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Report on

2015 Inspection of PricewaterhouseCoopers LLP
(Headquartered in New York, NY)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

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PCAOB
Public Company Accounting Oversight Board

2015 INSPECTION OF PRICEWATERHOUSECOOPERS LLP

Preface

In 2015, 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, Appendix D, and Appendix E. 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.

Note on this report's citations to auditing standards: On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization will be effective as of December 31, 2016, but the reorganized numbering system may be used before that date. In this report, citations to PCAOB auditing standards use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. A table cross-referencing the section numbers of those standards included in Part I of this report as reorganized is included at Appendix E.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from March 2015 to March 2016. The inspection team performed field work at the Firm's National Office and at 28 of its approximately 74 U.S. practice offices.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 53 issuer audits performed by the Firm and a review of the Firm's audit work on two other issuer audit engagements in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. Two of the deficiencies relate to auditing aspects of an issuer's financial statements that the issuer restated after the primary inspection procedures.[2] In addition, in six 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

[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 2015 inspection did not include review of any additional audit work related to these restatements.

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

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

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

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[3] Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for

The audit deficiencies that reached this level of significance are described in Part I.A.1 through I.A.12, below.

Effects on Audit Opinions

Of the 12 issuer audits that appear in Part I.A, deficiencies in 10 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in nine audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the nine audits in which substantive testing deficiencies were identified, two audits included deficiencies in substantive testing that the inspection team determined were caused by a reliance on controls that was excessive 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	7
Deficiencies included in Part I.A related to the financial statement audit only	2
Deficiencies included in Part I.A related to the ICFR audit only	3
Total	12

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changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and 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.

Most Frequently Identified Audit Deficiencies

The following table lists, in summary form, the types of deficiencies that are included most frequently in Part I.A of this report. A general description of each type is provided in the table; the description of each deficiency in Part I.A contains more specific information about the individual deficiency. The table includes only the three 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 the design and/or operating effectiveness of controls that the Firm selected for testing.	<u>8 Audits:</u> Issuers A, B, C, E, F, G, I, and J
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate.	<u>7 Audits:</u> Issuers A, B, C, D, E, F, and H
Failure to test controls over or test the accuracy and completeness of issuer-produced data or reports.	<u>6 Audits:</u> Issuers A, B, C, E, H, and I

Audit Deficiencies

A.1. <u>Issuer A</u>

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

- The Firm's procedures related to the valuation of goodwill for one of the issuer's reporting units were insufficient. Specifically –
    - o The Firm selected for testing two controls over the issuer's analysis of the possible impairment of goodwill. One of these controls consisted of management's review of the impairment analysis and the other consisted of management's review of the strategic plan on

which cash-flow forecasts used in the analysis were based. The Firm failed to sufficiently test these controls, as its procedures were limited to inquiring of management, comparing the financial information used in the analysis with financial information from the issuer's systems, comparing the cash-flow forecasts used in the impairment analysis with the cash-flow forecasts included in the issuer's strategic plan, and inspecting notes and subsequent changes to the cash-flow forecasts as evidence that the reviews had occurred. The Firm failed to evaluate whether the review procedures that the control owners performed to assess (1) the reasonableness of the cash-flow forecasts, including the type and amount of certain corporate expenses allocated to the reporting unit, and (2) the reasonableness of the working capital and debt adjustments that were used to determine the fair value of the reporting unit were designed and operating to meet the objectives of the control. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to sufficiently evaluate the reasonableness of the cash-flow forecasts that the issuer used to determine the fair value of the reporting unit's goodwill. Specifically –

  - The Firm compared the actual results for the year under audit to the issuer's cash-flow forecasts made in the prior year and to the cash-flow forecasts used in the analysis. The Firm concluded that the cash-flow forecasts used in the analysis were reasonable without considering (1) that the forecasts were significantly different from the actual results for the year under audit and (2) that the actual results for the year under audit were significantly different from the issuer's cash-flow forecasts for that year that had been made in the prior year. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, .31, and .36)

  - The Firm failed to evaluate the reasonableness of the allocation of corporate expenses to the cash-flow forecasts for the reporting unit. (AU 328, paragraphs .26 and .28)

  - The issuer had inappropriately included certain items in its calculation of the working-capital adjustment and inappropriately excluded certain items in its calculation of the debt adjustment; these adjustments were used in determining the fair value of the reporting unit. The Firm, however, failed to identify and evaluate the effect of these errors. (AU 328, paragraph .39)

  - The Firm concluded that the percentage that the issuer applied to its annual revenue to determine the working-capital adjustment was reasonable without considering that the percentage represented a significant difference from the historical percentage that the issuer had experienced. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, .31, and .36)

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

  - The Firm failed to identify and test any controls over the accuracy and completeness of both the quantities and prices of raw materials, labor, and overhead included in the bill of materials, which was used to determine the cost of work-in-progress and finished goods inventory. (AS No. 5, paragraph 39)

  - The Firm selected for testing a control that included management's review of the capitalization of variances from standard inventory costs, but it failed to sufficiently test this control. Specifically, the Firm limited its testing to (1) inquiring of management, (2) assessing the calculation of purchase price variances for reasonableness, and (3) determining that the related journal entries had been posted and approved. The Firm failed to test whether the control operated at a level of precision that would prevent or detect material misstatements, as it failed to ascertain and evaluate the nature of the review procedures performed, the criteria used to identify items for follow up, and how those items were resolved. (AS No. 5, paragraphs 42 and 44)

- o The Firm failed to perform sufficient substantive procedures to test work-in-progress and finished goods inventory. Specifically –

  - ▪ The Firm designed its substantive procedures – including sample sizes – 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 sizes the Firm used to test the valuation of these categories of inventory were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

  - ▪ With respect to work-in-progress and finished goods inventories, the Firm failed to test the calculation of the variances between actual and standard costs for raw materials, labor, and overhead. In addition, the Firm failed to test whether the costs for raw materials used in determining the value of the items the Firm selected for testing were the same as the standard costs that the issuer had approved and that the Firm had tested. (AS No. 13, paragraph 8)

