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Report on

2014 Inspection of PricewaterhouseCoopers LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

June 30, 2015

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. 104-2015-122

PCAOB

Public Company Accounting Oversight Board

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2014 INSPECTION OF PRICEWATERHOUSECOOPERS LLP

Preface

In 2014, 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.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 C, and Appendix D. Appendix C 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 D 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 November 2013 to January 2015. The inspection team performed field work at the Firm's National Office and at 28 of its approximately 65 U.S. practice offices.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 57 issuer audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement 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. One of the deficiencies related to auditing an aspect of an issuer's financial statements that the issuer restated after the primary inspection procedures.[2] In addition, for four of the audits described below, after the primary inspection procedures, the Firm revised its opinion on the effectiveness of the issuer's internal control over financial reporting ("ICFR") to express an adverse opinion.

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 D to this report. The references in this sub-Part include only standards that

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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] The 2014 inspection did not include review of any additional audit work related to the restatement.

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 the 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]

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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

The audit deficiencies that reached this level of significance are described in Part I.A.1 through I.A.17, below.

Effects on Audit Opinions

Of the 17 issuer audits that appear in Part I.A, deficiencies in 11 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in 15 audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the 15 audits in which substantive testing deficiencies were identified, three audits included deficiencies in substantive testing that the inspection team determined was caused by a reliance on controls that was too high in light of deficiencies in the testing of controls.

	Number of Audits
Deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	9
Deficiencies included in Part I.A related to the financial statement audit only	6
Deficiencies included in Part I.A related to the ICFR audit only	2
Total	17

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

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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.

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.

Issue	Part I.A Audits
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate.	12 Audits: Issuers A, B, C, D, E, F, G, H, I, K, L, and N
Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing.	10 Audits: Issuers A, B, C, E, F, G, M, N, O, and Q
Failure to sufficiently test controls over, or sufficiently test, the accuracy and/or completeness of issuer-produced data or reports.	4 Audits: Issuers B, E, O, and P
Failure to perform sufficient testing related to an account or significant portion of an account or to address an identified risk.	4 Audits: Issuers E, H, J, and M

Audit Deficiencies

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 issuer performed its annual analysis of the possible impairment of goodwill as of an interim date, and recorded a goodwill impairment loss for one of its reporting units. The Firm's procedures related to the issuer's analysis for that reporting unit were insufficient. Specifically –

  - o The Firm selected for testing certain controls that consisted of management's review of certain assumptions used in the analysis, but limited its procedures to test those controls to inquiring of management and comparing information used in the analysis to supporting documentation. The Firm's testing did not include (1) ascertaining the nature of the review procedures that the control owners performed to assess the reasonableness of these assumptions or (2) evaluating the criteria used by the control owners to identify matters for follow up and whether those matters were appropriately addressed. As a result, the Firm failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to evaluate whether the controls that it selected for testing were also designed to address the reasonableness of other significant assumptions used in the analysis. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions underlying the cash-flow projections that the issuer used to determine the fair value of the reporting unit and the amount of the goodwill impairment loss. Specifically –

  - The Firm limited its procedures for one assumption to verifying that the assumption was consistent with the information in a presentation that management had given to the issuer's board of directors in the prior year. (AU 328, paragraphs .26, .28, and .31)

  - The issuer's assumptions related to certain costs and selling prices were based on market information. For the costs, the Firm failed to evaluate whether the forecasted market information was relevant to the issuer. For certain selling prices, the issuer used market information as of four months before the date of the goodwill impairment analysis, but the Firm failed to evaluate the reasonableness of the use of this information in light of significant price declines throughout the year. (AU 328, paragraphs .26, .28, and .31)

  - The Firm failed to perform any procedures to evaluate the reasonableness of another of the issuer's significant assumptions. (AU 328, paragraphs .26 and .28)

        - The Firm failed to consider the implications of a significant shortfall in the issuer's actual results for the first nine months of the year compared to its forecast on the reliability of the issuer's projections. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, and .36)

    - The Firm selected for testing a control over the issuer's identification of possible triggering events, but failed to sufficiently test this control. Specifically, the Firm limited its procedures to gathering evidence that management had reviewed a comparison of actual results to budgeted amounts and noting whether management had identified a triggering event. The Firm, however, failed to ascertain the nature of any other procedures that management performed to consider the possible existence of other triggering events and the criteria used to make related judgments. (AS No. 5, paragraphs 42 and 44)

    - The issuer identified a triggering event at year end and performed an evaluation of the possible impairment of goodwill for the reporting unit discussed above, using certain of the same cash-flow assumptions that it had used in its earlier annual evaluation. The Firm failed to evaluate whether unfavorable operating results for the reporting unit and declines in actual and forecasted sales prices in the period after the issuer's annual evaluation should have affected the assumptions used in this year-end evaluation. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, and .31)

- The Firm's testing of the valuation of certain intangible assets, which the issuer acquired in a business combination during the year, was insufficient. Specifically, the Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions that the issuer used to determine the fair value of these acquired intangible assets –

    - For one assumption, the Firm limited its testing to inquiring of management and gathering documentation that management provided to the issuer's board of directors. (AU 328, paragraphs .26 and .28)

  - For another assumption, related to production volumes, the issuer forecasted its production for certain locations based on each location's average production for the four previous years. The Firm's testing of this assumption was limited to comparing certain historical data to underlying support and recalculating the average production for certain of these locations. For several individual locations, there were significant differences between the current-year production volume and the production volume projected for the following year based on the average production, but the Firm failed to evaluate the reasonableness of using the average production in light of these differences. (AU 328, paragraphs .26, .28, .31, and .36)

