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Report on

2013 Inspection of PricewaterhouseCoopers LLP

(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

June 19, 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. 104-2014-102

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2013 INSPECTION OF PRICEWATERHOUSECOOPERS LLP

Preface

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm PricewaterhouseCoopers 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.C of this report (which also contains additional information concerning the PCAOB inspections generally). Overall, the inspection process included reviews of portions of selected issuer audits completed by the Firm. These reviews were intended to identify whether deficiencies existed in those portions of the inspected audits, and whether such deficiencies indicated defects or potential 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 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 C, and Appendix D. Appendix C includes 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.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1/] for the inspection from December 2012 through November 2013. The inspection team performed field work at the Firm's National Office and at 33 of its approximately 69 U.S. practice offices.

A. Review of Audit Engagements

The 2013 inspection of the Firm included reviews of portions of 57 audits performed by the Firm and reviews of the Firm's audit work on two other issuer audit engagements in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. Four of the deficiencies relate to auditing aspects of an issuer's financial statements that the issuer restated after the primary inspection procedures.[2/] In addition, for five of the audits described below, the Firm revised its opinion on the effectiveness of the issuer's internal control over financial reporting ("ICFR") to express an adverse opinion or the issuer subsequently disclosed that there was a previously undisclosed material weakness as of the date of the Firm's opinion on ICFR.

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

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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 inspection planning, which may commence months before the primary procedures, and inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

[2/] The Board's inspection process did not include review of any additional audit work related to the restatement.

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

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

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

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

[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

The audit deficiencies that reached this level of significance are described below.

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 –

- The Firm failed to perform any procedures to test controls over the selection of the method of accounting for certain long-term contracts and failed to evaluate the appropriateness of the issuer's method of accounting for those contracts. (AS No. 5, paragraph 39; AS No. 12, paragraph 12)

- The Firm determined the scope of its procedures for the audits of the financial statements and the effectiveness of ICFR based on a materiality level that was too high under the circumstances. Specifically, the Firm, relying on its analysis of the issuer's earnings over the past seven years, determined to use the materiality level it had used in the prior year's audit; however, it failed to establish, in light of a significant decline in earnings from the beginning to the end of the seven years, that the issuer's earnings during that period constituted a reasonable basis for determining materiality. (AS No. 11, paragraph 6)

- The Firm failed to sufficiently evaluate deficiencies it had identified in the effectiveness of certain controls. Specifically –

  - The Firm identified multiple control deficiencies, at one location, related to certain significant accounts and determined that these deficiencies were significant deficiencies. The Firm also identified several control deficiencies related to these accounts at other locations. The Firm failed to evaluate whether the deficiencies at all

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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 the inspections staff may include in its procedures monitoring or assessing a firm's compliance.

locations in combination constituted a material weakness. (AS No. 5, paragraphs 62 and 65)

- The Firm identified compensating controls relating to these deficiencies, but failed to sufficiently test certain of the compensating controls. Specifically, for these compensating controls, the Firm limited its testing to determining that variances were identified, obtaining evidence of review, and attending a small number of meetings that constituted a part of the operation of one of the controls, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and 68)

- During the year, the issuer completed the acquisition of a significant business. The Firm's testing related to the accounting for the business combination was deficient in the following respects –

  - The Firm selected for testing certain controls over the accounting for business combinations; however, it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that reviews that constituted a part of these controls had occurred and, for some controls, obtaining underlying documentation, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

  - The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions and test certain data that the issuer used in (1) determining the fair values of acquired assets and (2) allocating the resulting goodwill to its business units. Specifically, for certain of these assumptions and data, the Firm limited its procedures to inquiring of management and, in some cases, comparing the assumptions or data to untested data provided by the issuer. For other assumptions and data, the Firm performed no procedures. (AU 328, paragraphs .26, .28, and .39)

- The Firm's procedures related to the issuer's analyses of the possible impairment of goodwill and other indefinite-lived intangible assets were insufficient. Specifically –

    - The Firm selected for testing certain controls over the issuer's annual analyses of the possible impairment of goodwill and other indefinite-lived intangible assets (including controls over the issuer's budgeting and forecasting process), but it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that the analyses and budget were reviewed, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

    - The issuer performed qualitative assessments to evaluate its goodwill and other indefinite-lived intangible assets for possible impairment, except for one reporting unit for which the issuer decided to perform a quantitative assessment without first performing a qualitative assessment. The Firm's procedures related to the issuer's qualitative and quantitative assessments for certain reporting units were insufficient. Specifically –

        - The Firm failed to evaluate the reasonableness of certain significant assumptions and test certain data that the issuer used in its qualitative assessment of goodwill for one reporting unit and in its qualitative assessment of other indefinite-lived intangible assets for two reporting units. In addition, the Firm failed to consider whether recent declining cash flows should have been evaluated as negative factors in the qualitative assessments of goodwill and other indefinite-lived intangible assets. (AS No. 14, paragraph 3; AU 342, paragraph .11)

        - The Firm failed to evaluate the reasonableness of certain significant assumptions and test certain data that the issuer used in its quantitative assessment of goodwill for one reporting unit. (AU 328, paragraphs .26, .28, and .39)

- The Firm's procedures related to the valuation of deferred tax assets were insufficient. Specifically –
  - The Firm selected for testing one control over the valuation of deferred tax assets; however, the Firm's procedures to test that control were insufficient. Specifically, the Firm's procedures were limited to obtaining evidence that a review had occurred, reading memoranda prepared as a part of the control, and inquiring of management, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
  - The Firm failed to evaluate the reasonableness of a significant assumption that the issuer used to determine the recoverability of a significant deferred tax asset. (AU 342, paragraph .11)