- During the year, the issuer acquired a significant business. The customer-retention rate was an important assumption that the issuer used to determine the value of the acquired customer-relationship intangible asset. The Firm failed to test the accuracy and completeness of the data that the issuer used to determine the customer-retention rate. (AU 328, paragraph .39)

A.2. Issuer B

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

- During the year, the issuer acquired a significant business. The Firm's testing related to the valuation of the customer-relationship intangible asset acquired in this transaction was insufficient in the following respects –

- o The Firm selected for testing a control over the valuation of the intangible asset. One aspect of this control consisted of a review of the 20-year cash-flow forecasts used to value the intangible asset, including a comparison of the underlying customer-retention rate assumption to historical customer-retention rates. The Firm failed to sufficiently test this aspect of the control, as it limited its testing to inquiring of management, obtaining meeting agendas, and inspecting emails noting comments from the control owner related to revisions made to the cash-flow forecasts. The Firm failed to evaluate the appropriateness of (1) the control owner's review of the reasonableness of the forecasted cash flows for any of the forecast periods beyond the three years that followed the current year and (2) the control owner's review of the reasonableness of the customer-retention rate. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the historical customer-retention data used in the operation of the control. (AS No. 5, paragraphs 39, 42, and 44)

- o The Firm failed to perform sufficient substantive procedures to evaluate the reasonableness of the cash-flow forecasts, including the underlying customer-retention rate assumption, that the issuer used in determining the value of the intangible asset. Specifically –

  - ▪ For a sample of customer contracts, the Firm compared the forecasted revenue for the current year for each contract to the actual revenue. For many of these contracts, the Firm identified significant differences; however, it failed to evaluate whether these differences indicated that adjustments should have been made to the issuer's cash-flow forecasts. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, .31, and .36)

  - ▪ The Firm failed to perform any procedures to evaluate the forecasted cash flows for any of the forecast periods beyond the three years that followed the current year. (AU 328, paragraphs .26 and .28)

- The Firm failed to test the accuracy and completeness of the historical information used in determining the customer-retention rate assumption, or test controls over this information as discussed above. (AU 328, paragraph .39)

- The issuer's assets included several customer-relationship intangible assets that had been recorded in a previous year. The customer-relationship intangible assets were based on relationships established through specific customer contracts. The issuer's financial statements disclosed that it would review and update the remaining useful economic lives of these assets whenever events indicated that the estimated duration of the specific customer relationships had decreased. The Firm's testing related to the valuation and remaining useful lives of certain of these customer-relationship intangible assets was insufficient. Specifically –

  - The Firm selected for testing a control that included the issuer's assessment of indicators of potential impairment for these intangible assets. Although the Firm identified that the issuer had not maintained information about which specific customers supported these intangible assets, the Firm failed to evaluate the implications of this on its assessment of the effectiveness of this control. (AS No. 5, paragraph 38)

  - The Firm failed to identify and test any controls over the issuer's assessment of the appropriateness of the remaining useful economic lives of these intangible assets. (AS No. 5, paragraph 39)

  - The Firm failed to perform sufficient substantive procedures to test the valuation of these intangible assets. Specifically, even though the issuer had not maintained information about which specific customers supported these intangible assets, as noted above, the Firm's testing was limited to (1) inquiring of management; (2) evaluating issuer, industry, and economic factors for indicators of potential impairment; and (3) re-calculating the future amortization of the intangible assets, without performing any procedures to assess the potential impairment of the customer relationships that supported the intangible assets. (AS No. 14, paragraph 3; AU 342, paragraph .11)

- 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 operating effectiveness of controls for almost all of the controls that the Firm considered to be of low and medium risk and that the Firm selected for testing, The Firm's use of the work of the consultants was excessive because the Firm's testing of the consultants' work was limited to reperformance for a small percentage of the controls, even though the Firm had information indicating that the consultants might have a low level of objectivity because they were engaged by the issuer's management and reported directly to the control owner for some of the controls they tested. (AU 322, paragraphs .10, .24, and .26)

A.3. Issuer C

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 a significant business. The Firm's testing related to the issuer's accounting for the business combination was insufficient in the following respects –
  - o The Firm selected for testing a control that included the review of cash-flow forecasts and other significant assumptions used to determine the fair value of acquired intangible assets; however, it failed to sufficiently test this control. Specifically, the Firm limited its testing to inquiring of management; inspecting the cash-flow forecast model; and reading a presentation to the board of directors, a due diligence report, and certain emails and notes. The Firm failed to evaluate the specific nature of the review procedures that the control owners performed to assess the reasonableness of

the cash-flow forecasts and other significant assumptions. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to perform sufficient procedures to evaluate the reasonableness of certain significant assumptions underlying the cash-flow forecasts that the issuer used to determine the values of the customer-relationship and technology-related intangible assets. Specifically, for the customer-relationship intangible assets, the Firm tested the overall projected revenue growth rate for the acquired business, but failed to test the specific revenue growth rates for the different groups of customers that were used to determine the values of the customer-relationship intangible assets. In addition, the Firm failed to test certain historical data used in developing attrition-rate assumptions. Further, for a significant assumption used to determine the value of the technology-related intangible asset, the Firm limited its testing to inquiry. (AU 328, paragraphs .26, .28, and .39)

- The Firm identified several likely sources of potential misstatement related to capitalized labor hours for internally developed software. The Firm's procedures related to the capitalization of labor costs were insufficient. Specifically –

  - The Firm selected for testing a control that included the review and approval of employee labor hours to be capitalized. The Firm tested the design of this aspect of the control, but it failed to test whether it was operating effectively. In addition, the Firm selected for testing a control that consisted of the comparison of budgeted hours to actual hours incurred by project, but failed to identify and test any controls over the accuracy and completeness of the budgeted hours used in the operation of that control. (AS No. 5, paragraphs 39 and 44)