- The Firm's procedures related to the issuer's deferred tax asset for research and development tax credits were insufficient. Specifically –

  - The Firm selected for testing one control over the research and development tax credits, which consisted of the issuer's identification and valuation of uncertain tax positions. The Firm limited its testing of this control to (1) inspecting emails and documents with signatures that indicated a review of the issuer's uncertain tax position memorandum had occurred and (2) inquiring of management. The Firm, however, failed to ascertain the nature of the review procedures performed, including the criteria that the control owner used to identify matters for follow up and whether those matters were appropriately resolved. As a result, the Firm failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements relating to these tax credits. (AS No. 5, paragraphs 42 and 44)

  - The Firm failed to test the accuracy and completeness of the data that the issuer used in determining the estimated tax credits. (AU 342, paragraph .11)

A.2. Issuer B

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

- The issuer generated revenue at numerous locations where certain types of routine transactions were initiated and entered for processing. In performing inquiries as part of planning the audit, the Firm obtained information that indicated there could be an opportunity to carry out a potential fraud, but the Firm did not take this into account when determining its fraud risks and, as a result, did not design procedures that were intended to specifically address this risk. The Firm's procedures to test revenue were insufficient, as follows –

    - The Firm's tests of controls over revenue from insurance reimbursements, which combined represented over 90 percent of the issuer's revenue, were insufficient. Specifically –

        - The issuer had a decentralized process for initiating revenue. The Firm selected for testing a quarterly monitoring control that operated over this process and was performed centrally. This control included (1) the review of a sample of invoices for errors and compliance with certain billing policies and (2) the subsequent reporting of the results of this review. These results showed a significant rate of errors and issues with respect to the reviewed invoices both before and after submission for reimbursement. The Firm failed to evaluate whether these errors and issues were the result of a deficiency in the controls over this revenue. In addition, the Firm's testing of the review aspect of this control was limited to reading the reports prepared as part of the control, without obtaining an understanding of, and evaluating, the review procedures performed by the control owners. (AS No. 5, paragraphs 42, 44, and 48)

        - During the year, for one of its significant business units, the issuer implemented a new application through which a large number of revenue transactions were initiated. The Firm failed to identify and test any controls over the accuracy and completeness of the important revenue data entered into this application. (AS No. 5, paragraph 39)

        - The issuer used a report as part of the operation of another control over revenue that the Firm tested; the Firm, however, failed to identify and test any controls over the accuracy and completeness of this report. (AS No. 5, paragraph 39)

        - The Firm's strategy included testing controls over user access to certain applications; the Firm, however, failed to sufficiently test those controls. Specifically, the Firm failed to verify that the access that was granted for the individuals included in its sample was the same as the access that had been approved. In addition, when testing controls consisting of management's review of the appropriateness of user-access roles, the Firm performed procedures only for the issuer's centralized service center, and failed to test the access of users at the individual locations who also had access to the applications. (AS No. 5, paragraph 44)

    - The Firm designed its substantive 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 revenue was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

- The Firm's procedures related to the issuer's analysis of the possible impairment of certain indefinite-lived intangible assets for one business unit were insufficient. Specifically –

    - The Firm selected for testing a control over the issuer's annual analysis of the possible impairment of indefinite-lived intangible assets, but failed to test the aspects of this control that related to the reasonableness of certain assumptions that the issuer used in its analysis. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of a report that the issuer used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

- o The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions and test certain data that the issuer used in its analysis of the possible impairment of these assets. Specifically, for one assumption, the Firm limited its testing to reviewing supporting schedules for unusual items. For another assumption, the Firm limited its testing to comparing the assumption to certain information that it had obtained independently, even though that information related to different geographic areas from those in which the assets were located. For a third assumption, the Firm performed no procedures. In addition, the Firm failed to test the accuracy of a report that the issuer used in determining the fair value of the intangible assets. (AU 328, paragraphs .26, .28, .31, and .39)

A.3. <u>Issuer C</u>

In this audit of a manufacturer of products used in certain industrial applications, 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 selected for testing a control over the cash-flow forecasts that the issuer used in its analysis of the possible impairment of goodwill. The control consisted of management's presentation to the board of directors of a budget, which formed an important basis for the cash-flow forecasts. The Firm failed to sufficiently test this control. Specifically, the Firm's procedures were limited to reviewing minutes of a meeting of the board of directors to obtain evidence that a review had been performed; the Firm did not obtain an understanding of the level of aggregation of the information reviewed, the criteria used to identify issues for further investigation, or the manner in which identified issues were investigated and resolved. As a result, the Firm failed to evaluate 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 sufficiently evaluate the reasonableness of certain significant assumptions that the issuer used in its analysis of the possible impairment of goodwill for a significant reporting unit. Specifically –

  - The Firm failed to perform procedures to test the issuer's revenue projections, beyond (1) performing separate analyses of possible revenue growth and future gross margins to determine the point at which the reporting unit's fair value would fall below its carrying value, (2) inquiring of management, and (3) comparing the forecasted revenue growth rate to forecasts for the industry in which the reporting unit's products were used. The Firm failed to evaluate whether these general industry forecasts were relevant to the issuer's specific market and to consider whether the assumptions were reasonable in light of the significant historical volatility in the issuer's revenue growth. (AU 328, paragraphs .26, .28, .31, and .36)

  - The issuer was in the process of undertaking a plant renovation for a component that represented a significant portion of the reporting unit, and it projected improvements in gross margins as a result of the renovation. The Firm failed to evaluate the reasonableness of the issuer's assumptions about the effect of the renovation on the component's gross margins. (AU 328, paragraphs .26, .28, and .36)