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's tests of controls over significant categories of revenue were insufficient. Specifically –
  - For certain categories of revenue that represented a substantial portion of total revenue, the Firm failed to test any controls over the input of customer pricing agreements in the issuer's system. For another category of revenue, the Firm selected for testing a control over customer pricing agreements, but failed to test an important attribute of the control related to whether the issuer's billings were in accordance with the agreements. (AS No. 5, paragraphs 39, 42, and 44)
  - The Firm selected for testing certain review controls over two categories of revenue and over customer credits for another category of revenue, but its tests of these controls were insufficient. Specifically, the Firm's testing was limited to obtaining evidence

that the reviews had occurred, and, for one control, determining the control owner's threshold for investigation, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, the issuer used reports as part of the operation of certain of these review controls; the Firm, however, failed to test controls over the accuracy and completeness of one of the reports and limited its testing of controls over another report to observing management generating the report. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed to perform sufficient substantive procedures related to revenue. Specifically –
  - The Firm failed to perform any testing of certain categories of revenue that were significant in the aggregate. (AS No. 13, paragraphs 8 and 36)
  - The Firm failed to perform sufficient procedures to test the prices that the issuer charged its customers for certain other categories of revenue. Specifically, for a majority of the transactions that it selected for price testing, the Firm limited its procedures to inquiring of management and obtaining subsequent payment information. (AS No. 13, paragraph 8)
  - The Firm designed its substantive procedures for one category of revenue based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls. Specifically, the Firm failed to identify and test any controls over quantities billed to customers for this revenue. As a result, the sample size the Firm used to test this revenue was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19 and .23)
  - The Firm failed to perform any procedures to test (1) the appropriateness of recorded credit adjustments to revenue and (2) whether revenue recorded near year end was recorded in the appropriate period. (AS No. 13, paragraphs 8 and 36)

- The Firm's procedures related to the issuer's accounting for a business combination were insufficient. Specifically –
  - The Firm failed to identify and test any controls over the accuracy of the data and reasonableness of the assumptions that the issuer used in the valuation of the acquired assets. (AS No. 5, paragraph 39)
  - The Firm selected for testing a control consisting of the review and approval of acquisitions before they were recorded, but it failed to sufficiently test the control. Specifically, the Firm limited its testing to obtaining evidence that the review had occurred and reading certain documents used in the performance of the review, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements related to the accounting for business combinations. (AS No. 5, paragraphs 42 and 44)
  - The Firm failed to evaluate the reasonableness of certain significant assumptions used in determining the fair values of certain acquired intangible assets. (AU 328, paragraphs .26 and .28)
- The Firm's procedures related to the valuation of inventory were insufficient. Specifically –
  - The Firm selected for testing two review controls over the valuation of inventory; however, it failed to sufficiently test these controls. Specifically, the Firm's testing was limited to obtaining evidence that the reviews had occurred and identifying certain aspects of the review process, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, for one of these controls, the Firm failed to test any controls over the accuracy and completeness of a system-generated report that the issuer used in the performance of the control. (AS No. 5, paragraphs 39, 42, and 44)
  - The Firm selected for testing an automated control over the processing of payments for inventory purchases, but it failed to

sufficiently test this control. Specifically, the Firm limited its testing to verifying that the system would not process an invoice with invalid data for one data field, but it failed to test whether payments would be processed if inconsistencies or errors in other important data fields occurred. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to identify and test any controls over the issuer's evaluation of whether inventory was recorded at the lower of cost or market. (AS No. 5, paragraph 39)

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

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 effectiveness of ICFR –

- The Firm identified several financial statement misstatements and determined that two control deficiencies existed related to these misstatements. The Firm failed to perform sufficient procedures to evaluate the severity of the identified control deficiencies, individually and in combination. Specifically, although the Firm identified compensating controls for the control deficiencies, the Firm failed to consider that the compensating controls had not detected the misstatements, one of which exceeded the Firm's established level of materiality. (AS No. 5, paragraph 68)

- The Firm selected for testing certain controls over the accounting for business combinations; however, it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that reviews that constituted all or a part of the controls had occurred, testing the mathematical accuracy of certain supporting documents, and verifying that relevant accounting literature was considered. The Firm, however, failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

- The Firm's procedures to test controls over the issuer's accounting for discontinued operations were insufficient in the following respects –

    - The Firm selected for testing certain controls over the presentation and disclosure of discontinued operations, which consisted of the analysis and review of certain transactions and the review of the issuer's financial statements. The Firm, however, failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence of review, determining that explanations of variances were provided by management, and verifying that relevant accounting literature was considered. The Firm, however, failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

    - The issuer determined that certain assets reported in discontinued operations were impaired. The Firm selected for testing a control that included the review of the impairment analysis, but failed to sufficiently test the control. Specifically, the Firm's procedures were limited to obtaining evidence of review, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 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 Firm's procedures related to revenue and deferred revenue were insufficient. Specifically –

- The Firm failed in the following respects to sufficiently test certain controls over revenue and deferred revenue that it selected for testing –

    - For certain controls, the Firm limited its procedures to one or more of the following: interviewing the control owner to determine the accuracy of the control description or the types of issues that would be investigated, obtaining documents reviewed as part of the control, determining that certain issues were investigated (without determining how the issues were investigated or their resolution), performing its own reviews of certain information, and/or obtaining evidence of the issuer's review, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

    - The Firm failed to test certain important attributes of certain automated application controls. (AS No. 5, paragraphs 42 and 44)

    - The Firm failed to test any controls over the accuracy and/or completeness of system-generated data and reports that the issuer used in the performance of certain of the controls over revenue and deferred revenue. (AS No. 5, paragraph 39)

- The Firm failed to perform sufficient substantive procedures to test a significant category of revenue. Specifically, the Firm selected a sample of transactions from the general ledger, but limited its testing to comparing the recorded revenue to the related invoices. (AS No. 13, paragraph 8)

- The issuer used an external organization as part of its process to calculate deferred revenue related to its customer loyalty program, and the issuer provided certain data to the external organization for use in the calculation. The Firm's procedures to test the accuracy and completeness of the data, however, were not sufficient. Specifically, the Firm could not rely on controls over the data due to certain of the deficiencies in testing controls described above, and it failed to perform any substantive procedures to test the data. (AU 342, paragraph .11)

- The Firm's procedures related to a significant asset were insufficient. Specifically –
  - o The Firm selected for testing two controls consisting of the review by management and the board of directors of information related to determining the value of the asset; however, it failed to sufficiently test these controls. Specifically, the Firm limited its testing to reviewing documents that were prepared as part of the control and obtaining evidence of approval, without evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
  - o The Firm failed to sufficiently test the recoverability of the asset, as it failed to evaluate certain evidence that indicated the asset may not be recoverable. (AS No. 14, paragraph 3)
- The issuer asserted that earnings from its foreign subsidiaries were permanently reinvested outside of the U.S., and therefore did not include those earnings in the calculation of its deferred tax liabilities. The Firm's procedures related to the issuer's assertion were insufficient. Specifically, during the year, the issuer's foreign subsidiaries transferred a significant amount of cash to the U.S., but the Firm failed to evaluate whether the issuer's income tax controls included the evaluation of the potential tax consequences of those transfers. In addition, the Firm failed to perform any substantive procedures to test the cash transfers from the issuer's foreign subsidiaries to determine whether those transfers affected the issuer's assertion regarding permanent reinvestment. (AS No. 5, paragraph 39; AS No. 13, paragraph 8)

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

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 goodwill and other indefinite-lived intangible assets were insufficient. Specifically –

  - The Firm selected for testing a control that included the performance of analyses of the possible impairment of goodwill and other indefinite-lived intangible assets and the review of those analyses. The Firm failed to sufficiently test this control, as its procedures were limited to confirming that documentation of the analyses had been prepared and reviewed. In addition, the Firm referenced its substantive testing when addressing its evaluation of the effectiveness of the control. In none of these procedures, however, did the Firm test whether the control operated in a manner that would prevent or detect material misstatements.