  - The Firm determined the sample size of its substantive test of the accuracy and occurrence of employee labor hours capitalized to internally developed software costs based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of the controls discussed above. As a result, the sample size the Firm used to test capitalized labor hours was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

- The Firm failed to identify and test any controls that addressed the risk that the Firm identified related to the accuracy and completeness of data that were used to record one type of revenue for certain components. (AS No. 5, paragraph 39)

A.4. Issuer D

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The issuer manufactured complex products and recognized revenue primarily using the percentage-of-completion method. For one of the issuer's two segments, which represented a majority of the issuer's revenue, the Firm failed to perform sufficient procedures related to revenue as follows –

- For two of the segment's significant components, the Firm failed to identify and test any controls over the selection of the method for determining the stage of completion for individual contracts. (AS No. 5, paragraph 39)

- The Firm selected certain open and closed contracts to evaluate the reasonableness of the significant assumptions used to determine the estimated costs to complete contracts, contract reserves, and any subsequent adjustments. The Firm's procedures to test the open contracts were limited to inquiring of management. (AU 342, paragraph .11)

- The Firm selected a sample of contracts for testing; one of these contracts contained certain performance incentives and another contained a significant modification. The Firm failed to evaluate whether the issuer's accounting related to these types of provisions was in conformity with GAAP. (AS No. 14, paragraph 30)

A.5. Issuer E

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. During the year, the issuer acquired multiple significant businesses. The Firm's testing related to the valuation of certain acquired intangible assets was insufficient in the following respects –

- To develop the attrition rates used in determining the fair value of acquired customer-relationship intangible assets, the issuer used attrition rates for other companies in the industry and, for certain of the acquisitions, also used historical data or qualitative considerations. The Firm's procedures related to the attrition rates that the issuer developed were insufficient. Specifically –

  - The Firm selected for testing a control that included a review of the reasonableness of the attrition rates; however, it failed to sufficiently test this aspect of the control. Specifically, the Firm limited its testing of this aspect to inquiring of management, obtaining historical and industry data that the issuer used in determining the attrition rates, and inspecting documents that indicated approval by the control owner. The Firm failed to (1) ascertain and evaluate the nature of the control owner's review of the extent to which the industry data related to companies that were comparable to the issuer and (2) identify and test any controls over the accuracy and completeness of the historical data used in the performance of the control. (AS No. 5, paragraphs 39, 42, and 44)

  - The Firm failed to test whether the industry data related to companies that were comparable to the issuer. In addition, the Firm failed to test the accuracy and/or completeness of the historical data that the issuer used in developing the attrition rates. (AU 328, paragraphs .26, .28, .31, .36, and .39)

  - For one of the acquired businesses, the Firm documented that the attrition rate was determined assuming long-standing customer relationships and that the rate was reasonable based on a reluctance of customers to change suppliers. The Firm, however, failed to (1) obtain corroboration of the representation that the acquired business had long-standing relationships with its customers and (2) consider the implications of the recent loss of customers by another acquired business with similar product characteristics. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, .31, and .36)

- For one of the acquired businesses, the Firm failed to sufficiently evaluate the reasonableness of certain other significant assumptions underlying the cash-flow forecasts that the issuer used in determining the value of acquired trademark and customer-relationship intangible assets ("original forecasts"). The Firm's procedures to test the original forecasts consisted of (1) comparing the original forecasts to five years of historical results, (2) comparing the first four months of the original forecasts to the actual results for the four months from the date of the acquisition to year end ("look-back analysis"), and (3) comparing the original forecasts to the forecasts used in the issuer's annual analysis of the potential impairment of goodwill (performed at year end). These procedures were insufficient in the following respects –

    - The Firm concluded the original forecasts were reasonable, even though the Firm's procedures to evaluate the reasons for the significant differences between the original forecasts and the five-year historical results were limited to inquiry. (AU 328, paragraphs .26, .28, .31, and .36)

    - The Firm identified significant differences between the original forecasts and (1) the actual results used in the look-back analysis and (2) the forecasts in the goodwill impairment analysis, despite the relatively short period between these analyses, and identified reasons for these differences. The Firm concluded that the original forecasts used in the analyses were reasonable without considering whether the reasons for the differences were known, and should have been taken into account, when the original forecasts were developed. (AS No. 14, paragraph 3; AU 328, paragraphs .26, .28, .31, and .36)

- o The values of the individual intangible assets were determined based on forecasts of cash flows for sub-units below the reporting-unit level. The Firm, however, performed its look-back analysis and comparison of the original forecasts to five-year historical results based on cash flows aggregated at the reporting-unit level. As a result, the Firm's procedures were not precise enough to provide sufficient evidence regarding the significant assumptions affecting the determination of fair values for the individual intangible assets. (AU 328, paragraphs .26 and .28)

A.6. Issuer F

In this audit of a software and hardware 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 planned to release several new products that were internally developed. These new products were based on technology that the issuer had previously acquired and recorded as an indefinite-lived intangible asset. The issuer planned to phase out the existing significant products that used this technology. The Firm's procedures related to the issuer's analysis of the possible impairment of this intangible asset were insufficient in the following respects –

    - o The Firm selected for testing two controls that consisted of (1) the review of cash-flow forecasts and certain other assumptions used in determining the fair value of the intangible asset and (2) the development, review, and approval of the issuer's budget, which was used in developing the cash-flow forecasts. The Firm failed to sufficiently test these controls. Specifically –

        - ▪ For the first control, the Firm limited its testing to inquiring of management and inspecting industry data used in the board-approved five-year plan.

        - ▪ For the second control, the Firm limited its testing to inquiring of management, inspecting board presentations and related minutes to obtain evidence that a review had been performed, and noting that the review covered certain topics.

