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Report on

2014 Inspection of McGladrey LLP
(Headquartered in Chicago, Illinois)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

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2014 INSPECTION OF MCGLADREY LLP

Preface

In 2014, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm McGladrey LLP ("McGladrey" or "the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

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

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

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from May 2014 through August 2014. The inspection team performed field work at the Firm's National Office and at 10 of its approximately 75 U.S. practice offices.[2]

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 15 issuer audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

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

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

[2] This represents McGladrey's total number of practice offices; however, approximately 38 of the Firm's practice offices have primary responsibility for issuer audit clients. The Firm's National Office is located in Minneapolis, Minnesota.

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

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

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

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[3] Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

The audit deficiencies that reached this level of significance are described in Part I.A.1 through I.A.7, below.

Effects on Audit Opinions

Of the seven issuer audits that appear in Part I.A, deficiencies in four audits relate to testing controls for purposes of the ICFR opinion and deficiencies in five audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below.

	Number of Audits
Deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	2
Deficiencies included in Part I.A related to the financial statement audit only	3
Deficiencies included in Part I.A related to the ICFR audit only	2
Total	7

Most Frequently Identified Audit Deficiencies

The following table lists, in summary form, the types of deficiencies that are included most frequently in Part I.A of this report. A general description of each type is provided in the table; the description of each deficiency in Part I.A contains more specific information about the individual deficiency. The table includes only the four most frequently identified deficiencies that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Deficiencies	Part I.A Audits
Failure to test controls over or test the accuracy and completeness of issuer-produced data or reports.	5 Audits: Issuers A, B, C, D, and G
Failure to perform sufficient testing related to an account or significant portion of an account or to address an identified risk.	5 Audits: Issuers A, B, E, F, and G
Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing.	4 Audits: Issuers A, B, C, and D
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate.	3 Audits: Issuers A, B, and F

Audit Deficiencies

A.1. Issuer A

The issuer's inventory was held both at issuer-owned locations and on consignment. The Firm identified fraud risks related to the existence of inventory held primarily on consignment and the valuation of inventory, including the allowance for obsolete and slow moving inventory. The Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR, as the Firm's testing related to the existence and valuation of inventory was insufficient. Specifically,

- To test certain controls over inventory cycle counts, calculation of standard cost rates and inventory reserves, and management review controls on cost variances, the Firm's testing was limited to inspecting evidence that the review occurred, but failed to evaluate whether the controls were designed to operate at, and operated at, a level of precision that would prevent or detect material misstatements. In addition, for review controls related to the allowance for obsolete and slow moving inventory, the Firm failed to evaluate whether the review controls operated at a level of precision that would prevent or detect material misstatements because it failed to evaluate the criteria used to identify items for investigation and/or determine whether specific items that were investigated were resolved. Further, the Firm failed to test any controls over the accuracy and completeness of the information produced by the issuer and used in the performance of the controls over inventory discussed above. (AS No. 5, paragraphs 39, 42, and 44)

- To test the existence of inventory held on consignment, the Firm sent confirmation requests at an interim date to confirm the existence of such inventory held. The Firm, however, failed to perform alternative procedures on confirmation requests of consigned inventory for which no replies were received. In addition, the Firm did not perform sufficient procedures to cover the remaining period from the interim date to year end. Specifically, the Firm's procedures were limited to comparing interim period amounts per consignee inventory location to year end without performing audit procedures to test the remaining period. In addition, the Firm identified deficiencies in the consigned inventory count process, including that certain consigned inventory sites were not counted, and that data at certain sites that were counted had been lost; however, it concluded that the consigned inventory counts were reliable without evaluating the identified deficiencies. (AS No. 13, paragraphs 6 and 45; AU 330, paragraph .31; AU 331, paragraph .14)

- With respect to the existence of raw materials held at issuer locations, the Firm failed to observe or perform procedures on any of the issuer's cycle counts. Specifically, the Firm was not present to observe any cycle counts and failed to test the issuer's procedures or methods to evaluate whether they were sufficiently reliable to produce results substantially the same as those that would have been obtained by a count of all items each year. (AU 331, paragraph .11)

