Despite the fact that the loans underlying the mortgage

^{7/} See AU 390, *Consideration of Omitted Procedures After the Report Date*, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T), and PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* ("AS No. 2"), ¶ 197.

^{8/} The Board inspection process generally did not include review of such additional procedures or documentation, or of such revised accounting, although future Board inspections of the Firm may, as appropriate, include further review of any of these matters.

servicing rights in that stratum displayed varying risk characteristics, such as including fixed rate, variable rate, and hybrid mortgages and being collateralized by properties located in every state, the Firm accepted the issuer's approach.

- The Firm failed to resolve potential audit differences, representing approximately six percent of pre-tax income, that it had identified in the Firm's assessment of the issuer's accounting for the amortization of mortgage servicing rights.
- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the data and assumptions that the issuer had used to support a change in the estimated period for the amortization of mortgage servicing rights.
- The Firm failed to perform substantive procedures to test the data and assumptions underlying the amortization expense for the first three quarters of the year. Further, in its fourth quarter testing, the Firm failed to test certain key inputs to the amortization calculation, such as the weighted average lives of the underlying loans and the carrying values of the mortgage servicing rights.

Issuer B

The issuer operates in many different industry segments and has numerous reporting units, many of which are individually insignificant and/or use different computer and internal control systems. The Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- Regarding the issuer's largest industry segment, the Firm identified deficiencies in all of the controls that the issuer had identified as key controls over certain assertions relating to significant portions of revenue. In many of those areas, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered how the identified deficiencies should have affected its assessment of control risk and the nature, timing, and extent of its substantive procedures.
- The Firm failed to perform sufficient procedures to test consolidated revenues. In addition to the matters described in the preceding paragraph,

which related to revenue and related areas, the Firm failed in the following respects –

- The Firm failed, for certain of the reporting units in the issuer's largest industry segment where the Firm performed testing, to properly design and execute tests of internal controls and substantive tests and to properly evaluate the results of those tests. Examples of failures at certain reporting units include the following:
 - The control activity selected for testing did not address the financial statement assertion for which the Firm planned to rely on controls, and therefore the test work performed on the control activity did not support reliance on controls for that assertion.
 - The test procedures did not relate to, or test, the selected control activity.
 - The Firm failed to sufficiently test whether revenue was recognized in the proper period.
 - The Firm failed to perform substantive audit procedures on certain critical estimates inherent in the accounting for long-term contracts.
 - The Firm failed to perform procedures on loss contracts.
 - The Firm failed to apply appropriate sampling techniques in its tests of details for revenue. For example, in some cases, it tested only a portion of the items it had selected for testing, and/or it did not consider the implications of certain of the errors it had identified.
- With respect to certain of the reporting units in the issuer's largest two industry segments where the Firm did not perform substantive procedures to test revenue – units that accounted for a significant amount of the consolidated revenue – there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered whether, in view of the matters described above, it needed to perform substantive tests of revenues.
- The Firm failed to reconcile the financial statement amounts audited by certain of its foreign affiliates to the information underlying the consolidated financial statements.

Issuer C

In this audit, the Firm failed to perform sufficient procedures to test accounts receivable. For one of the issuer's segments, the Firm requested confirmation of certain receivables that it selected based upon their size and age. For those returned confirmations on which there were differences, the Firm failed to investigate the differences beyond comparing the recorded amounts with the purchase orders and shipping documents that were in the issuer's possession. Further, the Firm failed to consider the effects of these unresolved differences on the portion of the population that was not subject to confirmation. In addition, for the portion of the accounts receivable that was not subject to confirmation, which represented 85 percent of the account balance, the Firm's planned substantive testing was limited to analytical procedures that covered the entire balance. As executed, however, these procedures did not qualify as substantive tests, as the Firm failed to establish precise expectations, set a threshold that would identify a potential material misstatement, and obtain corroboration of management's explanations of certain significant differences.

Issuer D

In this audit, the Firm failed to sufficiently test certain assumptions that management used in its goodwill impairment test. Specifically, the issuer projected significant revenue growth rates and operating profit margins with respect to the segment to which the goodwill was allocated. Although the segment's actual revenue growth rates in the prior three years were either flat or negligible, and the operating profit margins ranged from negative amounts to amounts below those projected, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the appropriateness of the projections, other than by making inquiries of management.