The Firm failed to evaluate the nature of the review procedures that the control owners performed to assess the reasonableness of the cash-flow forecasts and the related assumptions and budget. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to perform sufficient procedures to evaluate the reasonableness of the discount rate that the issuer used in determining the fair value of the intangible asset. Specifically, the Firm limited its procedures to comparing the rate to a range of rates that it had used in its testing three years earlier; the high end of the Firm's range was the rate that the issuer used to determine the fair value of the asset three years earlier and the low end of the range was calculated by subtracting the company-specific risk premium from the issuer's rate. The Firm failed to consider (1) the reasonableness of the current company-specific risk premium, which had been reduced as compared with the premium three years earlier, and (2) whether the rate should have been revised given the risk associated with the release of the new products. (AU 328, paragraphs .26, .28, and .36)

- The Firm failed to perform sufficient procedures to evaluate the reasonableness of the revenue assumptions underlying the cash-flow forecasts that the issuer used in determining the fair value of the intangible asset. The Firm's procedures to test these assumptions consisted of (1) inquiring of management, (2) comparing revenue forecasts for the previous and current years to actual results ("look-back analysis"), (3) comparing the revenue forecasts for future years to the forecasts for those years in the prior-year and current-year budgets ("budget comparisons"), and (4) calculating certain historical revenue growth rates and comparing them to the growth rates in the forecast. The Firm also performed a sensitivity analysis that provided little to no substantive assurance, as it used scenarios that were unlikely given the Firm's understanding of the facts and circumstances. The Firm's procedures were insufficient because the Firm failed to consider whether the historical data related to the existing products that were used in the look-back analysis, budget comparison, and comparison of historical growth rates were relevant given the issuer's plans to release the new products and phase out the existing products. In addition, in performing its look-back analysis and budget comparison procedures, the Firm concluded that the forecasts were reasonable, even though the Firm's procedures to evaluate the reasons for the significant differences between the forecasted and actual revenues were limited to inquiry. (AU 328, paragraphs .26, .28, .31, and .36)

- For certain product sales, the issuer reported revenue on a gross rather than net basis. The Firm agreed with this presentation and based its conclusion on the fact that the issuer had inventory risk, credit risk, and leverage in establishing the pricing of the product. The Firm, however, failed to obtain corroboration of the issuer's assertion that it was subject to inventory risk, and there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the other criteria set forth in GAAP for reporting revenue on a gross basis. (AS No. 14, paragraph 30)

A.7. Issuer G

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The issuer initiated, processed, and recorded revenue and inventory transactions through numerous divisions. For one of the issuer's geographic regions, the Firm reduced the number of divisions that it selected for testing based on the assumption that two entity-level controls ("ELCs") operated effectively across all of the divisions. This assumption, and therefore the associated reduction in the scope of the Firm's testing, was not supported as follows –

- One of the ELCs that the Firm selected for testing was described by the Firm as a quarterly review of certain income statement accounts for each division. The Firm, however, failed to identify that the review did not include all of the divisions. (AS No. 5, paragraphs 42, 44, and B11)

- The second ELC that the Firm selected for testing consisted of a quarterly review of balance sheet fluctuations at the level of the issuer's consolidated financial statements. The Firm failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements at the division level, given that the review was performed based on results at the consolidated level. In addition, the Firm failed to evaluate the specific nature of the review procedures performed, including how items selected for follow up were resolved. (AS No. 5, paragraphs 42, 44, and B11)

A.8. Issuer H

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

- The Firm failed to perform sufficient procedures to test the issuer's allowance for loan losses ("ALL"). Specifically –

  - For most of the issuer's loans, the Firm planned to use the work of the issuer's loan-review function ("LRF") to test the loan risk-rating process, which was used to identify potentially impaired loans. The Firm limited its procedures to evaluating the competence and objectivity of the LRF personnel, reading the LRF reports, and evaluating the conclusions in those reports. The Firm failed to evaluate whether the scope of the LRF work was sufficient to test the issuer's loan risk-rating process. In addition, the Firm failed to perform any testing of the LRF's work and therefore was not able to evaluate whether (1) the LRF reports were consistent with the results of the work performed and (2) the conclusions reached were appropriate. (AS No. 13, paragraph 8)

  - For certain loans acquired with credit impairment, the Firm documented that it designed its substantive procedures assuming high reliance on controls and that its procedures to test these loans were dual-purpose in nature. The Firm, however, failed to perform sufficient procedures to achieve the objectives of both the test of the control over the valuation of these loans and its substantive testing. Specifically –

- For part of the sample that the Firm selected for dual-purpose testing, the Firm performed only the procedures that tested the control. For the remainder of the sample, it performed only substantive procedures. In addition, the Firm performed part of its testing as of an interim date and divided its sample between loans outstanding at the interim date and those outstanding at year end; the Firm, however, selected some of the same loans for testing at both dates. As a result, the Firm failed to perform both control and substantive testing for an appropriate sample of items based on the sample size for its dual-purpose test. (AS No. 13, paragraph 47; AU 350, paragraph .25)

- In evaluating errors identified through its testing, the Firm limited its quantitative evaluation to netting the variances identified and concluding that the net amount was immaterial. In addition, the Firm failed to evaluate the effect of these errors when reaching its conclusion on the effectiveness of the control. (AS No. 13, paragraph 34; AU 350, paragraph .26)

- The Firm failed to perform sufficient procedures to test appraisals that the issuer used to value certain real estate assets at year end. Specifically, the Firm failed to (1) evaluate the qualifications and objectivity of certain of the appraisers, (2) evaluate the appropriateness of the methods and the reasonableness of the assumptions underlying the appraisals, and (3) test the data provided to the appraisers. (AU 328, paragraphs .26 and .28; AU 336, paragraphs .08, .10, and .12)