  - The Firm limited its testing of forecasted working capital to a comparison to historical data, without taking into account the effect of the forecasted increases in revenue. (AU 328, paragraphs .26, .28, .31, and .36)

A.4. Issuer D

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

- The issuer engaged an external party ("the consultants") to perform its testing of controls. The Firm used the work of the consultants as evidence of the effectiveness of the majority of the controls that the Firm selected for testing, including certain of the controls that the Firm considered to involve high risk or to address risks of fraud that it identified. The Firm used the work of the consultants to a greater extent than was appropriate, given:

- the risks involved;
- the Firm's failure to consider, in its evaluation of the consultants' objectivity, that the consultants reported to a member of management in the accounting department; and
- the extent of the Firm's testing of the consultants' work, which was insufficient to enable the Firm to make an evaluation of the overall quality and effectiveness of the consultants' testing, as the Firm's testing was limited to reperforming a small amount of the consultants' testing. (AS No. 5, paragraph 19; AU 322, paragraphs .10, .24, and .26)

- During the year, the issuer acquired two significant businesses. The Firm failed to sufficiently test the fair value of the in-process research and development acquired in those transactions. Specifically, the Firm failed to evaluate, beyond considering its industry knowledge and inquiring of management, the reasonableness of certain significant assumptions underlying the cash-flow forecasts that the issuer used to estimate the fair value of these assets. (AU 328, paragraphs .26 and .28)

A.5. Issuer E

In this audit of an issuer whose business included real estate development, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR –

- The issuer owned an interest in an entity that it had accounted for under the equity method; during the year, the issuer acquired an additional interest in that entity and accounted for the acquisition as a business combination. The Firm's procedures related to the issuer's accounting for the business combination were insufficient as follows –

- o The Firm selected for testing a control that included management's review of the results of the acquired entity. The Firm also selected for testing a control over the issuer's accounting for investments, including business combinations. The Firm limited its testing of these controls to inquiring of management, inspecting documents with signatures that indicated reviews performed as part of the controls had occurred, reading memoranda prepared as part of the controls, and, for one of these controls, attending several meetings that constituted a part of the operation of the control. The Firm's testing did not include ascertaining the nature of the review procedures performed, including the criteria used by the control owners to identify matters for follow up or the actions that the control owners performed to assess the reasonableness of the revenue projections used to determine the fair value of the trademarks that were acquired in the business combination. As a result, 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)

- o The Firm failed to sufficiently evaluate certain significant assumptions that the issuer used to develop revenue projections in order to value the acquired trademarks. Specifically, the Firm's procedures were limited to comparing certain pricing estimates, which were inputs into the revenue projections, to market information, without evaluating the reliability and comparability of such information. For certain other assumptions, the Firm performed no procedures. (AU 328, paragraphs .26, .28, and .31)

- o The Firm failed to identify and test any controls over the accuracy and completeness of data that the issuer used to determine the fair value of acquired favorable and unfavorable leases. In addition, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had substantively tested any of the data used to determine the fair value of these leases. (AS No. 5, paragraph 39; AU 328, paragraph .39)

- The issuer owned interests in several entities that it accounted for using the equity method. For the majority of these investments, the issuer asserted that the related real estate investments were under development, and, therefore, the issuer reported no equity income or loss. The Firm's testing of the issuer's equity-method investments was insufficient, as follows –

- o The Firm limited its substantive procedures and its tests of controls to those investments for which the issuer recognized equity income or loss during the year, which represented less than 40 percent of the issuer's total equity-method investments. (AS No. 5, paragraphs 42 and 44; AS No. 12, paragraph 63; AS No. 13, paragraph 8)

- o The Firm selected for testing two controls over the issuer's accounting for investments, but failed to sufficiently test these controls with respect to the equity-method investments for which the issuer recognized equity income or loss. Specifically, the Firm selected its samples to test the operating effectiveness of these controls without taking into account its assessment of the risk associated with these controls and the number of investments for which the controls operated, and the samples that the Firm selected were too small to provide sufficient appropriate evidence. (AS No. 5, paragraphs 46 and 47)

A.6. Issuer F

The issuer provided services to its customers under contracts specifying the services to be provided; the issuer often had multiple open contracts with a single customer. The Firm identified a fraud risk related to revenue recognition. The Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. Specifically, with respect to revenue at a significant location –

- The Firm tested controls over revenue that it believed addressed the identified fraud risk, and it used the results of this testing to assess control risk at less than the maximum. These controls included (1) the review and approval of revenue recognized and billings recorded for ongoing projects, (2) the preparation and review of reconciliations of revenue, unbilled revenue, and customer deposits to the general ledger, (3) the review and/or approval of project costs, and (4) the calculation and review of the allowance for uncollectible accounts. The Firm's procedures to test these controls were limited to one or more of the following: inquiring of management; gathering reconciliations, account analyses, and/or other documents prepared as part of the control; verifying that account balances on the reconciliations were consistent with the balance recorded in the general ledger and/or supporting documentation; and/or inspecting documents with signatures or notations that indicated reviews performed as part of the controls had occurred. These procedures were insufficient, as, for certain of these controls, the Firm's testing did not address the criteria used by the control owners to identify matters for investigation; for all of these controls, the Firm's testing did not ascertain the nature of the procedures performed to investigate matters that were identified for investigation. The Firm, therefore, failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 13, paragraphs 13, 16, 19, and 21)

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

- For the majority of the revenue transactions that it selected for testing, the Firm failed to review the underlying contract or other documents that delineated all the relevant contract terms and conditions. (AS No. 13, paragraphs 8 and 13)