Issuer E

In this audit, the Firm relied on the issuer's inventory cycle count process without appropriately testing the operating effectiveness of the cycle count controls or testing the cycle count procedures. For example, although the Firm relied on the cycle count controls to function effectively throughout the year, the Firm's observation and concurrent testing of the cycle counts was limited to one cycle count of finished goods during the fourth quarter at three of the six inventory sites. The Firm did not observe and test any counts of an important component of finished goods, nor did it observe and test any cycle counts of the raw materials and work in process, which have different risks and controls and which constituted a majority of the issuer's inventory at year end.

Issuer F

In this audit, the Firm relied on the issuer's inventory cycle count process without appropriately evaluating the design of the cycle count controls or testing the cycle count procedures. For example, the Firm failed to test the issuer's cycle count process to evaluate whether all inventory items were subject to cycle counting and whether the reports that were used in the process were complete and accurate. In addition, the Firm observed and concurrently tested only a single cycle count, although the Firm relied on this control to function effectively throughout the year.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following eight functional areas: (1) tone at the top; (2) practices for partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances, and arrangements; personal financial interests; and commissions and contingent fees; (4) practices for client acceptance and retention; (5) practices for consultations on accounting, auditing, and SEC matters; (6) the Firm's internal inspection program; (7) practices for establishment and communication of audit policies, procedures, and methodologies, including training; and (8) the supervision by U.S. audit engagement teams of the work performed by foreign affiliates on foreign operations of U.S. issuer audit clients. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

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

APPENDIX B

THE INSPECTION PROCESS

The inspection process was designed and performed to provide a basis for assessing the degree of compliance of the Firm with applicable requirements and standards related to auditing issuers. This process included reviews of components of selected issuer audit engagements completed by the Firm. These reviews were intended both to identify deficiencies, if any, in the conduct of those audits and to determine whether the results of those audits indicated deficiencies in the design or operation of the Firm's system of quality control over audits. In addition, the inspection included reviews of the design of, and in some cases the application of, policies and procedures related to certain functional areas of the Firm that could be expected to influence audit quality.

1. Review of Selected Audit Engagements

The inspection team reviewed aspects of selected audits performed by the Firm. The inspection team chose the engagements according to the Board's criteria. The Firm was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review.

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and, at the practice offices, inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenues, reserves or estimated liabilities, derivatives, income taxes, related party transactions, supervision of work performed by foreign affiliates, and assessment of risk by the audit team. The inspection team also analyzed potential adjustments to the issuer's financial statements that had been identified during the audit but not recorded in the financial statements. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other documentation, the inspection team issued a comment form on the matter and the Firm

provided a written response to the comment form. In certain instances, if the inspection team was unable to resolve the issue through these processes, the inspection team requested that the engagement team consult with the Firm's National Office. In many cases, this process resulted in resolution of the matter, either because the Firm agreed with the position the inspection team had taken and the Firm or the issuer took steps in light of the significance of the error to remedy the exception, or because the Firm was able to provide additional information that effectively addressed the inspection team's concerns.

2. Efficiency of Implementation of AS No. 2

The inspection team reviewed aspects of the Firm's approach to the implementation of AS No. 2 in light of the provisions of that standard and related Board statements.^{9/} Specifically, inspectors evaluated the Firm's approach to (1) integrating the audit of ICFR with the audit of the financial statements, (2) using a top-down approach to the audit, (3) using a risk-based approach, and (4) using the work of others.

The inspection procedures in this area began with the inspection team, along with senior staff in the Board's Division of Registration and Inspections and Office of the Chief Auditor, meeting with members of the Firm's leadership to hear the Firm's perspective on whether and how it had achieved efficiencies in ICFR audits. The inspection team then reviewed the Firm's methodology, tools, and training to determine if those methodology, tools, and training were designed to effectively achieve appropriate efficiencies. This evaluation was followed by a review of aspects of specific ICFR audits. For each audit of an accelerated filer that was the subject of an engagement review, the inspection team assessed the efficiency of the ICFR audit with respect to at least one of the four aspects identified above. The inspection team then met with members of the Firm's leadership to discuss observations from the specific engagement reviews and to provide other feedback relating to the Firm's methodology, tools, and training. The feedback was provided during the course of the inspection field work to facilitate the Firm's ability to use that feedback in ongoing and future ICFR audits.