A.9. <u>Issuer I</u>

In this audit of an issuer in the financial services industry, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to sufficiently test controls over the ALL. The Firm selected for testing two controls, one of which included reviews of the loan delinquency status and the other of loan charge-offs. The loan delinquency status and loan charge-offs were significant inputs in the calculation of the general reserve component of the ALL. The Firm failed to sufficiently test these controls as follows –

- Numerous employees of the issuer had the ability to change the delinquency and charge-off status for loans, and the issuer performed these controls to detect possible manipulation of loan delinquencies and charge-offs. Although the Firm identified that the control owners could also make similar changes to loans, the Firm failed to consider this fact when evaluating the design effectiveness of the controls. (AS No. 5, paragraph 42)

- The Firm's procedures to test these controls were limited to inquiring of management and inspecting certain documents that included signatures or notations to indicate that the reviews performed as part of the controls had occurred. The Firm failed to (1) determine if the control owners' reviews included evaluating whether changes to loans were within the issuer's policy and (2) ascertain and evaluate the criteria used to identify items for follow-up and how those items were resolved. In addition, in designing its tests of one of these controls and evaluating the results, the Firm failed to consider the risk that the control was not performed consistently, given (1) the very large number of control owners and (2) information in the Firm's work papers that suggested that the level of review varied significantly among control owners. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to sufficiently test the design effectiveness of the issuer's control over the accuracy and completeness of a report used in the performance of one of these controls. Specifically, the Firm failed to identify that the control was not designed to cover all the key data in the report. (AS No. 5, paragraph 42)

A.10. Issuer J

In this audit of a healthcare provider, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as the Firm's testing of controls over patient-service revenue and accounts receivable was insufficient. Specifically –

- The Firm selected for testing a control that consisted of a review of the reasonableness of the allowances for contractual adjustments and uncollectible amounts. The Firm's testing of this control was limited to inquiring of management, inspecting documents for evidence of review and approval, comparing amounts in the analysis to the general ledger and/or other documentation, and inspecting calendar invitations that indicated meetings had occurred. The Firm's testing did not include (1) ascertaining and evaluating the nature of the review procedures that the control owners performed to assess the reasonableness of the allowances 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 control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

- In its walkthroughs, the Firm identified two controls over the occurrence of one type of revenue; however, the Firm failed to test the operating effectiveness of either of these controls, or to identify and test any other controls that would address this assertion. (AS No. 5, paragraph 44)

- The Firm's strategy for testing controls over revenue included testing information-technology general controls ("ITGCs") over important systems that processed and recorded revenue transactions. The Firm selected for testing a change-management control that was intended to identify unauthorized changes to the source code of internally developed systems. The issuer determined that this control was ineffective, and the Firm identified six compensating controls. The Firm failed to sufficiently evaluate whether these compensating controls operated at a level of precision that would prevent or detect a material misstatement resulting from the identified deficiency. Specifically, for four of these compensating controls, the Firm failed to evaluate whether the controls addressed the risk of unauthorized changes to source code that was intended to be addressed by the ineffective control. In addition, the Firm failed to consider that one of the two remaining compensating controls relied on the ineffective control discussed above. Further, the Firm failed to test the design and operating effectiveness of the last compensating control. (AS No. 5, paragraph 68)

- The Firm tested an application control at an interim date using a sample of one item for each relevant scenario; this approach was based on an assumption that ITGCs were operating effectively, which was not supported due to the deficiencies in the testing of ITGCs that are described above. As a result, the Firm's testing of this control was insufficient. (AS No. 5, paragraphs 46 and 47)

A.11. Issuer K

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 recorded an impairment charge related to certain real estate held for investment and, in a subsequent quarter, determined that the charge was an error. The Firm failed to evaluate whether this error should have had an effect on the Firm's conclusion on the effectiveness of the issuer's controls relating to the determination of adjustments to the valuation of real estate held for investment. (AS No. 5, paragraph B8)

- For one of the issuer's equity investments, the Firm sent a letter of audit inquiry to an external lawyer. For certain ongoing litigation, the lawyer's response did not include an evaluation of the likelihood of an unfavorable outcome or an estimate of the amount or range of potential loss, but the Firm failed to follow up to obtain that information. (AU 337, paragraph .04)

A.12. Issuer L

The Firm was engaged by the principal auditor of an issuer to audit the financial information of a wholly owned subsidiary to support the principal auditor's opinion on the consolidated financial statements. The Firm failed to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in the audit, as the Firm failed to test an addition to property, plant, and equipment that was several times the established materiality level. (AS No. 13, paragraph 8)

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 may 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 F Issuer G Issuer I Issuer J Issuer K	3 3 3 1 1 1 2 3 4 1
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer C Issuer H Issuer L	2 1 3 1
AS No. 14, *Evaluating Audit Results*	Issuer A Issuer B Issuer D Issuer E Issuer F	2 2 1 2 1
AU 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial*	Issuer B	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
Statements		
AU 328, *Auditing Fair Value Measurements and Disclosures*	Issuer A Issuer B Issuer C Issuer E Issuer F Issuer H	5 3 1 5 2 1
AU 336, *Using the Work of a Specialist*	Issuer H	1
AU 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*	Issuer K	1
AU 342, *Auditing Accounting Estimates*	Issuer B Issuer D	1 1
AU 350, *Audit Sampling*	Issuer A Issuer C Issuer H	1 1 2

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

[4] Certain deficiencies that affect multiple accounts or areas, such as those related to the use of consultants as evidence of the operating effectiveness of controls, are excluded from this table, but are included in Appendix D.

following standards were cited for only one issuer and are excluded from the table: AU 336 and AU 337.[5]

	AS No. 5	AS No. 13	AS No. 14	AU 328	AU 342	AU 350
Business combinations, including contingent consideration	B, C, E		B, E	A, B, C, E		
Definite-lived long-lived assets, including amortization	C	C				C
Fixed assets		L				
Impairment of goodwill and intangible assets	A, B, F		A, B	A, F	B	
Inventory and related reserves	A, G	A				A
Loans, including ALL	I	H		H		H
Other long-lived assets	K			H		
Revenue, including accounts receivable, deferred revenue, and allowances	C, D, G, J		D, F		D	

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, and cross-references the issuer to the specific auditing standards related to the deficiencies.[7]

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5 The AU 336 issue for issuer H related to other long-lived assets. The AU 337 issue for issuer K related to legal contingencies.

