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Report on

2012 Inspection of McGladrey LLP
(Headquartered in Chicago, Illinois)

Issued by the

Public Company Accounting Oversight Board

February 27, 2014

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

PCAOB RELEASE NO. 104-2014-064

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2012 INSPECTION OF MCGLADREY LLP

Preface

In 2012, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm McGladrey LLP[1/] ("McGladrey" or "the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").[2/]

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. The inspection process included reviews of aspects of selected issuer audits completed by the Firm. The reviews were intended to identify whether deficiencies existed in those aspects of the audits, and whether such deficiencies indicated defects in the Firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The issuer audits and aspects of those audits inspected were selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in this report are not necessarily representative of the Firm's issuer audit practice.

The Board is issuing this report in accordance with the requirements of the Act.[3/] The Board is releasing to the public Part I of the report and portions of Appendix B. Appendix B includes the Firm's comments, if any, on a draft of the report. 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.

1/ The Firm has issued audit reports under the name of McGladrey & Pullen, LLP.

2/ The Act requires the Board to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers.

3/ In its *Statement Concerning the Issuance of Inspection Reports*, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from September 2012 through December 2012. The inspection team performed field work at the Firm's National Office and at nine of its approximately 74 U.S. practice offices.[4/]

A. Review of Audit Engagements

The 2012 inspection of the Firm included reviews of aspects of 16 audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

The inspection team considered certain of the deficiencies that it observed to be audit failures. As used in PCAOB inspection reports, the term "audit failure" refers to a circumstance where the inspection team identified one or more deficiencies in an audit that were of such significance that it appeared that the Firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting ("ICFR"). The audit deficiencies that reached this level of significance are described below.[5/]

[4/] This represents McGladrey's total number of practice offices; however, approximately 33 of the Firm's practice offices have primary responsibility for issuer audit clients. At the time of the inspection, the Firm's National Offices were located in Bloomington and Minneapolis, Minnesota.

[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. 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.

A.1. Issuer A

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 –

- Goodwill impairment indicators were identified for two of the issuer's reporting units. The issuer engaged an external specialist to assist the issuer in performing step one of the annual two-step impairment test of goodwill. In testing the issuer's evaluation of goodwill for impairment, the Firm failed to perform sufficient procedures to test the revenue forecasts and evaluate the growth rate assumptions used by the issuer in determining the fair value of the two reporting units. Specifically, the Firm's procedures were limited to a high-level review of the methodology and assumptions used in the forecast, and inquiry of management.

- The issuer had identified deficiencies in three controls related to revenue. The Firm performed no procedures to test those controls or a fourth control related to revenue, instead relying on a procedure performed by the issuer that was not a control test and that did not test whether the control deficiencies had been remediated or whether any compensating controls had a mitigating effect with respect to the deficiencies.

A.2. Issuer B

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 provided no allowance for loss on a past due trade account receivable from a related party collateralized by shares of the issuer's stock owned by the related party. The Firm failed to perform sufficient procedures to determine whether the issuer's valuation of the receivable complied with the requirements of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 310, *Receivables*. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm considered whether the receivable was a collateral-dependent loan and therefore whether it was appropriate to measure impairment of the receivable based on the fair value of the collateral.

- The issuer recorded inventory and cost of sales using an average cost method based on the total weight of the inventory that was estimated using growth rates and the amount of raw materials consumed. The Firm failed to evaluate the reasonableness of the growth rates and test beyond inquiry the amount of raw materials consumed.

- The Firm failed to test the accuracy and completeness of system-generated data and reports used in testing the issuer's inventory and cost of sales.

A.3. Issuer C

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

- The Firm failed to perform sufficient procedures to test the loss on the effective settlement of a pre-existing service contract between the issuer, as acquirer, and an acquiree in a business combination. Specifically, the Firm's procedures to test the issuer's revenue forecast, which was used to estimate the amount by which the contract was favorable from the perspective of the issuer when compared with pricing for current market transactions for similar items, included a comparison of the revenue growth rates used by the issuer to the rate of equity appreciation in a selected index over the most recent 60-year period; however, the Firm failed to perform procedures to evaluate whether the use of the index and the 60-year period were relevant to the issuer's revenue forecast.