    The Firm also selected for testing certain controls over the forecasts used in the analyses, including management's and the Board of Director's reviews of the financial plan, but it failed to sufficiently test these controls. Specifically, the Firm limited its procedures to obtaining evidence that such reviews had occurred and confirming that management compared information in certain documents used in the operation of the controls to supporting documents. The Firm, however, failed to test whether these controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and B9)

  - The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions that the issuer used in its analyses of the possible impairment of goodwill for certain reporting units. Specifically, the Firm limited its testing of the forecasts underlying the analyses to inquiring of management and, regarding only the next year, comparing the forecasts to budgeted amounts (without evaluating the reasonableness of the budget). (AU 328, paragraphs .26, .28, and .36)

  - The issuer performed a qualitative assessment to evaluate other indefinite-lived intangible assets for possible impairment. For intangible assets associated with certain reporting units, the issuer concluded that a quantitative impairment test was necessary. For each of these reporting units, the issuer performed a quantitative impairment test that combined goodwill and other indefinite-lived intangible assets. The Firm failed to identify, and to evaluate the effect on the financial statements of, the issuer's departure from Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Subtopic 350-30-35, *Intangibles-Goodwill and Other – General Intangibles Other Than Goodwill – Subsequent Measurement,* which specifies that other indefinite-lived intangible assets cannot be tested for possible impairment in combination with goodwill. (AS No. 14, paragraph 30)

  - The Firm failed to identify a significant mathematical error in the issuer's calculation of the fair value of one reporting unit in its quantitative impairment test, which resulted in the reporting unit's carrying value appearing to be less than its fair value, when it was not. In addition, and as a result of this failure, the Firm failed to evaluate (1) whether the error in the issuer's analysis of the possible impairment of goodwill resulted from a control deficiency and, if so, (2) the severity of that control deficiency. (AS No. 5, paragraphs 69 and B8; AU 328, paragraph .03)

- The Firm's procedures related to the valuation of certain intangible assets with definite lives were insufficient. Specifically, the Firm failed to identify and test any controls over the issuer's assessment of the recoverability of these assets. In addition, the Firm failed to evaluate evidence that suggested that these assets may not be recoverable. (AS No. 5, paragraph 39; AS No. 14, paragraph 3; AU 342, paragraph .04)

A.6. Issuer F

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

- The Firm's procedures related to revenue were insufficient. Specifically –

- o The issuer established pricing arrangements with its customers and entered the terms of those arrangements, as well as changes to those arrangements, in a database. Once a pricing arrangement or a change to a pricing arrangement was approved, the issuer entered the customer's prices into its accounting system. The Firm selected for testing a control that included the comparison of the prices in the database to those in the accounting system. The Firm, however, failed to test any controls over the consistency of the prices in the database or the accounting system with the pricing arrangements. (AS No. 5, paragraph 39)

- o The Firm's procedures to test a significant category of revenue used a combination of (1) a test of non-standard revenue transactions over a designated amount ("Test 1") and (2) a sample of standard revenue transactions ("Test 2") that was calculated based on the existence of Test 1. The Firm, however, inappropriately reduced its sample size for Test 2 because the type of transactions tested in Test 1 was not the same type as Test 2. (AS No. 13, paragraph 8; AU 350, paragraphs .21 and .23)

- o The Firm identified a deficiency in the operation of a control over rebates for one of the issuer's components, and it identified two controls that, in combination, the Firm asserted compensated for the deficiency. The Firm failed to sufficiently test one of these compensating controls. Specifically, the Firm limited its procedures to inquiring of management, reviewing meeting agendas, and obtaining evidence that certain adjustments were recorded, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and 68)

- The Firm failed to perform procedures, beyond inquiry of management, to test whether the issuer's inventory was valued at the lower of its cost or market. In addition, the Firm failed to identify and test any controls over the issuer's valuation of its inventory at the lower of its cost or market. (AS No. 5, paragraph 39; AS No. 12, paragraphs 4, 5, and 7; AS No. 13, paragraph 8)

A.7. Issuer G

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 failed to sufficiently test controls over the issuer's accounting for revenue, deferred revenue, unbilled revenue, and accounts receivable. Specifically –

    - The Firm failed to test any controls for certain significant categories of the issuer's revenue, deferred revenue, and unbilled revenue. (AS No. 5, paragraph 39)

    - The Firm selected for testing one control, an automated control, over the recording of certain revenue for one of the issuer's significant locations. The Firm failed to sufficiently test the operating effectiveness of this control because it performed its procedures in the issuer's information technology testing environment, which was different from the production environment that the issuer used to record the revenue. (AS No. 5, paragraph 44)

    - The Firm selected for testing certain controls over the issuer's allowance for doubtful accounts for two significant locations; however, it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that analyses were prepared and reviews had occurred, without determining whether the controls were designed to include a review of the reasonableness of the assumptions used to develop the allowance. (AS No. 5, paragraph 42)

- The Firm failed to perform sufficient substantive procedures to test revenue, deferred revenue, unbilled revenue, and accounts receivable. Specifically –

    - The Firm designed its procedures – including sample sizes – based on a level of reliance on controls that was excessive due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes the Firm used to test certain significant categories of revenue, deferred revenue, and accounts receivable were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

- o For the sample of transactions that the Firm selected to test one category of revenue, the Firm obtained evidence that customers were billed based on contractual terms without testing whether the related revenue was appropriately recognized. (AS No. 13, paragraph 8)

- o The Firm failed to evaluate the reasonableness of significant assumptions that the issuer used to develop the allowance for doubtful accounts. (AU 342, paragraph .11)