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. 13	AS No. 14	AU 322	AU 328	AU 336	AU 337	AU 342	AU 350
Consumer Staples	A	A	A		A				A
Financial Services	I, K	H			H	H	K		H
Health Care	J								
Industrials	B, D		B, D	B	B			B, D	
Information Technology	C, F	C	F		C, F				C
Materials	G	L							
Other	E		E		E				

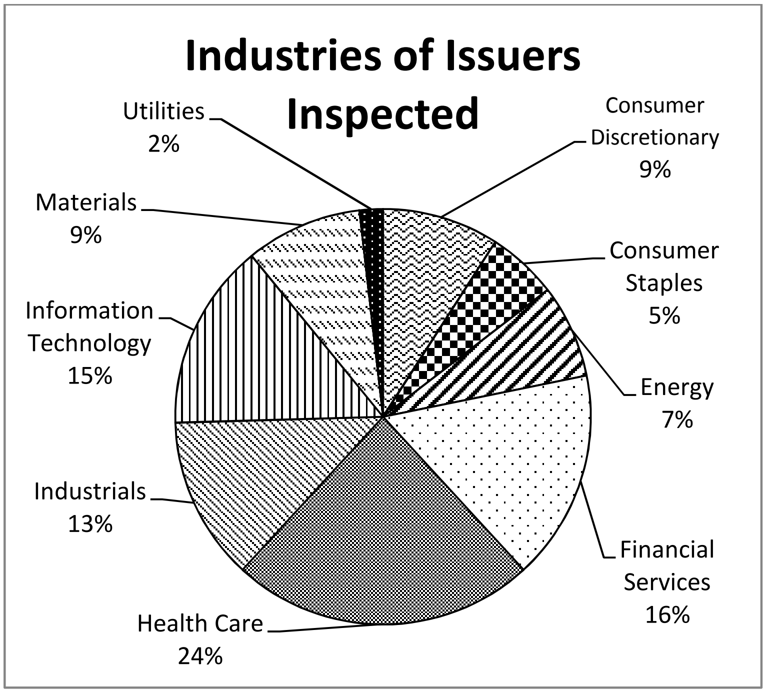
C. Data Related to the Issuer Audits Selected for Inspection[8]

C.1. Industries of Issuers Inspected

The chart below categorizes the 55 issuers whose audits were inspected in 2015, based on the issuer's industry.[9]

[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 in this section 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 53 selected issuer audits completed by the Firm and the Firm's audit work on two other issuer audit engagements in which it played a role but was not the principal auditor.

[9] See Footnote 7 for additional information on how industry sectors were classified.



Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	5	9%
Consumer Staples	3	5%
Energy	4	7%
Financial Services	9	16%
Health Care	13	24%
Industrials	7	13%
Information Technology	8	15%
Materials	5	9%
Utilities	1	2%

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 55 issuers whose audits were inspected in 2015.[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.

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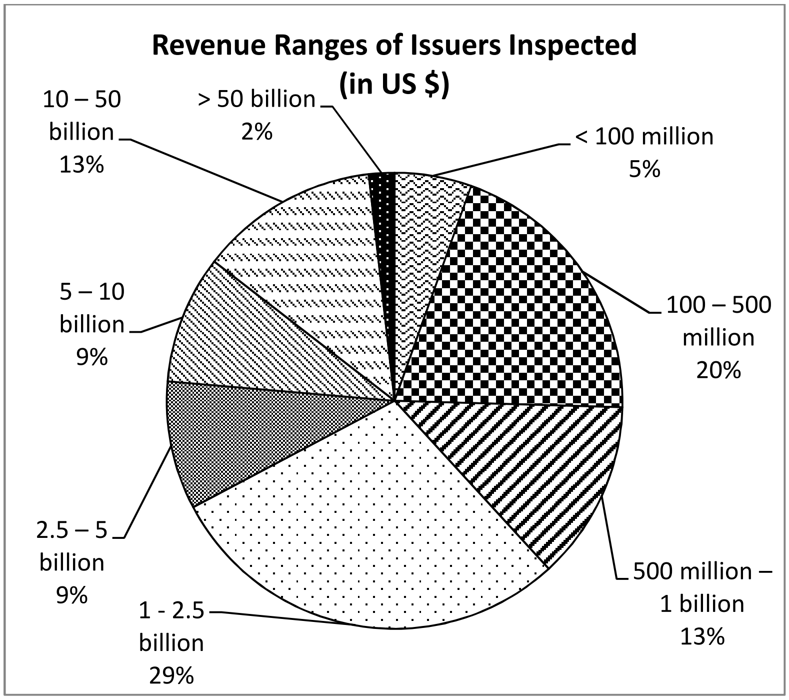
10 The revenue amounts reflected in the chart are for the issuer's fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.



Revenue (in US$)	Number of Audits Inspected	Percentage
< 100 million	3	5%
100 – 500 million	11	20%
500 million – 1 billion	7	13%
1 - 2.5 billion	16	29%
2.5 – 5 billion	5	9%
5 – 10 billion	5	9%
10 – 50 billion	7	13%
> 50 billion	1	2%

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.

[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.

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.

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

[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.

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 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

[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.

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 (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

[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.

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.

July 27, 2016

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 2015 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 2015 Inspection of our Firm's 2014 audits (the "Report").