^{9/} See PCAOB Release No. 2005-009, *Policy Statement Regarding Implementation of [AS No. 2]* (May 16, 2005); PCAOB Release No. 2005-023, *Report on the Initial Implementation of [AS No. 2]* (Nov. 30, 2005); see also Staff Questions and Answers, *Auditing Internal Control Over Financial Reporting* (May 16, 2005).

3. Review of Eight Functional Areas

The inspection team performed the review of the eight functional areas both to identify possible defects in the Firm's system of quality control and, where applicable, to update the Board's knowledge of the Firm's policies and procedures in the functional areas. A more detailed description of the scope with respect to each of the eight functional areas follows.

a. Review of Partner Evaluation, Compensation, Admission, Assignment of Responsibilities, and Disciplinary Actions

The inspection team reviewed the Firm's policies and procedures related to partner evaluation, partner compensation, nomination and admission of new partners, assignment of responsibilities, disciplinary actions, and termination of partners. The objective of the inspection procedures was to assess whether the design of these processes, as documented and communicated, could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm.

The inspection team interviewed members of the Firm's leadership at its National Office, as well as members of leadership and audit partners in practice offices, regarding these topics. In addition, the inspection team analyzed schedules provided by the Firm that detailed information on each partner, including the partner's office location and recent evaluation history. The inspection team also reviewed a sample of partners' evaluations, including evaluations of newly admitted partners, partners who resigned or took early retirement, and partners who received bonus compensation.

b. Review of Independence Policies

The objectives of the inspection procedures in this area included evaluating the Firm's policies and procedures relating to its compliance with independence requirements with respect to the provision of non-audit services to issuer audit clients; Firm participation in business ventures, alliances, and arrangements; commissions and contingent fee arrangements; personal financial interests and the relationships of Firm professionals with issuer audit clients; and the provision of non-audit services related to issuer audit clients' compliance with Section 404 of the Act. To accomplish these objectives, the inspection team reviewed the Firm's policies, procedures, guidance, and training materials pertaining to these independence matters. The inspection team also reviewed the Firm's internal inspection program as it relates to monitoring compliance with the Firm's independence policies and procedures; tested the Firm's independence

consultation process; and reviewed information concerning the Firm's existing business ventures, alliances, and arrangements, as well as the Firm's process for establishing such enterprises. The inspection team also interviewed numerous National Office and practice office personnel regarding the Firm's independence policies, practices, and procedures.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, reviewed relevant information to identify any non-audit services performed for the issuer, including whether any of the services involved commissions or contingent fee arrangements; to determine whether the fees for the services provided were classified appropriately in the issuer's proxy statement; and to determine whether the Firm was involved in any business ventures, alliances, or arrangements with the issuer. In addition, for the sample, the inspection team read and evaluated the most recent letter pursuant to Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*.

c. Review of Client Acceptance and Retention Policies

The objectives of the inspection procedures in this area were to evaluate whether the Firm's client acceptance and retention policies and procedures reasonably assure that it is not associated with issuers whose management lacks integrity, that it undertakes only engagements within its professional competence, and that it appropriately considers the risks involved in accepting and retaining clients in the particular circumstances. Toward those objectives, the inspection team reviewed the Firm's policies, procedures, and forms related to client acceptance and continuance; evaluated documentation related to new clients and to clients that had recently changed auditors from the Firm; and interviewed members of the Firm's leadership.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, evaluated whether the client acceptance or continuance documentation was completed and approved in accordance with Firm policies; interviewed the audit partners and managers on these engagements concerning the reasons for accepting the issuer as a client or continuing to serve the issuer, the approval process, and whether specific risk mitigation steps were performed and documented in response to any identified risks; and assessed whether the audit planning documentation incorporated the specific actions, if any, contemplated in response to any identified risks.

d. Review of Practices for Consultations

The objective of the inspection procedures in this area was to assess the Firm's compliance with professional requirements regarding consultations on accounting, auditing, and SEC matters. Toward this objective, the inspection team gained an understanding of and evaluated the Firm's policies and procedures relating to its consultation process. The inspection team also reviewed a sample of consultations that occurred during the inspection period to evaluate the effectiveness of the Firm's consultation process, the Firm's compliance with its policies and procedures, whether the conclusions were in accordance with professional standards, and whether the engagement teams acted in accordance with the conclusions.

e. Review of Internal Inspection Program

The objectives of the inspection procedures in this area were to evaluate the effectiveness of the Firm's annual internal inspection program in enhancing audit quality, as well as to assess the Firm's compliance with the quality control standards adopted by the Board. To meet those objectives, the inspection team reviewed policies, procedures, guidance, and forms related to the Firm's internal inspection program, documentation of the results of the current year's inspection program, and steps the Firm took in response to those results. The inspection team also interviewed the Firm's leadership concerning the process and effectiveness of its internal inspection program.