- The Firm failed to sufficiently evaluate the reasonableness of two significant assumptions that the issuer used in allocating revenue to the different phases of its customer contracts. Specifically, for one of these assumptions, the Firm limited its procedures to inquiring of management, and for the other assumption, the Firm performed no procedures. (AS No. 13, paragraphs 8 and 13; AU 342, paragraph .11)

- The Firm failed to obtain evidence that the issuer had overcome the presumption under GAAP that contracts negotiated with the same customer at or near the same time should be evaluated as a single arrangement. (AS No. 14, paragraph 30)

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 –

- During the year, the issuer acquired two significant businesses. The Firm's testing related to the issuer's accounting for business combinations was insufficient in the following respects –

    - The Firm selected for testing two controls over the accounting for business combinations; however, it failed to sufficiently test these controls. Specifically, the Firm limited its testing to inquiring of management, inspecting documents with signatures or other notations that indicated reviews performed as part of the controls had occurred, and reading issuer-prepared memoranda summarizing the transactions. The Firm's procedures did not include any testing of an important aspect of the controls, which consisted of the assessment of the reasonableness of the forecasts that the issuer used to determine the fair value of the acquired intangible assets and contingent consideration. (AS No. 5, paragraphs 42 and 44)

    - For one of the acquired businesses, the Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions underlying the forecasts that the issuer used to determine the fair value of the acquired intangible assets and the contingent consideration. Specifically, the Firm's procedures were limited to inquiring of management and comparing the revenue projections underlying the forecasts used in the valuation to (1) presentations provided to the issuer's board of directors and (2) actual results for a short period after the business combination. (AU 328, paragraphs .26, .28, and .31)

- The issuer amortized the acquired intangible assets on a straight-line basis over the estimated useful lives of the assets. The Firm failed to evaluate whether the issuer's use of the straight-line basis was appropriate, given indicators in the issuer's cash-flow forecasts that the economic benefit of these intangible assets would be consumed on a variable basis. (AS No. 14, paragraph 3; AU 342, paragraph .11)

A.8 Issuer H

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

- The Firm's procedures to test the issuer's analysis of the possible impairment of goodwill were insufficient. The Firm's procedures related to the revenue forecasts, which the issuer used to estimate the fair value of one of its reporting units and the implied fair value of that reporting unit's goodwill, consisted of (1) inquiring of management, (2) comparing forecasted sales growth rates to industry information for the issuer's most significant product, (3) performing sensitivity analyses, and (4) comparing the issuer's budget for the current year to actual results. These procedures were insufficient in the following respects –

    - The Firm failed to consider the implications on the revenue forecasts of a significant shortfall in the reporting unit's actual results for the current year compared to its previously budgeted amount. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, and .36)

    - The Firm failed to sufficiently evaluate the reasonableness of certain assumptions that the issuer used in its revenue forecasts. For certain assumptions, the Firm limited its testing to inquiry of management. For one assumption for one product, the Firm failed to perform any procedures. (AU 328, paragraphs .26 and .28)

- The Firm failed to perform sufficient procedures to test property, plant, and equipment ("PPE"). Specifically –

- o The Firm tested certain additions to PPE through an interim date. The Firm, however, failed to test a non-routine significant entry in the issuer's listing of additions to PPE, despite the fact that this entry was in an amount that was multiple times the Firm's established materiality level. In addition, the Firm failed to perform sufficient procedures to extend its conclusions to the year end. Specifically, the Firm limited its procedures to gathering a list of the additions that occurred after the interim date. The total of the additions included in the list, however, did not agree to the issuer's accounting records. Further, the Firm's procedures did not include testing any of these additions. (AS No. 13, paragraphs 8 and 45)

- o The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions underlying the forecasts that the issuer used in its analysis of the possible impairment of one of the issuer's asset groups; this asset group represented over 90 percent of the issuer's PPE. Specifically, the Firm limited its testing to inquiring of management, verifying the mathematical accuracy of certain calculations, and comparing the forecasted selling prices for the issuer's products to actual selling prices in recent years, without evaluating the significant variances that it identified. (AU 328, paragraphs .26, .28, .31, and .36)

A.9. Issuer I

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. During the year, the issuer acquired a business with significant property and equipment and accounted for this acquisition as a business combination. The Firm failed to evaluate the reasonableness of significant assumptions and test the data that the issuer used in determining the fair value of the acquired property and equipment. (AU 328, paragraphs .26, .28, and .39)

A.10. Issuer J

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The issuer acquired a significant business during the year, and it accounted for the acquisition as a business combination. The Firm failed to substantively test the fair value of certain significant acquired assets and assumed liabilities as of the acquisition date. (AS No. 13, paragraph 8; AU 328, paragraph .23)

A.11. Issuer K

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as the Firm's procedures to test the valuation of certain significant assets acquired during the year in a business combination were insufficient. Specifically, the Firm failed to test the accuracy of certain data that the issuer used in determining the fair value of the majority of the acquired PPE. (AU 328, paragraph .39)

A.12. Issuer L

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. To test the fair value measurement of certain of the issuer's securities, the Firm requested pricing information from external pricing services. For certain securities, which consisted primarily of collateralized debt obligations and collateralized loan obligations, the Firm did not receive a price. The Firm limited its substantive procedures for these securities to gathering directly from the issuer (1) broker quotes, without evaluating whether the broker quotes were executable, or (2) other valuation information that the issuer had obtained from external sources, without evaluating the specific methods and/or assumptions underlying these fair value measurements. (AU 328, paragraphs .26, .28, and .31)