We recognize the inspection process provides a valuable opportunity to improve the quality of our audits. 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. Bringing value to the capital markets by consistently performing high-quality audits remains our top priority, and we will address the matters raised in the Report in a thorough and thoughtful way. We understand that many of our stakeholders will review the PCAOB's final report and our response and have therefore included a link to our most recent annual audit quality report to encourage our stakeholders to see the tangible steps we are taking to maintain and improve audit quality. (http://www.pwc.com/us/en/cfodirect/issues/auditing/our-focus-on-audit-quality.html)

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 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 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,

Tim Ryan
US Chairman and Senior Partner
PricewaterhouseCoopers LLP

Maria C. Moats
US Assurance Leader
PricewaterhouseCoopers LLP

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APPENDIX D

AUDITING STANDARDS REFERENCED IN PART I.A

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

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
Understanding Likely Sources of Misstatement		
AS No. 5.38	In performing a walkthrough, at the points at which important processing procedures occur, the auditor questions the company's personnel about their understanding of what is required by the company's prescribed procedures and controls. These probing questions, combined with the other walkthrough procedures, allow the auditor to gain a sufficient understanding of the process and to be able to identify important points at which a necessary control is missing or not designed effectively. Additionally, probing questions that go beyond a narrow focus on the single transaction used as the basis for the walkthrough allow the auditor to gain an understanding of the different types of significant transactions handled by the process.	Issuer B
Selecting Controls to Test		
AS No. 5.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, B, C, D, and E
TESTING CONTROLS		
Testing Design Effectiveness		
AS No. 5.42	The auditor should test the design effectiveness of	Issuers A, B, C,

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements. Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.	E, F, G, I, and J
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, F, G, I, and J
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	Issuer J

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	Note: Although the auditor must obtain evidence about the effectiveness of controls for each relevant assertion, the auditor is not responsible for obtaining 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	Issuer J

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	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 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.	
EVALUATING IDENTIFIED DEFICIENCIES		
AS No. 5.68	The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.	Issuer J
APPENDIX B - Special Topics		
INTEGRATION OF AUDITS		
AS No. 5.B8	*Effect of Substantive Procedures on the Auditor's Conclusions About the Operating Effectiveness of Controls.* In an audit of internal control over financial reporting, the auditor should evaluate the effect of the findings of the substantive auditing procedures performed in the audit of financial statements on the effectiveness of internal control	Issuer K

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	over financial reporting. This evaluation should include, at a minimum – • The auditor's risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud. • Findings with respect to illegal acts and related party transactions. • Indications of management bias in making accounting estimates and in selecting accounting principles. • Misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls.	
MULTIPLE LOCATIONS SCOPING DECISIONS		
AS No. 5.B11	In assessing and responding to risk, the auditor should test controls over specific risks that present a reasonable possibility of material misstatement to the company's consolidated financial statements. In lower-risk locations or business units, the auditor first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides the auditor with sufficient evidence.	Issuer G

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 A, H, and L
Testing Controls		
TESTING CONTROLS IN AN AUDIT OF FINANCIAL STATEMENTS		
AS No. 13.16	*Controls to be Tested.* If the auditor plans to	Issuers A and C

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	assess control risk at less than the maximum by relying on controls,[12/] and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire **period of reliance**.[13/] However, the auditor is not required to assess control risk at less than the maximum for *all* relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	
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 A and C
ASSESSING CONTROL RISK		
AS No. 13.34	When deficiencies affecting the controls on which the auditor intends to rely are detected, the auditor should evaluate the severity of the deficiencies and the effect on the auditor's control risk assessments. If the auditor plans to rely on controls relating to an assertion but the controls that the auditor tests are ineffective because of control deficiencies, the auditor should: a. Perform tests of other controls related to the same assertion as the ineffective controls, or	Issuer H

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
	b. Revise the control risk assessment and modify the planned substantive procedures as necessary in light of the increased assessment of risk. Note: Auditing Standard No. 5 establishes requirements for evaluating the severity of a control deficiency and communicating identified control deficiencies to management and the audit committee in an integrated audit. AU sec. 325, *Communications About Control Deficiencies in an Audit of Financial Statements,* establishes requirements for communicating significant deficiencies and material weaknesses in an audit of financial statements only.	
Substantive Procedures		
AS No. 13.37	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 A and C
Dual-purpose Tests		
AS No. 13.47	In some situations, the auditor might perform a substantive test of a transaction concurrently with a test of a control relevant to that transaction (a "**dual-purpose test**"). In those situations, the auditor should design the dual-purpose test to achieve the objectives of both the test of the control and the substantive test. Also, when performing a dual-purpose test, the auditor should evaluate the results of the test in forming conclusions about both the assertion and the effectiveness of the control being tested.[20/]	Issuer H
Footnote to AS No. 13.47 [20/] Paragraph .44 of AU sec. 350 discusses applying audit sampling in dual-purpose tests.		

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, B, and E
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.	Issuers D and 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		

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 B

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	Issuer B

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

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, E, F, and H
AU 328.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management	Issuers A, B, C, E, F, and H

AU 328, *Auditing Fair Value Measurements and Disclosures*		
	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.	
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, E, and F
AU 328.36	To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows),[fn 5] individually and taken as a whole, need to be realistic and consistent with: a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances; b. Existing market information; c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies; d. Assumptions made in prior periods, if appropriate; e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable; f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; 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.	Issuers A, B, E, and F
Footnote to AU 328.36		

AU 328, *Auditing Fair Value Measurements and Disclosures*		
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 A, B, C, and E

AU 336, *Using the Work of a Specialist*		
Qualifications and Work of a Specialist		
AU 336.08	The auditor should consider the following to evaluate the professional qualifications of the specialist in determining that the specialist possesses the necessary skill or knowledge in the particular field: a. The professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate b. The reputation and standing of the specialist in the views of peers and others familiar with the specialist's capability or performance c. The specialist's experience in the type of work under consideration.	Issuer H
Relationship of the Specialist to the Client		
AU 336.10	The auditor should evaluate the relationship[fn 6] of the specialist to the client, including circumstances that might impair the specialist's objectivity. Such circumstances include situations in which the client has the ability—through employment, ownership, contractual right,	Issuer H