- In testing the valuation of inventory, the Firm failed to evaluate the appropriateness of changes to standard costs for reasons other than changes in the purchase price of raw material components. In addition, in evaluating purchase price variances, the Firm failed to evaluate whether the information produced by the issuer and used in the Firm's tests was accurate and complete and sufficiently detailed for its intended purpose. (AS No. 14, paragraphs 4 and 24; AS No. 15, paragraph 10)

- In testing the allowance for obsolete and slow moving inventory, the Firm failed to perform sufficient procedures to test the issuer's estimate. The Firm obtained an understanding of the issuer's methodology for determining the allowance and used the issuer's inventory aging and consumption reports in its testing. The Firm, however, failed to perform procedures to identify and evaluate inventory items with little or no movement over a period of time, and to test the accuracy and completeness of the inventory aging and consumption reports produced by the issuer. (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 relied on information technology general controls ("ITGCs") over a financially significant application that supported one of the core banking functions, including information produced by that application. The issuer's internal audit ("IA") issued a report, which identified that certain of the issuer's change management and logical security ITGCs over this financially significant application were ineffective at an interim date approximately eight months before year end. The issuer indicated that certain manual compensating controls were in place to mitigate the risk and that planned corrective actions were initiated to remediate the change management ITGC deficiencies by or prior to year end and the logical security ITGC deficiencies by or after year end. The Firm failed to:
  - o Sufficiently test ITGC controls that had identified deficiencies at interim, including the failure to test the effectiveness of the issuer's remedial actions at year end and evaluate the mitigating effect of the manual compensating controls that operated during the entire period of control reliance. (AS No. 5, paragraphs 62 and 68; AS No. 13, paragraph 34)

  - o Modify the nature, timing, and extent of its procedures to address the risks associated with the ITGC deficiencies identified in the IA report. (AS No. 13, paragraphs 16 and 34)

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the existence and completeness of loans. Specifically, the Firm failed to sufficiently test the operating effectiveness of certain of the issuer's controls over loan approval, reconciliation, and servicing as the Firm's testing was limited to obtaining evidence that the controls had operated. The Firm's testing was limited to reading the notation of the person executing the controls and dates of approval. The Firm failed to understand, evaluate or consider if the controls satisfied the control objectives. In addition, for two other controls, the Firm failed to test the controls over the accuracy and completeness of information produced by the issuer and used in the performance of those controls. Lastly, for four controls, the Firm failed to determine whether the controls were designed and operated at a sufficient level of precision to identify a material misstatement because it failed to evaluate the criteria used to identify items for investigation and/or determine whether specific items that were investigated were resolved. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the allowance for loan losses ("ALL"). Specifically, the Firm's procedures to test the operating effectiveness of certain of the issuer's controls over the identification and approval of impaired loans and the recording of the ALL were limited to obtaining evidence that the controls had operated. The Firm failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements as its testing was limited to inspecting evidence of acknowledgement that preparation, reviews, and/or approvals were performed. In addition, for one management review control, it also failed to evaluate the criteria used to identify items for investigation and/or determine whether specific items that were investigated were resolved. Lastly, the Firm relied upon information produced by the issuer and used in the performance of these controls, but failed to test the controls over the accuracy and completeness of that information. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to perform sufficient procedures to test certain components of the ALL. Specifically, other than reading issuer-prepared memorandums, the Firm failed to perform procedures to test the reliability and relevance of the underlying data and evaluate the reasonableness of the significant assumptions used by the issuer in developing environmental factors used in the determination of the ALL. (AU 342, paragraph .11)