- The Firm failed to perform sufficient procedures to test the fair value of a customer list acquired in a business combination. Specifically, the Firm failed to evaluate the issuer's revenue growth rate assumptions and test the operating expense forecasts. In addition, the Firm reviewed selected historical information and market data of comparable companies, but failed to evaluate the wide range of data obtained and the effect it had on the reasonableness of the assumptions used by the issuer in its valuation.

A.4. Issuer D

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

- The Firm failed to perform sufficient procedures to test the issuer's revenue recognized under the percentage-of-completion method of accounting. Specifically, the Firm used system-generated reports to test the revenue recognized by the issuer using the percentage-of-completion method and failed to test the accuracy and completeness of all reports.

- The Firm failed to perform sufficient procedures to test the fair value of intangible assets acquired in a business combination. Specifically, the Firm's evaluation of the growth rate assumptions used in the revenue forecast to value the intangible assets was limited to comparing the growth rates used to historical growth rates derived from unaudited revenue amounts that were volatile and significantly different from the forecasted growth rates.

A.5. Issuer E

In this audit, the Firm failed to perform sufficient procedures to test the issuer's general reserve component of the allowance for loan losses ("ALL"). The Firm assessed inherent risk and control risk as high for valuation of the ALL. As a result of concluding that the issuer's support for the qualitative sub-component of the general reserve was inadequate, the Firm chose to develop an independent estimate of the qualitative reserve. The Firm failed to perform sufficient procedures to obtain a reasonable basis for its independent estimate. Specifically, although the Firm identified individual factors such as local economic conditions, collateral valuations, past due and problem loans, and portfolio growth, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm performed procedures to apply these individual factors to determine its estimate of the overall qualitative reserve.

A.6. Issuer F

In this audit, the Firm failed to perform sufficient procedures to test the valuation of the issuer's debt instruments without readily determinable fair values. The Firm assessed inherent risk as high and control risk as low for the valuation of investments.

The issuer used internal valuation models to estimate the fair values of debt instruments using borrower-specific financial data and other unobservable inputs. The Firm failed to test the accuracy and completeness of the issuer's borrower-specific financial data. In addition, the Firm failed to evaluate the reasonableness of the yield spreads used by the issuer to determine the fair value of the debt instruments.

A.7. Issuer G

In this audit, the Firm failed to perform sufficient procedures to test the issuer's revenue and cost of sales recognized using the percentage-of-completion method of accounting. The Firm assessed inherent risk and control risk as high for the valuation of revenue recognized under the percentage-of-completion method. The Firm's testing of the issuer's foreign subsidiary's revenue and cost of sales involved testing one contract by recalculating the contract's percentage-of-completion calculation and comparing one job cost item, which composed less than one percent of the foreign subsidiary's revenue and cost of sales for the year, to supporting documentation.

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which the Firm failed to comply with the requirement to obtain sufficient appropriate evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable accounting principles, and/or for its opinion concerning whether the issuer maintained, in all material respects, effective internal control over financial reporting. Each deficiency relates to several applicable standards that govern the conduct of audits.

AU Section 230, *Due Professional Care in the Performance of Work* ("AU 230") requires the independent auditor to plan and perform his or her work with due professional care. AU 230 and Auditing Standard ("AS") No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), specify that due professional care requires the exercise of professional skepticism. This is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13 requires the auditor to design and implement audit responses that address the identified risks of material misstatement, and AS No. 15, *Audit Evidence* ("AS No. 15") 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 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 support of the related conclusions.