AU 336, *Using the Work of a Specialist*		
	family relationship, or otherwise—to directly or indirectly control or significantly influence the specialist.	
Footnote to AU 336.10 fn 6 The term *relationship* includes, but is not limited to, those situations meeting the definition of "related parties" contained in the financial reporting framework applicable to the company under audit.		
Using the Findings of the Specialist		
AU 336.12	The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.	Issuer H

AU 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*		
Auditing Considerations		
AU 337.04	With respect to litigation, claims, and assessments, the independent auditor should obtain evidential matter relevant to the following factors: *a.* The existence of a condition, situation, or set of circumstances indicating an uncertainty as to the possible loss to an entity arising from litigation, claims, and assessments. *b.* The period in which the underlying cause for legal action occurred. *c.* The degree of probability of an unfavorable outcome. *d.* The amount or range of potential loss.	Issuer K

AU 342, *Auditing 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 data is sufficiently reliable for the purpose. f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions. h. Consider using the work of a specialist regarding certain assumptions (section 336, Using the Work of a Specialist). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	Issuers B and D

AU 350, *Audit Sampling*		
Sampling In Substantive Tests Of Details		
AU 350.19	The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed." After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details.[fn 3] Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuers A and C
Footnote to AU 350.19 [fn 3] Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.		
AU 350.23	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 A and C
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	Issuers A and C

AU 350, *Audit Sampling*		
	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.	
Performance and Evaluation		
AU 350.25	Auditing procedures that are appropriate to the particular audit objective should be applied to each sample item. In some circumstances the auditor may not be able to apply the planned audit procedures to selected sample items because, for example, supporting documentation may be missing. The auditor's treatment of unexamined items will depend on their effect on his evaluation of the sample. If the auditor's evaluation of the sample results would not be altered by considering those unexamined items to be misstated, it is not necessary to examine the items. However, if considering those unexamined items to be misstated would lead to a conclusion that the balance or class contains material misstatement, the auditor should consider alternative procedures that would provide him with sufficient evidence to form a conclusion. The auditor also should evaluate whether the reasons for his or her inability to examine the items have (a) implications in relation to his or her risk assessments (including the assessment of fraud risk), (b) implications regarding the integrity of management or employees, and (c) possible effects on other aspects of the audit.	Issuer H
AU 350.26	The auditor should project the misstatement results of the sample to the items from which the sample was selected. [fn 5fn 6] There are several acceptable ways to project misstatements from a sample. For example, an auditor may have selected a sample of every twentieth item (50 items) from a population containing one thousand items. If he discovered overstatements of $3,000 in that sample, the auditor could project a $60,000 overstatement by dividing the amount of misstatement in the sample by the fraction of total items from the population included in the sample. The auditor should add that projection to the misstatements discovered in any items examined 100 percent. This total projected misstatement should be compared with the tolerable misstatement for the account balance or class of transactions, and appropriate consideration should be given to sampling risk. If the total projected misstatement is less than tolerable misstatement for the account balance or class of transactions, the auditor should consider the risk that such a result might be	Issuer H

AU 350, *Audit Sampling*		
	obtained even though the true monetary misstatement for the population exceeds tolerable misstatement. For example, if the tolerable misstatement in an account balance of $1 million is $50,000 and the total projected misstatement based on an appropriate sample (see paragraph .23) is $10,000, he may be reasonably assured that there is an acceptably low sampling risk that the true monetary misstatement for the population exceeds tolerable misstatement. On the other hand, if the total projected misstatement is close to the tolerable misstatement, the auditor may conclude that there is an unacceptably high risk that the actual misstatements in the population exceed the tolerable misstatement. An auditor uses professional judgment in making such evaluations.	

Footnotes to AU 350.26

[fn 5] If the auditor has separated the items subject to sampling into relatively homogeneous groups (see paragraph .22), he separately projects the misstatement results of each group and sums them.

[fn 6] Paragraphs 10 through 23 of Auditing Standard No. 14, *Evaluating Audit Results*, discuss the auditor's consideration of differences between the accounting records and the underlying facts and circumstances.

APPENDIX E

REORGANIZED STANDARDS REFERENCED IN PART I

On March 31, 2015, the PCAOB adopted the reorganization of its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). On September 17, 2015, the SEC approved the PCAOB's adoption of the reorganization. The reorganized standards will be effective as of December 31, 2016. The citations to PCAOB auditing standards included in this report use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. This table provides the section numbers of those standards included in Part I of this report as reorganized, as well as the titles of the standards both before and after the reorganization. The complete standards are available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.

Auditing Standards – before the reorganization		**Auditing Standards – as reorganized**	
AS No. 3	*Audit Documentation*	AS 1215	*Audit Documentation*
AS No. 5	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	AS 2201	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
AS No. 13	*The Auditor's Responses to the Risks of Material Misstatement*	AS 2301	*The Auditor's Responses to the Risks of Material Misstatement*
AS No. 14	*Evaluating Audit Results*	AS 2810	*Evaluating Audit Results*
AS No. 15	*Audit Evidence*	AS 1105	*Audit Evidence*
AU 230	*Due Professional Care in the Performance of Work*	AS 1015	*Due Professional Care in the Performance of Work*
AU 322	*The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*	AS 2605	*Consideration of the Internal Audit Function*
AU 328	*Auditing Fair Value Measurements and*	AS 2502	*Auditing Fair Value Measurements and*

Auditing Standards – before the reorganization		Auditing Standards – as reorganized	
	Disclosures		*Disclosures*
AU 336	*Using the Work of a Specialist*	AS 1210	*Using the Work of a Specialist*
AU 337	*Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*	AS 2505	*Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*
AU 342	*Auditing Accounting Estimates*	AS 2501	*Auditing Accounting Estimates*
AU 350	*Audit Sampling*	AS 2315	*Audit Sampling*