- The Firm's procedures related to the valuation of certain significant customer-relationship intangible assets were insufficient. Specifically, the Firm failed to identify and test any controls over the issuer's evaluation of the remaining useful lives of these assets. In addition, the Firm failed to evaluate whether the decrease in revenue for one of the issuer's reporting units and the loss of certain customers indicated that the remaining useful lives of certain of the intangible assets needed revision. (AS No. 5, paragraph 39; AS No. 14, paragraph 3; AU 342, paragraph .04)

A.8. <u>Issuer H</u>

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 –

- During the year, a reconsideration event occurred and the issuer reevaluated whether a significant variable interest entity ("VIE") should be consolidated. The Firm failed to sufficiently evaluate whether the issuer's conclusion not to consolidate the VIE was appropriate. Specifically, the Firm failed to perform procedures to test management's assertion that the rights the issuer received as a result of the event did not represent the power to direct the activities of the VIE that most significantly affected its economic performance, beyond inquiring of management, reading an issuer-prepared memorandum that did not address all of the relevant considerations required by generally accepted accounting principles ("GAAP"), and reading the underlying trust agreement. (AS No. 13, paragraph 8)

- The Firm failed to perform sufficient procedures to test the fair value measurements of, and the disclosures related to, the issuer's financial instruments without readily determinable fair values ("hard-to-value securities"), which consisted of non-agency residential mortgage-backed securities, commercial mortgage-backed securities, collateralized debt obligation securities, and other asset-backed securities. Specifically –

  - To test the issuer's fair value measurements of the hard-to-value securities, the Firm requested pricing information from pricing services for comparison to the issuer's recorded price.

    - The Firm failed to obtain an understanding of the specific methods and assumptions underlying the fair value measurements that were obtained from pricing services and used in the Firm's testing of the fair value of certain of the hard-to-value securities. (AU 328, paragraphs .26 and .40)

    - The Firm did not receive prices for a significant portion of the issuers' hard-to-value securities. For all but a small number of securities for which the Firm did not obtain prices, the Firm performed combinations of other procedures, consisting of obtaining information about the individual securities and the assumptions the issuer used to value some of them and comparing the issuer's price to that of the issuer's pricing service; the Firm, however, failed to evaluate, through these procedures, the appropriateness of the valuation methods and the reasonableness of the significant assumptions the issuer used to develop the fair value measurements for these securities. (AU 328, paragraph .26 and .28)

  - The Firm failed to sufficiently test the issuer's disclosure of hard-to-value securities as level 2 or level 3 in the fair value hierarchy set forth in FASB ASC Topic 820, *Fair Value Measurement*.

Specifically, the Firm failed to obtain an understanding of whether the securities were valued using significant inputs that were observable or unobservable. (AU 328, paragraph .43)

A.9. Issuer I

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

- For certain acquired impaired consumer loans, the issuer used historical data, consisting of actual loan prepayments, defaults, and losses, to develop certain assumptions related to estimated cash flows that were significant inputs into the allowance for loan loss ("ALL") calculation. The Firm identified a control that included the review of the accuracy of certain loan information, but failed to test an important attribute of the control that addressed the accuracy of the historical data described above. The Firm also did not perform any substantive procedures to test the accuracy of the data. (AS No. 5, paragraphs 42 and 44; AU 342, paragraph .11)

- With respect to its commercial loan portfolio, to develop a significant assumption used to estimate the ALL, the issuer selected a subset of its defaulted loans that had been resolved, calculated the loans' historical collateral recovery rates, and adjusted these rates using other information, such as data related to certain of the issuer's impaired loans and input obtained from its internal and external specialists. The Firm's control and substantive procedures related to the ALL for this portion of the issuer's loan portfolio were insufficient. Specifically –

    - The Firm selected for testing a control that included management's review of the appropriateness of the assumption; however, its testing of this control was insufficient. The Firm's procedures were limited to attending the meetings that constituted the operation of the control and inspecting data and reports that management reviewed in these meetings. The Firm, however, failed to determine whether the control sufficiently addressed the reasonableness of the inputs used to develop the assumption, as these procedures did not evaluate the level of precision of the control with respect to these inputs. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to test any controls over the completeness of the data from which the issuer selected loans to calculate the historical collateral recovery rates. (AS No. 5, paragraph 39)

- The Firm failed to perform sufficient substantive procedures to evaluate the reasonableness of the assumption. Specifically –

  - The Firm failed to perform any procedures to address the completeness of the population of loans from which the issuer selected loans to calculate the historical collateral recovery rates. (AU 342, paragraph .11)

  - The Firm failed to obtain evidence to establish that the subset of defaulted loans that the issuer used to calculate the historical collateral recovery rates was appropriate to form conclusions about the commercial loan portfolio. (AU 342, paragraph .11)

  - The Firm failed to test the accuracy and completeness, and/or evaluate the reasonableness, of the other information that the issuer used to develop the assumption. (AU 342, paragraph .11)

A.10. <u>Issuer J</u>

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

- The Firm failed to identify and appropriately address that the issuer had omitted required disclosures related to material changes in contract estimates. (AS No. 14, paragraph 31)

- The Firm identified a significant risk related to the recoverability of the issuer's goodwill. The Firm's tests of the forecasted cash flows, which the issuer used to determine the fair value for one of its reporting units for use in its analysis of the recoverability of goodwill, consisted of inquiring of management, comparing the forecasted information to the issuer's business plans and the previous year's forecast, and performing a sensitivity analysis. The Firm also compared the forecasted information for previous years to actual results, but the Firm's calculations in this comparison were incorrect and did not identify the significant variances between forecasted and actual results. The Firm's procedures were insufficient, as the Firm failed to consider the implications of evidence that appeared inconsistent with the issuer's projected revenue growth rates, including a significant decline in the reporting unit's revenue in recent years and shortfalls from previous forecasts. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, and .31)

- The Firm selected for testing certain controls over the issuer's accounting for business combinations, but failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to reading memoranda prepared by the issuer and the valuation report prepared by an external specialist, comparing the valuation report to supporting documentation, obtaining evidence of review of the valuation report, and inquiring of management. The Firm, however, failed to test whether the controls operated at a level of precision that would prevent or detect material misstatements related to business combinations. (AS No. 5, paragraphs 42 and 44)

A.11. <u>Issuer K</u>

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 the Firm's procedures related to a significant business combination were insufficient. Specifically –