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* ("AS No. 5") and AS No. 13 establish requirements regarding testing and evaluating internal control over financial reporting. In an audit of internal control over financial reporting in an integrated audit, AS No. 5 requires the auditor to plan and perform the audit to obtain appropriate evidence that is sufficient to support the auditor's opinion on internal control over financial reporting as of the date of that opinion. AS No. 13 requires that, if the auditor plans to assess control risk at less than the maximum and to base the nature, timing, and extent of substantive procedures on that lower assessment, the auditor must obtain evidence that the controls tested were designed and operating effectively during the entire period for which the auditor plans to rely on controls to modify the substantive procedures.

The deficiencies described in Part I.A of this report relate to one or more of the provisions referenced above, and in many cases also relate to the failure to perform, or to perform sufficiently, certain specific audit procedures that are required by other applicable auditing standards. The table below lists the specific auditing standards that are primarily implicated by the deficiencies identified in Part I.A of this report. The broadly applicable aspects of AS No. 5, AS No. 13, AS No. 15, and AU 230 discussed above are not repeated in the table below.[6/]

PCAOB Auditing Standards	Issuers
AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	A
AS No. 15, *Audit Evidence*	B, C, D, and G
AU 328, *Auditing Fair Value Measurements and Disclosures*	A, C, D, and F
AU 342, *Auditing Accounting Estimates*	B and E

[6/] This table does not necessarily include reference to every auditing standard that may have been implicated by the deficiencies included in Part I.A.

C. General Information Concerning PCAOB Inspections

Board inspections are designed to identify whether weaknesses and deficiencies exist related to how a firm conducts audits and to address any such weaknesses and deficiencies. To achieve that goal, inspections include reviews of certain aspects of selected audit work performed by the Firm and reviews of certain aspects of the Firm's quality control system. The focus on weaknesses and deficiencies 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 and potential deficiencies should not be construed as an indication that the Board has made any determination about other aspects of the firm's systems, policies, procedures, practices, or conduct not included within the report.

The inspection team selects the audits and aspects to review, and the Firm is not allowed an opportunity to limit or influence the selections. In the course of reviewing aspects of selected audits, the inspection team may identify matters that it considers to be deficiencies in the performance of the work it reviews. Those deficiencies may include failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[7/] as well as failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures. 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 audit work, or the relevant issuers' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

[7/] 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 applicable accounting principles, 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.

If the Board inspection team identifies deficiencies that exceed a certain significance threshold in the audit work it reviews, those deficiencies are summarized in the public portion of the Board's inspection report. The Board cautions, however, against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout the Firm's practice. Audit work is selected for inspection largely on the basis of an analysis of 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.

In some cases, the conclusion that a 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 claimed to have performed the procedure. AS 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.

Inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. 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 deficiencies 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.[8/]

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 processes related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas: (1) management

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[8/] The inspection team may review, either in the same inspection or in subsequent inspections, the adequacy of the firm's compliance with these requirements. 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.

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 clients, 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 audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control.

END OF PART I

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

APPENDIX B

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[1/]

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

McGladrey LLP

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January 17, 2014

Ms. Helen A. Munter
Director, Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
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Re: Response to the Public Company Accounting Oversight Board (PCAOB)
Draft Report on 2012 Inspection of McGladrey LLP

Dear Ms. Munter:

We are pleased to provide our response to Part I of the PCAOB's Draft Report on the 2012 Inspection of McGladrey LLP dated December 20, 2013 ("Draft Report").

We support the PCAOB's inspection process and believe that it helps us enhance the quality of audit engagements. McGladrey LLP is committed to using the inspection comments and observations to improve our system of quality controls. We have a long history of audit quality founded on our commitment to integrity, objectivity and excellence.

We have evaluated the matters identified in Part I of the Draft Report and have taken appropriate actions to address the findings in accordance with PCAOB auditing standards and our policies.

We appreciate the opportunity to provide our response to the Draft Report and remain committed to working with the PCAOB to improve audit quality.

Very Truly Yours,

McGladrey LLP

McGladrey LLP