A.13. Issuer M

In this audit of a manufacturer and distributor of consumer products, 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 inventory were insufficient, as follows –
    - o The Firm failed to perform sufficient procedures related to the existence and completeness of inventory held at external locations, consisting of outside warehouses and manufacturers. This inventory was multiple times the Firm's established level of materiality and represented a significant proportion of current

assets. The Firm failed to identify and test any controls over the existence and completeness of this inventory. In addition, to substantively test this inventory, the Firm inappropriately limited its procedures to confirming a sample of inventory balances with the warehouses and manufacturers. (AS No. 5, paragraph 39; AU 331, paragraph .14)

  - The Firm failed to perform sufficient procedures related to inventory held at the issuer's warehouses. The Firm selected for testing a control over the inventory cycle counts at the issuer's warehouses and planned for its testing of this control to provide both substantive and control assurance. The Firm, however, failed to test whether the issuer's cycle-count procedures addressed that sufficient inventory items were counted. (AS No. 5, paragraph 42; AU 331, paragraph .11)

- The Firm selected for testing certain controls over the issuer's allowances for sales returns and discounts, but failed to sufficiently test these controls. Specifically, the Firm limited its procedures to test each control to two of the following three procedures: inspecting documents with signatures or other notations that indicated a review performed as part of the controls had occurred, comparing certain information in schedules prepared as a part of the controls to supporting schedules and/or to the general ledger and, for one of these controls, noting that certain variances were explained. The Firm's testing did not include ascertaining the nature of the review procedures performed or evaluating the criteria used by the control owners to identify matters for investigation, and, therefore, 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.14. <u>Issuer N</u>

In this audit of a marketer of consumer products, 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 the issuer's accounting for certain customer discounts were insufficient. Specifically –

  - The Firm selected for testing two controls over the issuer's customer discount reserve, but failed to test the operating effectiveness of the aspects of the controls related to evaluating whether the reserve accurately included all authorized discounts. (AS No. 5, paragraph 44)

  - The Firm failed to sufficiently test the issuer's customer discount reserve. Specifically, the Firm failed to evaluate certain of the significant assumptions, and test certain data, that the issuer used to calculate the reserve. (AU 342, paragraph .11)

- The Firm's procedures related to the issuer's inventory reserve were insufficient. Specifically –

  - The Firm selected for testing a control consisting of a review of the issuer's analysis of the inventory reserve, but failed to test the aspect of the control related to assessing the reasonableness of the reserve percentages. Specifically, the Firm's procedures were limited to performing its own assessment of the reasonableness of the reserve percentages, and did not include evaluating how the control owner assessed the reasonableness of the percentages. Therefore, the Firm failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

  - The issuer disclosed that it had experienced a decline in its inventory turnover, and the Firm identified a number of inventory items that had had no sales within the last 12 months, but the Firm failed to consider whether this evidence should have affected its conclusion that the issuer's inventory reserve was appropriate. (AS No. 14, paragraph 3; AU 342, paragraph .11)

- The Firm selected for testing a control that included management's review of the accrual for in-transit inventory, but it limited its procedures to test this control to determining whether the accrual agreed to the underlying documentation and the approved journal entry. The Firm failed to test the procedures that the control owner performed to assess the accuracy and completeness of the underlying documentation and therefore failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

A.15. Issuer O

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 two controls that included the review of aspects of the issuer's accounting for income taxes; these controls operated with respect to a large number of tax jurisdictions and were performed by multiple control owners. The Firm failed to sufficiently test these controls. Specifically –

- The Firm's procedures were limited to inspecting the results of certain parts of the control owners' analyses, verifying certain tax rates used in the analyses, and inquiring of two individuals. One of these individuals was one of the multiple control owners; the other individual was not one of the control owners. The Firm's testing did not include ascertaining (1) the nature of the review activities performed by the control owners, including determining how adjustments or issues were identified, investigated, and resolved or (2) the consistency of the control owners' performance. Therefore, 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)

- The issuer used certain reports and schedules as part of the operation of these controls; the Firm, however, failed to identify and test any controls over the accuracy and completeness of these reports and schedules. (AS No. 5, paragraph 39)

- The Firm selected its samples without taking into account (1) its assessment of the risk associated with these controls, (2) the large number of tax jurisdictions for which the controls operated, and (3) that each control was performed by multiple control owners, and the samples that the Firm selected to test the operating effectiveness of these controls were too small to provide sufficient evidence. (AS No. 5, paragraphs 46 and 47)

A.16. Issuer P

In this audit of an insurer, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. Specifically, the Firm's procedures related to the property and casualty loss reserve, with respect to which the Firm identified a significant risk, were insufficient, as follows –

- The issuer used internal actuaries as part of its process to develop its estimate of its property and casualty reserve. When testing controls over this process, the Firm failed to identify and test any controls over the accuracy and completeness of certain system-generated reports showing claims data that the issuer provided to the actuaries for use in the development of the estimate. (AS No. 5, paragraph 39)

- The Firm developed an independent expectation of the estimate as part of its substantive procedures. The Firm's procedures related to this expectation, however, were insufficient. Specifically, the Firm used the issuer's loss triangles (which were developed from the reports described above and which included loss data for multiple periods) to develop its independent expectation and determined that it needed to substantively test the accuracy and completeness of the loss triangles in addition to relying on controls over them. The Firm determined its sample sizes for this testing, however, based on a high level of control reliance, which was not supported due to the deficiency in the Firm's testing of controls that is discussed above. As a result, the sample sizes that the Firm used to test the accuracy and completeness of the loss triangles were too small to provide sufficient evidence. In addition, with respect to the testing of the completeness of the data within the loss triangles, the Firm selected its sample from within certain of the loss triangles to compare to supporting documentation, which was not appropriate for the purpose of testing the completeness of such data. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .17, .19, .23, and .23A)