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the valuation of available-for-sale and held-to-maturity investment securities. Specifically, the Firm's tests of operating effectiveness of three of the issuer's controls over investment purchases, sales, and pricing were limited to obtaining evidence that the controls had operated, and failed to include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. Further, for one review control, the Firm failed to test the operating effectiveness of the control as it was designed. Lastly, for other-than-temporary impairment of investments, the Firm did not identify and test any controls. (AS No. 5, paragraphs 39, 42, and 44)

A.3. Issuer C

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

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the ALL. Specifically, the Firm's procedures to test the operating effectiveness of certain of the issuer's controls over the ALL were limited to obtaining evidence that the controls had operated. With respect to certain of the controls, the Firm failed to inspect the underlying data, reports, and analysis provided to the issuer's board of directors for purposes of its evaluation and conclusions of the ALL and, therefore, could not sufficiently evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements and whether the criteria used to identify items for investigation and/or determine whether specific items that were investigated were resolved. Further, the Firm failed to test the controls over the accuracy and completeness of information produced by the issuer and used in the performance of certain of the above controls. Lastly, the Firm identified two reconciliation controls over the ALL, but failed to sufficiently test the operating effectiveness of these controls because, for one of the two items selected for each control in that testing, the Firm used evidence obtained from its substantive testing and failed to test the effectiveness of the control directly. (AS No. 5, paragraphs 39, 42, 44, and B9)

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the existence and completeness of loans and leases, and the occurrence and allocation of interest income. Specifically –

  - The Firm's procedures to test certain of the issuer's controls over loans, leases, and interest income were limited to obtaining evidence that controls had operated. The Firm failed to evaluate whether the controls operated effectively because its procedures were limited to inspecting evidence that the reviews occurred without testing whether the control operated at a level of precision that would prevent or detect material misstatements. For one control, the Firm used its substantive testing when addressing its evaluation of the operating effectiveness of the control but did not test the effectiveness of the control directly. For a second control, the Firm relied on other tests of controls; however, those tests of controls failed to test the effectiveness of an important aspect of the control. (AS No. 5, paragraphs 42, 44, and B9)

  - For certain controls, the Firm failed to perform procedures to update its interim testing to the year end. (AS No. 5, paragraphs 44 and 55)

A.4. Issuer D

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

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's higher risk controls over the existence and completeness of loans. Specifically, for controls selected for testing, the Firm's procedures were limited to inquiring of management and obtaining evidence that the controls had operated. The Firm failed to evaluate, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to perform procedures to test controls over the accuracy and completeness of information produced by the issuer and used in the performance of certain controls over loans. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed to perform sufficient procedures to test the design and operating effectiveness of the issuer's controls over the ALL that was identified as having both a fraud risk and a significant risk. Specifically, for the controls identified, the Firm's procedures were limited to inquiring of management and obtaining evidence that the controls had operated. The Firm 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)

A.5. Issuer E

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the valuation of inventory were insufficient. Specifically, for the raw materials and work-in-process components of inventory, the Firm failed to perform any substantive procedures to test the accumulation of costs. (AS No. 13, paragraphs 8 and 36)

A.6. Issuer F

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the valuation of goodwill for one of the issuer's reporting units were insufficient. The issuer performed an annual analysis of the possible impairment of goodwill. The Firm identified a significant risk related to management's assessment of goodwill. The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions, including revenue projections, growth rate, and related assumptions that appeared contradictory to recent historical results used by the issuer in its analysis, as the Firm's procedures were limited to inquiring of management. (AU 328, paragraphs .26, .28, .31, and .36)

A.7. Issuer G

In this audit, the Firm failed to perform sufficient procedures to test participant and employer contributions in a defined contribution benefit plan. Specifically, in testing the significant inputs used in determining the amount of participant and employer contributions, the Firm failed to test the accuracy and completeness of information produced by the issuer related to the compensation eligible for contributions. (AS No. 15, paragraph 10)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also relate, however, to other paragraphs of those standards and to other auditing standards, including those concerning due professional care, responses to risk assessments, and audit evidence.