- The Firm selected for testing one control over the issuer's accounting for the business combination, but its testing of this control was insufficient. Specifically, the Firm limited its procedures to inquiry of management, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and 50)

- The Firm failed to sufficiently test the fair value of the significant intangible assets acquired in the business combination. Specifically, the Firm failed to sufficiently test management's significant assumptions underlying the cash flow projections used to value these assets, as the Firm's procedures were limited to inquiring of management, obtaining certain projections prepared early in the prior year that related to product development, and comparing the cash flow projections used in the valuation to cash flow projections management had prepared before the business combination. (AU 328, paragraphs .26, .28, and .31)

A.12. Issuer L

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 issuer's analysis of the possible impairment of the revenue-generating long-lived assets were insufficient. Specifically, the Firm failed to test any controls over the reasonableness of the assumptions that the issuer used in its analysis of the possible impairment of these assets. In addition, in its analysis, the issuer used the same revenue and expense assumptions for each of the assets, and the Firm failed to consider evidence indicating that these assumptions should not have been the same. (AS No. 5, paragraph 39; AS No. 14, paragraph 3; AU 342, paragraphs .09 and .11)

A.13. Issuer M

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing a control over the issuer's accounting for business combinations. The control included the analysis of the transaction, the preparation and review of a memorandum summarizing the transaction, and the completion of a checklist. The Firm's testing of the control was not sufficient. Specifically, the Firm's procedures were limited to holding discussions with management, observing evidence that the review had occurred, and obtaining evidence that the checklist had been completed. In addition, the Firm referenced its substantive testing when addressing its evaluation of the effectiveness of this control. The Firm, however, failed to test, through any of its procedures, whether the control operated at a level of precision that would prevent or detect material misstatements related to the accounting for business combinations. (AS No. 5, paragraphs 42, 44, and B9)

A.14. Issuer N

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. During the year, through transactions that were accounted for as business combinations, the issuer acquired certain significant assets. The issuer recorded these assets at their fair values as of the acquisition date. To evaluate the reasonableness of the quantitative assumptions that management used to develop the fair value measurements, the Firm developed a wide range of values for each assumption, based on its market research, and compared the range to the relevant assumption. The Firm, however, failed to evaluate whether the market research it used to develop the ranges was based solely on assets that were comparable to the acquired assets and, therefore, it failed to support the reasonableness of the ranges. (AU 328, paragraphs .26 and .28)

A.15. Issuer O

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 issuer recognized a significant portion of its revenue under the percentage-of-completion method of accounting. The Firm's procedures related to this revenue were insufficient. Specifically –

- The Firm selected for testing certain controls consisting of meetings in which the issuer's accounting for percentage-of-completion revenue was reviewed and approved, but it failed to sufficiently test the controls. Specifically, the Firm's procedures were limited to attending several of the meetings, obtaining evidence that a review had occurred, and, for one control, inquiring of management, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

- The Firm's substantive procedures to test the issuer's revenue recognized from contracts accounted for under the percentage-of-completion method were insufficient, as it failed to sufficiently test the estimated costs to complete the contracts, as follows. The Firm selected for testing certain contracts that were more than 20 percent complete, but limited its testing of the estimated costs to complete these contracts to inquiring of management and comparing information in certain schedules to information in the issuer's accounting system or purchase orders, despite not having performed procedures to evaluate the reasonableness of the issuer's initial estimated costs to complete any contracts for which the percentage-of-completion method was used. For certain other contracts for which there was a change in the contract price, the Firm tested that change, but it did not test, beyond inquiry of management, changes in the estimated costs to complete these contracts. (AU 342, paragraph .11)

- The issuer's process for entering labor costs, which represented an important input to the percentage-of-completion calculation, involved a significant manual element. For each of four of the issuer's components, the Firm selected one labor cost entry for testing. The Firm's test of one per component was insufficient to support a conclusion that the labor costs were complete and recorded accurately. (AU 342, paragraph .11; AU 350, paragraphs .19, .23, and .23A)

A.16. Issuer P

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. For each of the issuer's significant components, the Firm selected for testing one control over that component's allowances for customer credits, sales returns, customer rebates, and excess and obsolete inventory. The Firm's testing of these controls was limited to obtaining evidence that reconciliations or account analyses had been prepared and that a review had occurred and, in certain cases, inquiring of management to update its interim testing to the year end. In addition, the Firm referenced its substantive testing when evaluating the effectiveness of these controls; however, the Firm failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements related to these allowances. (AS No. 5, paragraphs 42, 44, and B9)

A.17. Issuer Q

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing certain controls consisting of the review of the issuer's income tax calculations and related analyses and disclosures; however, it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to obtaining evidence that such reviews had occurred, testing the mathematical accuracy of certain documents prepared by management to support its income tax calculations, and comparing certain items to underlying support. The Firm's procedures did not include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

A.18. Issuer R

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The issuer prepared calculations that it used in developing certain significant estimates. The Firm selected for testing several controls consisting of the performance of calculations and the review of these calculations, but its testing of those controls was insufficient. Specifically, the Firm limited its testing to obtaining evidence that the reviews had occurred, and, for one control, comparing information used in the control to supporting documentation. The Firm's testing did not include evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

A.19. Issuer S

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. To determine the reserve for a significant component of inventory, the issuer applied reserve percentages to various categories of inventory. The categories of inventory, which the issuer considered to be months of sales on hand, were determined based on the amount of inventory items on hand and estimates of future inventory usage of those items; the estimates of future inventory usage were based mainly on usage during the prior year. The Firm's procedures related to this reserve were insufficient. Specifically –

- The Firm selected for testing controls over the issuer's analysis of the inventory reserve, but failed to evaluate whether the controls were designed to address the reasonableness of the significant assumptions used in the analysis. (AS No. 5, paragraph 42)

- The substantive procedure that the Firm intended to evaluate the reasonableness of the reserve percentages and estimates of months of sales on hand was a look-back analysis. This analysis consisted of comparing the usage projections (which considered both the reserve percentages and the months of sales on hand) determined in the prior year to the actual inventory usage in the current year. For many inventory items, the Firm's analysis identified significant differences, some of which represented usage that exceeded, and some that represented usage that was less than, the prior-year usage estimates. The Firm failed to sufficiently consider these differences, as the Firm merely documented (1) the effect of general trends in revenue and (2) that the prior year's reserve was conservative. (AU 342, paragraph .11)

- The Firm failed to test the reasonableness of the specific reserve percentages used, other than as described in the preceding bullet. (AU 342, paragraph .11)

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 audit 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 ICFR. Each deficiency could relate to several applicable provisions of the standards that govern the conduct of audits, including both the paragraphs of the standards that are cited at the end of each description of the deficiency included in Part I.A of this report and one or more of the specific paragraphs discussed below.