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 issuer recognized revenue for one of its components, which generated a significant portion of total revenue, under the percentage-of-completion method of accounting. The Firm selected for testing a control that included management's review of contract terms and the initial estimate of total project costs. The Firm, however, failed to test the aspect of this control related to the review of the initial estimate. In addition, the Firm failed to sufficiently test controls over the appropriateness of the actual costs incurred, as the control that the Firm identified and tested consisted of a comparison of those actual costs to the initial estimate and the investigation and resolution of differences that exceeded certain thresholds. As a result, this control was dependent on the accuracy of that initial estimate. (AS No. 5, paragraphs 42 and 44)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also 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 Issuer E Issuer G Issuer M Issuer N Issuer O Issuer P Issuer Q	3 5 1 1 4 1 3 3 3 1 1
AS No. 12, *Identifying and Assessing Risks of Material Misstatement*	Issuer E	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer B Issuer E Issuer F Issuer H Issuer J Issuer P	1 1 4 1 1 1
AS No. 14, *Evaluating Audit Results*	Issuer A Issuer F Issuer G Issuer H Issuer N	2 1 1 1 1
AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*	Issuer D	1
AU 328, *Auditing Fair Value Measurements and Disclosures*	Issuer A Issuer B Issuer C Issuer D Issuer E Issuer G Issuer H Issuer I Issuer J Issuer K Issuer L	7 1 3 1 2 1 3 1 1 1 1
AU 331, *Inventories*	Issuer M	2
AU 342, *Auditing Accounting Estimates*	Issuer A Issuer F Issuer G Issuer N	1 1 1 2

PCAOB Auditing Standards	**Audits**	**Number of Deficiencies per Audit**
AU 350, *Audit Sampling*	Issuer B Issuer F Issuer P	1 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] The following standard was cited for only one issuer and is excluded from the table: AU 322.[5]

	AS No. 5	AS No. 12	AS No. 13	AS No. 14	AU 328	AU 331	AU 342	AU 350
Business combinations, including contingent consideration	E, G		J		A, D, E, G, I, J, K			
Fixed assets			H		H			
Impairment of goodwill and intangible assets	A, B, C			A, H	A, B, C, H			
Income taxes	A, O						A	
Insurance reserves	P		P					P
Inventory and	M, N			N		M	N	

[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 D.

[5] The AU 322 issue for Issuer D related to controls for all financial statement areas except business combinations.

	AS No. 5	AS No. 12	AS No. 13	AS No. 14	AU 328	AU 331	AU 342	AU 350
related reserves								
Investment securities and equity-method investments	E	E	E		L			
Long-lived assets, including amortization, depreciation or depletion				G			G	
Revenue, including accounts receivable, deferred revenue, and allowances	B, M, N, Q		B, F	F			F, N	B, F

B.3. Audit Deficiencies by Industry

The table below lists the industries[6] 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.[7] 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. 12	AS No. 13	AS No. 14	AU 322	AU 328	AU 331	AU 342	AU 350
Consumer	1		1	2		1		2	1

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

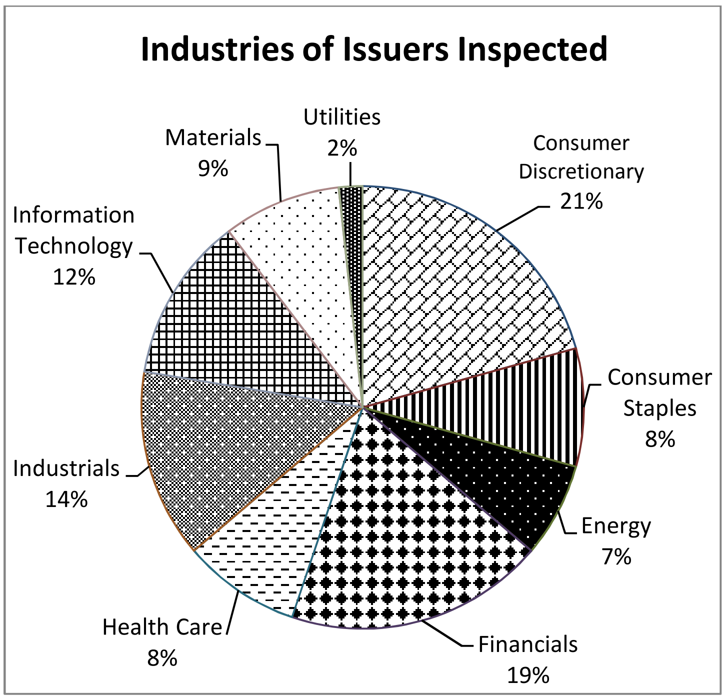
[7] Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

	AS No. 5	AS No. 12	AS No. 13	AS No. 14	AU 322	AU 328	AU 331	AU 342	AU 350
Discretionary									
Consumer Staples	2	1	1			1	1		
Energy	1								
Financial	1		2			2			1
Healthcare	2		1	1		2		1	1
Industrials	1					1			
Information Technology	1				1	1			
Materials	2		1	2		3		1	

C. Data Related to the Issuer Audits Selected for Inspection[8]

C.1. Industries of Issuers Inspected

The chart below categorizes the 58 issuers whose audits were inspected in 2014, based on the issuer's industry.[9]



Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	12	21%
Consumer Staples	5	8%
Energy	4	7%
Financials	11	19%
Health Care	5	8%
Industrials	8	14%
IT	7	12%
Materials	5	9%
Utilities	1	2%