Many audit deficiencies involve a lack of due professional care. AU 230, *Due Professional Care in the Performance of Work*, paragraphs .02, .05, and .06 requires the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AU 230, paragraphs .07 through .09 and AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*, 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* 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 providing support for the related conclusions.

The paragraphs of the standards that are described immediately above are not cited in Part I.A, unless those paragraphs are the most directly related to the relevant deficiency.

B.1. List of Specific Auditing Standards Referenced in Part I.A

The table below lists the specific auditing standards that are referenced in Part I.A of this report, cross-referenced to the issuer audits for which each standard is cited. For each auditing standard, the table also provides the number of distinct deficiencies for which the standard is cited for each of the relevant issuer audits. This information identifies only the number of times that the standard is referenced, regardless of whether the reference includes multiple paragraphs or relates to multiple financial statement accounts.

PCAOB Auditing Standards	**Audits**	**Number of Deficiencies per Audit**
AS No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements*	Issuer A Issuer B Issuer C Issuer D	1 4 3 2
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer B Issuer E	1 2 1
AS No. 14, *Evaluating Audit Results*	Issuer A	1
AS No. 15, *Audit Evidence*	Issuer A	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer G	1
AU 328, *Auditing Fair Value Measurements and Disclosures*	Issuer F	1
AU 330, *The Confirmation Process*	Issuer A	1
AU 331, *Inventories*	Issuer A	2
AU 342, *Auditing Accounting Estimates*	Issuer A Issuer B	1 1

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

The table below lists the financial statement accounts or auditing areas related to each deficiency included in Part I.A of this report and identifies the audits described in Part I.A where deficiencies relating to the respective areas were observed.[4]

	AS No. 5	AS No. 13	AS No. 14	AS No.15	AU 328	AU 330	AU 331	AU 342
Inventory and related reserves	A	A, E	A	A		A	A	A
Impairment of goodwill					F			
Investment securities	B							
IT-related		B						
Loans, including ALL, leases and interest income	B, C, D							B
Post-retirement plan contributions				G				

4 Certain deficiencies that affect multiple accounts or areas, such as those related to scoping multi-location audits and those related to the evaluation of control deficiencies, are excluded from this table, but are included in appendix C.

B.3. Audit Deficiencies by Industry

The table below lists the industries[5] of the issuers for which audit deficiencies were discussed in Part I.A of this report, along with the specific auditing standards related to the deficiencies and the number of issuer audits where those deficiencies were observed.[6] Because an issuer audit may have deficiencies that relate to more than one standard, the total for each row should not be read as the total number of issuers.

	AS No. 5	AS No. 13	AS No. 14	AS No.15	AU 328	AU 330	AU 331	AU 342
Benefit Plans				1				
Financial Services	9	2						1
Healthcare	1	1	1	1		1	2	1
Industrials		1			1			

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

The chart below categorizes the 15 issuers whose audits were inspected in 2014, based on the issuer's industry.[7]

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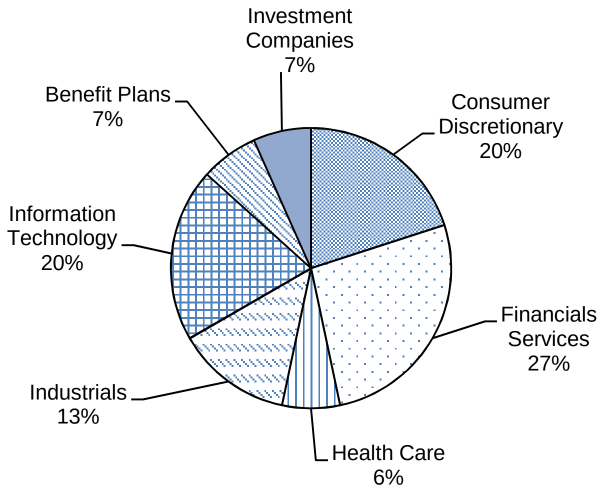
5 The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer was not available from S&P, classifications were assigned based upon North American Industry Classification System ("NAICS")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

6 Although all issuer audits with deficiencies described in Part I.A are included in this table, industry information is not included in the more detailed description of the deficiency in Part I.A of this report for all issuer audits; this information is generally provided in Part I.A when it appears to be relevant to the description of a deficiency.