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

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

The table below lists the specific auditing standards that are referenced for each deficiency included in Part I.A of this report. See the descriptions of the deficiencies in Part I.A for identification of the specific paragraphs, in addition to those noted above, that relate to the individual deficiencies.

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, B, C, D, E, F, G, I, J, K, L, M, O, P, Q, R, and S
AS No. 11, *Consideration of Materiality in Planning and Performing an Audit*	A
AS No. 12, *Identifying and Assessing Risk of Material Misstatement*	A and F
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	B, D, F, G, and H
AS No. 14, *Evaluating Audit Results*	A, D, E, G, J, and L
AU Section 328, *Auditing Fair Value Measurements and Disclosures*	A, B, E, H, J, K, and N
AU Section 342, *Auditing Accounting Estimates*	A, E, G, I, L, O, and S
AU Section 350, *Audit Sampling*	B, F, G, and O

C. Information Concerning PCAOB Inspections 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 audits 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.

C.1. Reviews of Audit Work

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

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[4/] as well as a firm's failures to perform, or to perform sufficiently, certain necessary audit procedures. The inspection does not involve the review of all of a firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

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

[4/] 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.

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.[5/]

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.

Inclusion of an audit 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 the issuer of the need for changes to its financial statements or reporting on ICFR, or to take steps to prevent reliance on previously expressed audit opinions.[6/]

[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.

[6/] 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.

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

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* ("QC 20") 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.[7/] 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;[8/] related firm methodology, guidance, and practices; and possible root causes.

[7/] 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.

[8/] 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.

In addition to evaluating the audit work performed on specific audits, inspections include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining issuer audit engagements, including the application of the firm's risk-rating system; (4) processes related to the firm's use of audit work that the firm's foreign affiliates perform on the foreign operations of the firm's U.S. issuer audits; and (5) the firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

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

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

C.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 (a) 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; (b) the firm's processes for allocating its partner resources; and (c) 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. In addition, the inspection team may review a sample of partners' personnel files.

C.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 (a) 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 (b) observe whether the audit procedures were responsive to the risks identified during the process.

C.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 foreign affiliated firms' internal inspections, interview members of the firm's leadership, and review the U.S. engagement teams' supervision and control procedures concerning the audit work that the firm's foreign affiliates performed on a sample of audits. In some cases, the inspection team may also review certain of the audit work performed by the firm's foreign affiliates on the foreign operations of the firm's U.S. issuer audits.

C.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

C.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 regarding how the firm identifies, evaluates, and responds 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.

C.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 related 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.

C.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.

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, APPENDIX A, AND APPENDIX B OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

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.[9/]

9/ 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.

May 14, 2014

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

Re: Response to Draft Report on the 2013 Inspection of PricewaterhouseCoopers LLP

Dear Ms. Munter:

On behalf of PricewaterhouseCoopers LLP (the “Firm”), we are pleased to provide our response to the Public Company Accounting Oversight Board's (“PCAOB” or the “Board”) Draft Report on the 2013 Inspection of our Firm's 2012 audits (the “Report”).

The top priority of the Firm and our partners continues to be consistently performing high-quality audits in order to serve the investing community and bring value to the capital markets. To deliver on this responsibility, we must listen to and respond to the evolving needs of our stakeholders while meeting the expectations of our regulators, including the PCAOB. In this regard, we recognize the value of the inspection process and have taken all of the Board’s observations into account in formulating our plan to continuously improve audit quality. We will address the matters raised in the Report in a thorough and thoughtful way. We continue to support the PCAOB in its mission, and are committed to furthering the public interest through the preparation of informative, accurate and independent audit reports.

We have evaluated each of the observations set forth in *Part I - Inspection Procedures and Certain Observations* of the Report and have taken appropriate actions under both PCAOB standards and our policies. Our evaluation included those steps that we considered necessary to comply with AU 390, *Consideration of Omitted Procedures After the Report Date,* and where applicable, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report*.

We look forward to continuing our dialogue with the PCAOB in support of our priority commitment to audit quality and would be pleased to discuss any aspect of this response or any other questions you may have.

Sincerely,

Bob Moritz
US Chairman and Senior Partner
PricewaterhouseCoopers LLP

Vincent Colman
US Assurance Leader
PricewaterhouseCoopers LLP

APPENDIX D

AUDITING STANDARDS REFERENCED IN PART I

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

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
TESTING CONTROLS		
Selecting Controls to Test		
AS No. 5.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, B, D, E, F, G, I, and L
Testing Design Effectiveness		
AS No. 5.42	The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.	Issuers A, B, C, D, E, F, G, I, J, K, M, O, P, Q, R, and S
Testing Operating Effectiveness		
AS No. 5.44	The auditor should test the operating effectiveness	Issuers A, B,

	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.	C, D, E, F, G, I, J, K, M, O, P, Q, and R
Relationship of Risk to the Evidence to be Obtained		
AS No. 5.50	*Nature of Tests of Controls*. Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. The following tests that the auditor might perform are presented in order of the evidence that they ordinarily would produce, from least to most: inquiry, observation, inspection of relevant documentation, and re-performance of a control. Note: Inquiry alone does not provide sufficient evidence to support a conclusion about the effectiveness of a control.	Issuer K
EVALUATING IDENTIFIED DEFICIENCIES		
AS No. 5.62	The auditor must evaluate the severity of each control **deficiency** that comes to his or her attention to determine whether the deficiencies, individually or in combination, are material weaknesses as of the date of management's assessment. In planning and performing the audit, however, the auditor is not required to search for deficiencies that, individually or in combination, are less severe than a material weakness.	Issuer A
AS No. 5.65	Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following – • The nature of the financial statement accounts, disclosures, and assertions involved; • The susceptibility of the related asset or liability to loss or fraud; • The subjectivity, complexity, or extent of judgment required to determine the amount involved;	Issuer A