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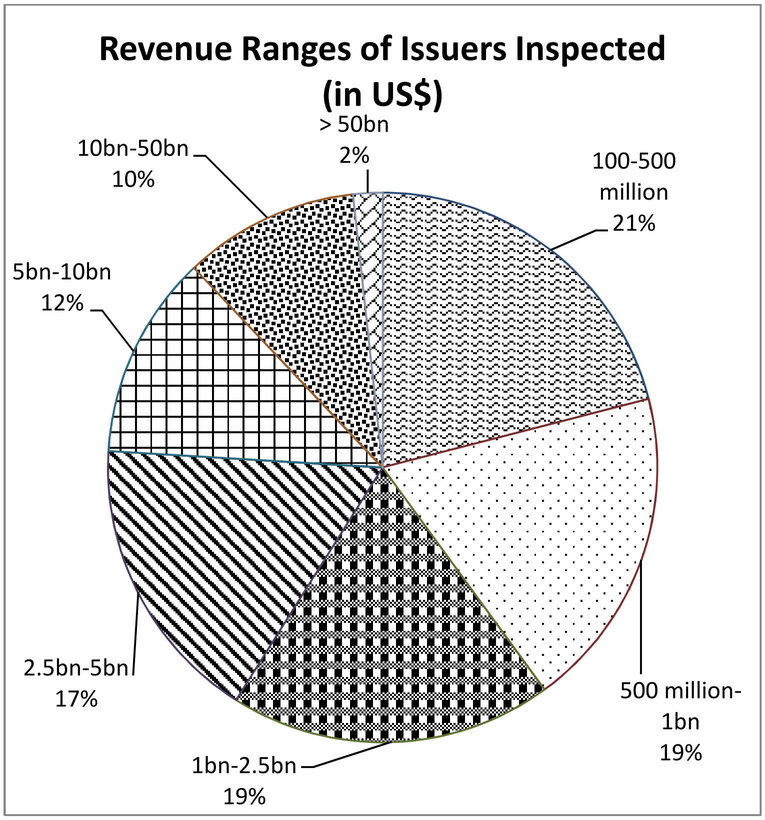
[8] Where the audit work inspected related to an engagement in which the Firm played a role but was not the principal auditor, the industry and the revenue included in the tables and charts below are those of the entity for which an audit report was issued by the primary auditor. As discussed above, the inspection process included reviews of portions of 57 selected issuer audits completed by the Firm and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor.

[9] See Footnote 6 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 58 issuers whose audits were inspected in 2014.[10] This presentation of revenue data is intended to provide information about the size of issuer audits that were inspected and is not indicative of whether the inspection included a review of the Firm's auditing of revenue in the issuer audits selected for review.



Revenue (in US$)	Number of Audits inspected	Percentage
100-500 million	12	21%
500 million - 1 billion	11	19%
1-2.5 billion	11	19%
2.5-5 billion	10	17%
5-10 billion	7	12%
10-50 billion	6	10%
>50 billion	1	2%

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

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

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

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. 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,[11] 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 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.

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[11] 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.

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.[12]

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

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

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice,* provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable

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[12] 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.

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 the firm's role in an audit may indicate a defect or potential defect in a firm's quality control system.[13] 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;[14] related firm methodology, guidance, and practices; and possible root causes.

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

[13] 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.

[14] 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.

(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, 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.[15]

[15] 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.

June 12, 2015

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 2014 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 2014 Inspection of our Firm's 2013 audits (the "Report").

Consistently performing high-quality audits remains the top priority of the Firm and our partners in order to serve the investing community and bring value to the capital markets. 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 various actions to continuously improve audit quality. We will address the matters raised in the Report in a thorough and thoughtful way.

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* and AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit of Financial Statements.*

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 look forward to continuing our dialogue with the PCAOB 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
Vice Chairman and US Assurance Leader
PricewaterhouseCoopers LLP

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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***		
PLANNING THE AUDIT		
AS No. 5.19	The extent to which the auditor may use the work of others in an audit of internal control also depends on the risk associated with the control being tested. As the risk associated with a control increases, the need for the auditor to perform his or her own work on the control increases.	Issuer D
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 B, E, M, O, and P
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.	Issuers A, B, C, E, G, M, N, O, and Q

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of 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.	
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 provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for a company's financial reporting and associated controls, the auditor may take into account the combined competence of company personnel and other parties that assist with functions related to financial reporting.	Issuers A, B, C, E, G, M, N, O, and Q
Relationship of Risk to the Evidence to be Obtained		
AS No. 5.46	For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness would result. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases Note: Although the auditor must obtain evidence about the effectiveness of controls for each relevant assertion, the auditor is not responsible for obtaining	Issuers E and O

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	sufficient evidence to support an opinion about the effectiveness of each individual control. Rather, the auditor's objective is to express an opinion on the company's internal control over financial reporting overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.	
AS No. 5.47	Factors that affect the risk associated with a control include – • The nature and materiality of misstatements that the control is intended to prevent or detect; • The inherent risk associated with the related account(s) and assertion(s); • Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness; • Whether the account has a history of errors; • The effectiveness of entity-level controls, especially controls that monitor other controls; • The nature of the control and the frequency with which it operates; • The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information technology general controls); • The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; • Whether the control relies on performance by an individual or is automated (i.e., an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and Note: A less complex company or business	Issuers E and O