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



Industries of Issuers Inspected

Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	3	20%
Financial Services	4	27%
Health Care	1	6%
Industrials	2	13%
Information Technology	3	20%
Benefit Plans	1	7%
Investment Companies	1	7%

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 13 issuers[8] whose audits were inspected in 2014.[9] This presentation of revenue data is intended to provide information about the size of issuer audits that were inspected and is not indicative of whether the inspection included a review of the Firm's auditing of revenue in the issuer audits selected for review.

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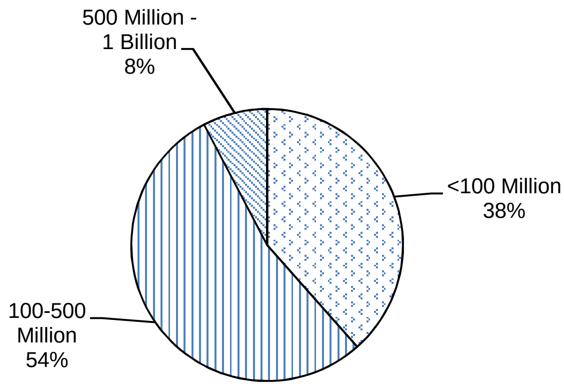
8 Excludes a Benefit Plan and an Investment Company that have no revenue data.

9 The revenue amounts reflected in the chart are for the issuers' fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.



Revenue Ranges of Issuers Inspected

Revenue	Number of Audits Inspected	Percentage
<100 Million	5	38%
100-500 Million	7	54%
500 Million -1 Billion	1	8%

D. Information Concerning PCAOB Inspections that is Generally Applicable to Annually Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. 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,[10] as well as a firm's failure to perform, or to perform sufficiently, certain necessary audit procedures. An inspection of an annually inspected firm does not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In 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

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[10] When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with the applicable financial reporting framework, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

constitute persuasive other evidence. In reaching its conclusions, an inspection team considers whether audit documentation or any other evidence that a firm might provide to the inspection team supports the firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In 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.

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.[11]

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

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

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence,

[11] 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.

integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion or a failure to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in an audit may indicate a defect or potential defect in a firm's quality control system.[12] 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;[13] related firm methodology, guidance, and practices; and possible root causes.

Inspections also include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (1) management structure and processes,

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[12] 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.

[13] 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.

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.

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

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

D.2.b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area are designed to focus on (1) whether the firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as distinct from marketing or other activities of the firm; (2) the firm's processes for allocating its partner resources; and (3) the accountability and responsibilities of the different levels of firm management with respect to partner management. The inspection team may interview members of the firm's management and review documentation related to certain of these topics. In addition, the inspection team's evaluation may include the results of interviews of audit partners regarding their responsibilities and allocation of time. Further, the inspection team may review a sample of partners' personnel files.

D.2.c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Issuer Audit Engagements, Including the Application of the Firm's Risk-Rating System

The inspection team may consider the firm's documented policies and procedures in this area. In addition, the inspection team may select certain issuer audits to (1) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the issuer audit engagements and (2) observe whether the audit procedures were responsive to the risks identified during the firm's process.

D.2.d. Review of Processes Related to a Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audits

The inspection team may review the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the firm's U.S. issuer audits, review available information relating to the most recent internal inspections of foreign affiliated firms, interview members of the firm's leadership, and review the U.S. engagement teams' supervision concerning, and procedures for control of, the audit work that the firm's foreign affiliates performed on a sample of audits.

D.2.e. Review of a Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Defects or Potential Defects in Quality Control

D.2.e.i. Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area are designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team may interview members of the firm's management and review documents relating to the firm's identification, and evaluation of, and response to, possible indicators of deficiencies in audit performance. In addition, the inspection team may review documents related to the design, operation, and evaluation of findings of the firm's internal inspection program, and may compare the results of its review of audit work to those from the internal inspection's review of the same audit work.