	• The interaction or relationship of the control with other controls, including whether they are interdependent or redundant; • The interaction of the deficiencies; and • The possible future consequences of the deficiency. Note: The evaluation of whether a control deficiency presents a reasonable possibility of misstatement can be made without quantifying the probability of occurrence as a specific percentage or range. Note: Multiple control deficiencies that affect the same financial statement account balance or disclosure increase the likelihood of misstatement and may, in combination, constitute a material weakness, even though such deficiencies may individually be less severe. Therefore, the auditor should determine whether individual control deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness.	
AS No. 5.68	The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.	Issuers A, C, and F
Indicators of Material Weaknesses		
AS No. 5.69	Indicators of material weaknesses in internal control over financial reporting include – • Identification of fraud, whether or not material, on the part of senior management;[14/] • Restatement of previously issued financial statements to reflect the correction of a material misstatement;[15/] • Identification by the auditor of a material misstatement of financial statements in the current period in circumstances that indicate that the misstatement would not have been detected by the company's internal control over financial reporting; and • Ineffective oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee.	Issuer E

Footnote to AS No 5.69:

[14/] For the purpose of this indicator, the term "senior management" includes the principal executive and financial officers signing the company's certifications as required under Section 302 of the Act as well as any other members of senior management who play a significant role in the company's financial reporting process.

[15/] See Financial Accounting Standards Board Statement No. 154, *Accounting Changes and Error Corrections*, regarding the correction of a misstatement.

APPENDIX B - Special Topics		
Integration of Audits		
AS No. 5.B8	*Effect of Substantive Procedures on the Auditor's Conclusions About the Operating Effectiveness of Controls.* In an audit of internal control over financial reporting, the auditor should evaluate the effect of the findings of the substantive auditing procedures performed in the audit of financial statements on the effectiveness of internal control over financial reporting. This evaluation should include, at a minimum – • The auditor's risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud. • Findings with respect to illegal acts and related party transactions. • Indications of management bias in making accounting estimates and in selecting accounting principles. • Misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls.	Issuer E
AS No. 5.B9	To obtain evidence about whether a selected control is effective, the control must be tested directly; the effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, should inform the auditor's risk assessments in determining the testing necessary to conclude on the effectiveness of a control.	Issuers E, M, and P

AS No. 11, Consideration of Materiality in Planning and Performing an Audit

CONSIDERING MATERIALITY IN PLANNING AND PERFORMING AN AUDIT		
Establishing a Materiality Level for the Financial Statements as a Whole		

AS No. 11.6	To plan the nature, timing, and extent of audit procedures, the auditor should establish a materiality level for the financial statements as a whole that is appropriate in light of the particular circumstances. This includes consideration of the company's earnings and other relevant factors. To determine the nature, timing, and extent of audit procedures, the materiality level for the financial statements as a whole needs to be expressed as a specified amount. Note: If financial statements for the audit period are not available, the auditor may establish an initial materiality level based on estimated or preliminary financial statement amounts. In those situations, the auditor should take into account the effects of known or expected changes in the company's financial statements, including significant transactions or adjustments that are expected to be reflected in the financial statements at the end of the period.	Issuer A

AS No. 12, Identifying and Assessing Risks of Material Misstatement		
PERFORMING RISK ASSESSMENT PROCEDURES		
AS No. 12.4	The auditor should perform risk assessment procedures that are sufficient to provide a reasonable basis for identifying and assessing the risks of material misstatement, whether due to error or fraud,[3/] and designing further audit procedures.[4/]	Issuer F
Footnote to AS No. 12.4 3/ AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*, discusses fraud, its characteristics, and the types of misstatements due to fraud that are relevant to the audit, i.e., misstatements arising from fraudulent financial reporting and misstatements arising from asset misappropriation. 4/ Auditing Standard No. 15, *Audit Evidence*, describes further audit procedures as consisting of tests of controls and substantive procedures.		
AS No. 12.5	Risks of material misstatement can arise from a variety of sources, including external factors, such as conditions in the company's industry and environment, and company-specific factors, such as the nature of the company, its activities, and internal control over financial reporting. For example, external or company-specific factors can affect the judgments involved in determining accounting estimates or create pressures to manipulate the financial statements to achieve certain financial targets. Also, risks of material misstatement may relate to, e.g., personnel who lack the necessary financial reporting competencies, information	Issuer F

<table>
<tr><td></td><td>systems that fail to accurately capture business transactions, or financial reporting processes that are not adequately aligned with the requirements in the applicable financial reporting framework. Thus, the audit procedures that are necessary to identify and appropriately assess the risks of material misstatement include consideration of both external factors and company-specific factors. This standard discusses the following risk assessment procedures:

a. Obtaining an understanding of the company and its environment (paragraphs 7-17);
b. Obtaining an understanding of internal control over financial reporting (paragraphs 18-40);
c. Considering information from the client acceptance and retention evaluation, audit planning activities, past audits, and other engagements performed for the company (paragraphs 41-45);
d. Performing analytical procedures (paragraphs 46-48);
e. Conducting a discussion among engagement team members regarding the risks of material misstatement (paragraphs 49-53); and
f. Inquiring of the audit committee, management, and others within the company about the risks of material misstatement (paragraphs 54-58).

Note: This standard describes an approach to identifying and assessing risks of material misstatement that begins at the financial statement level and with the auditor's overall understanding of the company and its environment and works down to the significant accounts and disclosures and their relevant assertions.[5/]</td><td></td></tr>
<tr><td colspan="3"><u>Footnote to AS No. 12.5</u>

5/ Paragraph 11 of Auditing Standard No. 15 discusses financial statement assertions.</td></tr>
<tr><td>OBTAINING AN UNDERSTANDING OF THE COMPANY AND ITS ENVIRONMENT</td><td></td><td></td></tr>
<tr><td>AS No. 12.7</td><td>The auditor should obtain an understanding of the company and its environment ("understanding of the company") to understand the events, conditions, and company activities that might reasonably be expected to have a significant effect on the risks of material misstatement. Obtaining an understanding of the company includes understanding:

a. Relevant industry, regulatory, and other external factors;</td><td>Issuer F</td></tr>
</table>

	b. The nature of the company; c. The company's selection and application of accounting principles, including related disclosures; d. The **company's objectives and strategies** and those related **business risks** that might reasonably be expected to result in risks of material misstatement; and e. The company's measurement and analysis of its financial performance.	
AS No. 12.12	As part of obtaining an understanding of the company's selection and application of accounting principles, including related disclosures, the auditor should evaluate whether the company's selection and application of accounting principles are appropriate for its business and consistent with the applicable financial reporting framework and accounting principles used in the relevant industry. Also, to identify and assess risks of material misstatement related to omitted, incomplete, or inaccurate disclosures, the auditor should develop expectations about the disclosures that are necessary for the company's financial statements to be presented fairly in conformity with the applicable financial reporting framework.	Issuer A