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	unit with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of information technology controls might focus on the application controls built into the pre-packaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls. • The complexity of the control and the significance of the judgments that must be made in connection with its operation. Note: Generally, a conclusion that a control is not operating effectively can be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.	
AS No. 5.48	When the auditor identifies deviations from the company's controls, he or she should determine the effect of the deviations on his or her assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control. Note: Because effective internal control over financial reporting cannot, and does not, provide absolute assurance of achieving the company's control objectives, an individual control does not necessarily have to operate without any deviation to be considered effective.	Issuer B

AS No. 12, *Identifying and Assessing Risks of Material Misstatement*		
IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT		
Identifying Significant Accounts and Disclosures and Their Relevant Assertions		
AS No. 12.63	The components of a potential significant account or disclosure might be subject to significantly differing risks.	Issuer E

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 E, F, H, and J
RESPONSES TO FRAUD RISKS		
AS No. 13.13	*Addressing Fraud Risks in the Audit of Financial Statements*. In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in accordance with paragraphs 16-17 of this standard, the auditor should perform tests of those controls.	Issuer F
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	Issuers B, F, and P

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AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	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.	

Footnotes 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, F, and P
TESTING DESIGN EFFECTIVENESS		
AS No. 13.19	The auditor should test the design effectiveness of the controls selected for testing 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 error 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	Issuer F

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	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.	
TESTING OPERATING EFFECTIVENESS		
AS No. 13.21	The auditor should test the operating effectiveness of a control selected for testing 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.	Issuer F
Substantive Procedures		
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, F, and P
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 H

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 conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.	Issuers A, G, H, and N
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 F

AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*		
Assessing the Competence and Objectivity of the Internal Auditors		
Objectivity of the Internal Auditors		

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AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*		

AU 322.10	When assessing the internal auditors' objectivity, the auditor should obtain or update information from prior years about such factors as—
	• The organizational status of the internal auditor responsible for the internal audit function, including—
	  ◦ Whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors.
	  ◦ Whether the internal auditor has direct access and reports regularly to the board of directors, the audit committee, or the owner-manager.
	  ◦ Whether the board of directors, the audit committee, or the owner-manager oversees employment decisions related to the internal auditor.
	• Policies to maintain internal auditors' objectivity about the areas audited, including—
	  ◦ Policies prohibiting internal auditors from auditing areas where relatives are employed in important or audit-sensitive positions.
	  ◦ Policies prohibiting internal auditors from auditing areas where they were recently assigned or are scheduled to be assigned on completion of responsibilities in the internal audit function.
		Issuer D

Evaluating and Testing the Effectiveness of Internal Auditors' Work		
AU 322.24	The auditor should perform procedures to evaluate the quality and effectiveness of the internal auditors' work, as described in paragraphs .12 through .17, that significantly affects the nature, timing, and extent of the auditor's procedures. The nature and extent of the procedures the auditor should perform when making this	Issuer D

AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*		
	evaluation are a matter of judgment depending on the extent of the effect of the internal auditors' work on the auditor's procedures for significant account balances or classes of transactions.	
AU 322.26	In making the evaluation, the auditor should test some of the internal auditors' work related to the significant financial statement assertions. These tests may be accomplished by either (*a*) examining some of the controls, transactions, or balances that the internal auditors examined or (*b*) examining similar controls, transactions, or balances not actually examined by the internal auditors. In reaching conclusions about the internal auditors' work, the auditor should compare the results of his or her tests with the results of the internal auditors' work. The extent of this testing will depend on the circumstances and should be sufficient to enable the auditor to make an evaluation of the overall quality and effectiveness of the internal audit work being considered by the auditor.	Issuer D

AU 328, *Auditing Fair Value Measurements and Disclosures*		
Testing The Entity's Fair Value Measurements and Disclosures		
AU 328.23	Based on the auditor's assessment of the risk of material misstatement, the auditor should test the entity's fair value measurements and disclosures. Because of the wide range of possible fair value measurements, from relatively simple to complex, and the varying levels of risk of material misstatement associated with the process for determining fair values, the auditor's planned audit procedures can vary significantly in nature, timing, and extent. For example, substantive tests of the fair value measurements may involve (*a*) testing management's significant assumptions, the valuation model, and the underlying data (see paragraphs .26 through .39), (*b*) developing independent fair value estimates for corroborative purposes (see paragraph .40), or (*c*) reviewing subsequent events and transactions (see paragraphs .41 and .42).	Issuer J

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). 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.	Issuers A, B, C, D, E, G, H, I, and L
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, C, D, E, G, H, I, and L
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 A, B, C, E, G, H, and L
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;	Issuers A, C, and H

AU 328, *Auditing Fair Value Measurements and Disclosures*		
	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.	
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.	Issuers B, E, I, and K

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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 M
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 reliable. *c.* Observe physical counts of the goods, if practicable and reasonable.	Issuer M

AU 331, *Inventories*		
	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. 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	Issuers A, F, G, and N

AU 342, *Auditing Accounting Estimates*		
	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.	

AU 350, *Audit Sampling*		
Sampling In Substantive Tests Of Details		
Planning Samples		
AU 350.17	When planning a particular sample, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures, to be applied will achieve that objective. The auditor should determine that the population from which he draws the sample is appropriate for the specific audit objective. For example, an auditor would not be able to detect understatements of an account due to omitted items by sampling the recorded items. An appropriate sampling plan for detecting such understatements would involve selecting from a source in which the omitted items are included. To illustrate, subsequent cash disbursements might be sampled to test recorded accounts payable for understatement because of omitted purchases, or shipping documents might be sampled for understatement of sales due to shipments made but not recorded as sales.	Issuer P
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	Issuers B, F, and P

AU 350, ***Audit Sampling***		
	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.	
<u>Footnote to AU 350.19</u> [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 350.23	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 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.	Issuers B, F, and P
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, F, and P