D.2.e.ii. Review of Response to Defects or Potential Defects in Quality Control

The inspection team may review steps the firm has taken to address possible quality control deficiencies and assess the design and effectiveness of the underlying processes. In addition, the inspection team may inspect audits of issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies have improved.

D.2.e.iii. Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team may assess policies, procedures, and guidance related to aspects of independence requirements and the firm's consultation processes, as well as the firm's compliance with these requirements and processes. In addition, the inspection team may review documents, including certain newly issued policies and procedures, and interview firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

END OF PART I

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

APPENDIX B

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[14]

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

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June 1, 2015

Ms. Helen A. Munter
Director, Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006

Re: Response to the Public Company Accounting Oversight Board (PCAOB)
Draft Report on 2014 Inspection of McGladrey LLP

Dear Ms. Munter:

We are pleased to provide our response to Part I of the PCAOB's Draft Report on the 2014 Inspection of McGladrey LLP dated May 5, 2015 ("Draft Report").

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

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

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

Very Truly Yours,

McGladrey LLP

McGladrey LLP

APPENDIX C

AUDITING STANDARDS REFERENCED IN PART I

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

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS 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, C, and D
TESTING CONTROLS		
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, and D
Testing Operating Effectiveness		
AS No. 5.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. Note: In some situations, particularly in smaller companies, a company might use a third party to	Issuers A, B, C, and D

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	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.	
Relationship of Risk to the Evidence to be Obtained		
AS No. 5.55	*Roll-Forward Procedures.* When the auditor reports on the effectiveness of controls as of a specific date and obtains evidence about the operating effectiveness of controls at an interim date, he or she should determine what additional evidence concerning the operation of the controls for the remaining period is necessary.	Issuer C
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 B
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.	Issuer B

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
APPENDIX B – Special Topics		
INTEGRATION OF AUDITS		
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.	Issuer C

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
Overall Responses		
AS No. 13.6	The auditor also should determine whether it is necessary to make pervasive changes to the nature, timing, or extent of audit procedures to adequately address the assessed risks of material misstatement. Examples of such pervasive changes include modifying the audit strategy to: a. Increase the substantive testing of the valuation of numerous significant accounts at year end because of significantly deteriorating market conditions, and b. Obtain more persuasive audit evidence from substantive procedures due to the identification of pervasive weaknesses in the company's control environment.	Issuer A
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.	Issuer E
Testing Controls		

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
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 reasons, the auditor may choose not to do so.	Issuer B
Footnotes to AS No. 13.16 [12/] Reliance on controls that is supported by sufficient and appropriate audit evidence allows 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 extend of planned substantive procedures. [13/] Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.		
ASSESSING CONTROL RISK		
AS No. 13.34	When deficiencies affecting the controls on which the auditor intends to rely are detected, the auditor should evaluate the severity of the deficiencies and the effect on the auditor's control risk assessments. If the auditor plans to rely on controls relating to an assertion but the controls that the auditor tests are ineffective because of control deficiencies, the auditor should: a. Perform tests of other controls related to the same assertion as the ineffective controls, or b. Revise the control risk assessment and modify the planned substantive procedures as necessary in light of the increased assessment of risk. Note: Auditing Standard No. 5 establishes requirements for evaluating the severity of a control deficiency and communicating	Issuer B

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	identified control deficiencies to management and the audit committee in an integrated audit. AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* establishes requirements for communicating significant deficiencies and material weaknesses in an audit of financial statements only.	
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 E
TIMING OF SUBSTANTIVE PROCEDURES		
AS No. 13.45	When substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. Such procedures should include (a) comparing relevant information about the account balance at the interim date with comparable information at the end of the period to identify amounts that appear unusual and investigating such amounts and (b) performing audit procedures to test the remaining period.	Issuer A