The inspection team reviewed and tested the conduct of the internal inspection program by performing reviews of certain engagements on which the Firm had conducted internal inspections. These procedures included evaluating the qualifications of the Firm's inspectors, reading the inspectors' comments, and interviewing both regional leadership and selected audit personnel concerning the internal inspection program. In addition, for a sample of engagements, the inspection team reviewed documentation of the internal inspectors' review, reviewed certain aspects of the audit work papers, and discussed with the Firm any significant differences in the results of the inspection team's review and those of the Firm's internal inspectors.

f. Review of Practices for Establishment and Communication of Audit Policies, Procedures, and Methodologies, Including Training

The objectives of the inspection procedures in this area were to update the inspection team's understanding of the Firm's processes for establishing and communicating audit policies, procedures, and methodologies, including training; to evaluate whether the design of these processes could be expected to promote audit

quality and enhance compliance; and to evaluate changes in audit policies that the Firm had made since the Board's most recent inspection of the Firm.

Toward those objectives, the inspection team reviewed documentation relating to the Firm's method for developing policies and procedures, as well as internal guidance and/or training materials distributed to audit personnel with respect to recent changes in requirements and with respect to selected specific areas. The inspection team also evaluated the effectiveness of the design of the Firm's processes for monitoring developments that could affect the Firm's audit policies, procedures, and methodologies.

g. Review of Policies Related to Foreign Affiliates

The objective of the inspection procedures in this area was to evaluate the processes the Firm uses to ensure that the audit work that its foreign affiliates perform on the foreign operations of U.S. issuers is effective and in accordance with standards established by the Board. The inspection team did not inspect the audit work of foreign affiliates; rather, the inspection procedures in this area were limited to the supervision and control exercised by the U.S. engagement team over such work.

To accomplish this objective, the inspection team reviewed the Firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the foreign operations of U.S. issuer clients; analyzed audit guidance related to planning and administering multi-location engagements; and reviewed available information relating to the most recent foreign affiliated firms' internal inspections. In addition, the inspection team interviewed members of the Firm's leadership with responsibility for oversight of the work performed by foreign affiliates on foreign operations of U.S. issuer clients. Finally, with respect to a sample of the engagements reviewed, the inspection team reviewed the U.S. engagement team's supervision and control procedures concerning the audit work that the Firm's foreign affiliates performed.

h. Review of Tone at the Top

The objective of the review of the Firm's "tone at the top" was to assess whether actions and communications by the Firm's leadership demonstrate a commitment to audit quality and compliance with the Act, the rules of the Board, the rules of the SEC, and PCAOB standards in connection with the Firm's performance of audits, issuance of audit reports, and related matters involving issuers. Toward that end, the inspection team reviewed and analyzed information at the Firm's National Office. Such information

included the Firm's code of conduct; documents relating to measuring and monitoring audit quality; descriptions of the duties of, and relationships between and among, the Firm's staff and leadership; results of surveys of staff and clients; public company audit proposals; internal and external communications from management; and agendas and minutes of the Firm's Board of Partners. In addition, the inspection team interviewed numerous members of the Firm's leadership team.

The inspection team conducted interviews at 15 of the Firm's practice offices to obtain perspectives on communications from the Firm's leadership relating to audit quality and tone at the top. The inspection team interviewed members of the leadership at certain of these offices, as well as certain audit partners and senior managers assigned to engagements that were reviewed.

APPENDIX C

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.^{10/}

^{10/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

September 26, 2007

Mr. George H. Diacont
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006

**Re: PricewaterhouseCoopers LLP Response to Draft Report on 2006 Inspection of
PricewaterhouseCoopers LLP**

Dear Mr. Diacont:

We are pleased to provide our response on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Draft Report on the 2006 Inspection of our firm's 2005 audits (the "Report").