AS No. 13, The Auditor's Responses to the Risks of Material Misstatement		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS No. 13.8	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuers B, D, F, G, and H
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS No. 13.16	*Controls to be Tested.* If the auditor plans to assess control risk at less than the maximum by relying on controls,[12/] and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire **period of reliance**.[13/] However, the auditor is not required to assess control risk at less than the maximum for *all* relevant assertions and, for a variety of	Issuers B and G

	reasons, the auditor may choose not to do so.	
Footnote to AS No. 13.16 [12/] Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures. [13/] Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.		
AS No. 13.18	Evidence about the Effectiveness of Controls in the Audit of Financial Statements. In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers B and G
SUBSTANTIVE PROCEDURES		
AS No. 13.36	The auditor should perform substantive procedures for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk.	Issuer B
AS No. 13.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	Issuers B and G

AS No. 14, Evaluating Audit Results		
EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS		
AS No. 14.3	In forming an opinion on whether the financial statements are presented fairly, in all material respects, in	Issuers A, D, E, G, J, and L

	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.	
Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS No. 14.30	The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Note: AU sec. 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles,* establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, *Evaluating Consistency of Financial Statements,* establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements. Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.	Issuer E
AS No. 14.31	As part of the evaluation of the presentation of the financial statements, the auditor should evaluate whether the financial statements contain the information essential for a fair presentation of the financial statements in conformity with the applicable financial reporting framework. Evaluation of the information disclosed in the financial statements includes consideration of the form, arrangement, and content of the financial statements (including the accompanying notes), encompassing matters such as the terminology used, the amount of detail given, the classification of items in the statements, and the bases of amounts set forth. Note: According to AU sec. 508, if the financial statements, including the accompanying notes, fail to disclose information that is required by the applicable financial reporting framework, the auditor should express a qualified or adverse opinion and should provide the information in the report, if practicable, unless its omission from the report is recognized as appropriate by a specific auditing standard.[18/]	Issuer J
Footnote to AS No. 14.31 18/ AU secs. 508.41-.44.		

AU Section 328, Auditing Fair Value Measurements and Disclosures

INTRODUCTION		
AU 328.03	The auditor should obtain sufficient appropriate audit evidence to provide reasonable assurance that fair value measurements and disclosures are in conformity with GAAP. GAAP requires that certain items be measured at fair value. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, defines the fair value of an asset (liability) as "the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale." [fn 1] Although GAAP may not prescribe the method for measuring the fair value of an item, it expresses a preference for the use of observable market prices to make that determination. In the absence of observable market prices, GAAP requires fair value to be based on the best information available in the circumstances.	Issuer E
Footnote to AU 328.03 [fn 1] Generally accepted accounting principles (GAAP) contain various definitions of fair value. However, all of the definitions reflect the concepts in the definition that appears in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Concepts No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. For example, Governmental Accounting Standards Board Statement of Governmental Accounting Standards No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, defines fair value as "the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale."		
TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AU 328.26	The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether: a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market	Issuers A, B, E, H, J, K, and N

	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.	
AU 328.28	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, B, E, H, J, K, and N
AU 328.31	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.	Issuers J and K
AU 328.36	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),[fn 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 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.	Issuer E
Footnote to AU 328.36		

fn 5 The auditor also should consider requirements of GAAP that may influence the selection of assumptions (see FASB Concepts Statement No. 7).		
AU 328.39	The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.	Issuer A
Developing Independent Fair Value Estimates for Corroborative Purposes		
AU 328.40	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. [fn 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 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.	Issuer H
<u>Footnote to AU 328.40</u> fn 6 See section 329, *Analytical Procedures*.		
DISCLOSURES ABOUT FAIR VALUES		
AU 328.43	The auditor should evaluate whether the disclosures about fair values made by the entity are in conformity with GAAP.[fn 8] Disclosure of fair value information is an important	Issuer H

	aspect of financial statements. Often, fair value disclosure is required because of the relevance to users in the evaluation of an entity's performance and financial position. In addition to the fair value information required under GAAP, some entities disclose voluntary additional fair value information in the notes to the financial statements.	
Footnote to AU 328.43 fn 8 See also paragraph 31 of Auditing Standard No. 14, *Evaluating Audit Results*.		

AU Section 342, Auditing Accounting Estimates		
AU 342.04	The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole. As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.	Issuers E and G
EVALUATING ACCOUNTING ESTIMATES		
Evaluating Reasonableness		
AU 342.09	In evaluating the reasonableness of an estimate, the auditor normally concentrates on key factors and assumptions that are— a. Significant to the accounting estimate. b. Sensitive to variations. c. Deviations from historical patterns. d. Subjective and susceptible to misstatement and bias. The auditor normally should consider the historical experience of the entity in making past estimates as well as the auditor's experience in the industry. However, changes in facts, circumstances, or entity's procedures may cause factors different from those considered in the past to become significant to the accounting estimate.[fn 4]	Issuer L
Footnote to AU 342.09		

fn 4 In addition to other evidential matter about the estimate, in certain instances, the auditor may wish to obtain written representation from management regarding the key factors and assumptions.

AU 342.11	Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach: a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation. b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose. f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions. h. Consider using the work of a specialist regarding certain assumptions (section 336, Using the Work of a Specialist). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	Issuers A, D, G, I, L, O, and S

AU Section 350, Audit Sampling

SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		

AU 350.19	The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed." After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details.[fn 3] Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuers B, G, and O
Footnote to AU 350.19 fn 3 Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.		
AU 350.21	The sufficiency of tests of details for a particular account balance or class of transactions is related to the individual importance of the items examined as well as to the potential for material misstatement. When planning a sample for a substantive test of details, the auditor uses his judgment to determine which items, if any, in an account balance or class of transactions should be individually examined and which items, if any, should be subject to sampling. The auditor should examine those items for which, in his judgment, acceptance of some sampling risk is not justified. For example, these may include items for which potential misstatements could individually equal or exceed the tolerable misstatement. Any items that the auditor has decided to examine 100 percent are not part of the items subject to sampling. Other items that, in the auditor's judgment, need to be tested to fulfill the audit objective but need not be examined 100 percent, would be subject to sampling.	Issuer F
AU 350.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the	Issuers B, F, G, and O

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