AS No. 14, *Evaluating Audit Results*		
Evaluating the Results of the Audit of Financial Statements		
AS No. 14.4	In the audit of financial statements,[1/] the auditor's evaluation of audit results should include evaluation of the following: a. The results of analytical procedures performed in the overall review of the financial statements ("overall review");	Issuer A

AS No. 14, *Evaluating Audit Results*		
	b. **Misstatements** accumulated during the audit, including, in particular, **uncorrected misstatements**;[2/] c. The qualitative aspects of the company's accounting practices; d. Conditions identified during the audit that relate to the assessment of the risk of material misstatement due to fraud ("fraud risk"); e. The presentation of the financial statements, including the disclosures; and f. The sufficiency and appropriateness of the audit evidence obtained.	
Footnote to AS No. 14.4 [1/] For purposes of this standard, the term "audit of financial statements" refers to the financial statement portion of the integrated audit and to the audit of financial statements only. [2/] Terms defined in Appendix A, Definitions, are set in **boldface type** the first time they appear.		
EVALUATING THE QUALITATIVE ASPECTS OF THE COMPANY'S ACCOUNTING PRACTICES		
AS No. 14.24	When evaluating whether the financial statements as a whole are free of material misstatement, the auditor should evaluate the qualitative aspects of the company's accounting practices, including potential bias in management's judgments about the amounts and disclosures in the financial statements.	Issuer A

AS No. 15, *Audit Evidence*		
Sufficient Appropriate Audit Evidence		
USING INFORMATION PRODUCED BY THE COMPANY		
AS No. 15.10	When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:[3/] • Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and • Evaluate whether the information is sufficiently precise and detailed for purposes of the audit.	Issuers A and G
Footnote to AS No. 15.10 [3/] When using the work of a specialist engaged or employed by management, see AU sec. 336, *Using the Work of a Specialist.* When using information produced by a service organization or a service auditor's report as audit evidence, see AU sec. 324, *Service Organizations*, and for integrated audits, see Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.		

AU 328, *Auditing 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 information (see paragraph .06).	Issuer F

AU 328, *Auditing Fair Value Measurements and Disclosures*		
	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.	Issuer F
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.	Issuer F
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;	Issuer F

AU 328, *Auditing Fair Value Measurements and Disclosures*		
	and g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate. Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience.	
Footnote to 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 330, *The Confirmation Process*		
Alternative Procedures		
AU 330.31	When the auditor has not received replies to positive confirmation requests, he or she should apply alternative procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level. However, the omission of alternative procedures may be acceptable (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated.	Issuer A

AU 331, *Inventories*		
Inventories		
AU 331.11	In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances. [Revised, June 1981, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 39.]	Issuer A
Inventories Held in Public Warehouses [fn3]		
AU 331.14	If inventories are in the hands of public warehouses or other outside custodians, the auditor ordinarily would obtain direct confirmation in writing from the custodian. If such inventories represent a significant proportion of current or total assets, to obtain reasonable assurance with respect to their existence, the auditor should apply one or more of the following procedures as he considers necessary in the circumstances. a. Test the owner's procedures for investigating the warehouseman and evaluating the warehouseman's performance. b. Obtain an independent accountant's report on the warehouseman's control procedures relevant to custody of goods and, if applicable, pledging of receipts, or apply alternative procedures at the warehouse to gain reasonable assurance that information received from the warehouseman is	Issuer A

AU 331, *Inventories*		
	reliable. c. Observe physical counts of the goods, if practicable and reasonable. d. If warehouse receipts have been pledged as collateral, confirm with lenders pertinent details of the pledged receipts (on a test basis, if appropriate).	
Footnote to AU 331 fn 3 See section 901 for Special Report of Committee on Auditing Procedure.		

AU 342, *Auditing Accounting Estimates*		
Evaluating Accounting Estimates		
Evaluating Reasonableness		
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.	Issuers A and B

AU 342, *Auditing Accounting Estimates*		
	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.	