We strongly support the PCAOB's efforts. The on-going communication and interactions between the PCAOB Inspections Staff and our firm contribute to our overall efforts to execute consistent, quality audits. Fundamental to our view of audit quality is our conviction that, to perform a quality audit, each and every engagement must have a properly-balanced focus on effectiveness and efficiency. We continue to enhance our extensive training and our internal review processes in support of improved audit methodology and delivery. While our internal efforts continuously reinforce this view, we value the input from the PCAOB in this regard.

We have carefully assessed each of the Part I findings under our policies and under PCAOB standards and we have reassessed our work on each of the specific audits identified in *Part I - Inspection Procedures and Certain Observations* of your Report. We have concluded that, in each instance, our original procedures were sufficient to support our audit conclusions and the opinion rendered at the time. Provided below are additional comments regarding the specific audit engagements discussed in Part I of the 2006 Report:

Issuer A

In connection with addressing the PCAOB's comments on this engagement, we have reassessed the issuer's underlying accounting. In our judgment, the issuer's accounting for mortgage servicing rights and related amortization is acceptable under the applicable authoritative literature. With respect to the PCAOB comments on our audit work, in our judgment the audit procedures originally performed by us were sufficient to support our audit opinion. We have, however, enhanced certain of the documentation in our audit work papers, including with regard to the "potential audit differences" discussed in the Report to reflect our conclusion that such matter did not in fact constitute an audit adjustment.

Mr. George H. Diacont
September 26, 2007
Page 2

Issuer B

We believe it is important to place the PCAOB comments in the proper context in order to recognize that the comments deal principally with a single audit area (revenue) within a single business unit of the issuer. In our judgment, virtually all of this business unit's revenue transactions were not considered complex, and the portion that were considered complex and, therefore, higher risk, comprised a small percentage of consolidated revenues.

We have re-evaluated the relevant audit work performed in this area, in the context of our respective risk assessments, and have concluded that the opinion originally rendered on the consolidated financial statements was appropriate and that there was no need to perform any additional audit procedures. However, we acknowledge that aspects of the work performed in auditing this area for this business unit could have been enhanced and more fully documented.

In addition, the comment within the Report indicating that we had "identified deficiencies in all of the key controls that the issuer had identified" is factually incorrect. Rather, within this business unit, a majority of the key controls were not considered deficient.

With respect to the last matter described in this aspect of the Report, in our judgment the audit procedures performed to reconcile the amounts audited to the consolidated financial statements were sufficient and responsive to our risk assessment, and we believe that our procedures, including the testing of the issuer's controls, support the audit opinion rendered by us.

Issuer C

Our engagement team concluded at the time of the original audit work that the potential impact of the confirmation differences described in the Report could not be material to the consolidated financial statements. Further, it is our judgment that the audit evidence obtained from the substantive analytic procedures was sufficient in the context of our risk assessment and overall top-down, risk-based approach to this audit. Accordingly, we concluded that the procedures performed support the opinion rendered by us.

Issuer D

We believe as a matter of professional judgment that the audit procedures originally performed were responsive to our risk assessment and also to the results of our testing of the issuer's internal controls over both its forecasting and impairment assessment processes. The level of testing of a forecasting process in the context of a goodwill impairment test is a matter of audit judgment. As noted above, we concluded that the procedures originally performed support the opinion rendered by us.



Mr. George H. Diacont
September 26, 2007
Page 3

Issuers E and F

In our judgment, the nature and extent of our testing was sufficient given our risk assessments and the entirety of the inventory testing performed at the time of the audit. For each of these issuers, we performed a top-down, risk-based assessment in planning and conducting the audit. Our cumulative audit knowledge demonstrated that, historically, highly-effective internal controls over physical inventory were in place. Therefore, as noted above, we concluded that the procedures which had been performed supported the opinion rendered by us.

We take seriously the matters identified by the PCAOB during the 2006 inspection process. As with any audit process, judgments are necessarily involved in the PCAOB's inspections. We recognize that your findings and comments are offered in a constructive context. We have carefully reviewed all of the matters included within your 2006 Report, and will fully consider your findings and recommendations.

We appreciate this opportunity to formally respond to the PCAOB's 2006 Inspection Report and look forward to continuing to work with the PCAOB in support of our unwavering commitment to audit quality. We would be pleased to discuss any aspect of our response or any questions you may have.

Sincerely,

PricewaterhouseCoopers LLP