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Report on
2009 Inspection of BDO Seidman, LLP
(Headquartered in Chicago, Illinois)

Issued by the
Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

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Preface to Reports Concerning Annually Inspected Firms

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements and of internal control over financial reporting. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in different years.



Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



2009 INSPECTION OF BDO SEIDMAN, LLP

In 2009, the Board conducted an inspection of the registered public accounting firm BDO Seidman, LLP ("BDO" or "the Firm"). The Board is issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix B, and portions of Appendix C. Appendix B provides an overview of the inspection process. Appendix C includes the Firm's comments, if any, on a draft of the report.^{1/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{2/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

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

^{2/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from September 2009 through January 2010. The inspection team performed field work at the Firm's national and practice offices in New York City and Chicago, its Center for Information Management in Grand Rapids, and at an additional 18 of its approximately 37 U.S. practice offices.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{3/} To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix B to this report provides a description of the steps the inspection team took with respect to the review of audits and the review of certain firm-wide quality control processes.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{4/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

^{3/} This focus on weaknesses and deficiencies necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

^{4/} When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

A. Review of Audit Engagements

The inspection procedures included reviews of aspects of 33 audits performed by the Firm. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies.^{5/} Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP, including an error that appeared likely to be material to the issuer's financial statements. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3") provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.^{6/} For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to the firm's present ability to support its previously expressed opinions.^{7/}

^{5/} The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

^{6/} See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28.

^{7/} See AU 390, *Consideration of Omitted Procedures After the Report Date*, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB

and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers.^{8/}

In some cases, 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 competent evidential matter to support its opinion on the issuer's financial statements or internal control over financial reporting ("ICFR"). The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis.

Issuer A

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinions on the issuer's financial statements and internal control over financial reporting.

- The issuer's portfolio of fixed-maturity securities was held by an external custodian and was managed by an external manager, which provided valuations to the issuer that the issuer recorded. The Firm failed to obtain an understanding of how these fair value measurements were determined. Further, the Firm relied on the issuer's and the manager's controls over valuation without obtaining sufficient evidence regarding the effectiveness of these controls. Specifically, the service auditor's report for the manager did not address controls over the valuation of the securities, other than specific controls related to significant changes in valuations or the inability to obtain a valuation, and the Firm failed to test the issuer's controls over valuation other than controls that relied on valuations provided by the manager. In addition, the Firm failed to substantively test the valuation of these securities, other than by tracing the prices to a statement from the custodian without obtaining evidence about the controls over the valuations in that statement.

Rule 3200T), and PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements* ("AS No. 5"), ¶ 98.

^{8/} The Board inspection process generally did not include review of such additional procedures or documentation, although future Board inspections of the Firm may, as appropriate, include further review of any of these matters.

In addition, the Firm failed to test whether the issuer had appropriately classified the securities in the fixed-maturity portfolio as level 1, level 2, or level 3 within the framework established by SFAS No. 157, *Fair Value Measurements*, other than by verifying that prices were available in the financial press for those securities classified as level 1, that such prices were not available for those classified as level 2 or level 3, and that the level 2 and level 3 securities were classified as such in the custodian's and manager's reports.

- The Firm failed to perform sufficient procedures to test certain of the issuer's assertions related to the other-than-temporary impairment ("OTTI") of available for sale investments. Specifically, the Firm obtained from the issuer an analysis of securities that were reviewed for OTTI based on certain issuer-determined criteria, but the Firm failed to perform procedures to evaluate whether the issuer had identified all the securities that were other-than-temporarily impaired. The Firm also failed to evaluate the reasonableness of the issuer's assumptions regarding the future receipt of principal and interest for these securities. In addition, for certain securities that were in an unrealized loss position but that the issuer considered not to be other-than-temporarily impaired, the Firm failed to test the issuer's assertion that it had the intent and ability to hold the securities until the securities could recover from the unrealized losses.
- The Firm failed to perform sufficient procedures to test the completeness and accuracy of claims information that the issuer's actuarial specialist used to estimate losses. For a significant business segment, the Firm placed substantial reliance on controls. For this segment, the Firm identified a control related to the approval of certain claims, but inappropriately tested only one claim because the Firm incorrectly considered the control to be an automated control. The Firm did not test any other controls over the completeness and accuracy of claims information entered into the processing system from which the approval was based. The Firm also failed to test the completeness and accuracy of claims that were processed before the issuer implemented a new processing system during the year.
- The Firm failed to perform sufficient procedures to test the completeness and accuracy of revenue and claims for two other operating segments, which represented approximately half of the issuer's total recorded revenue. The issuer used outside parties to process and report revenue and certain claims for these

two segments. The Firm placed substantial reliance on controls when auditing revenue and claims originating from these two segments.

- For one of these operating segments, the Firm failed to test the operating effectiveness of the controls over the processing of the revenue and claims by outside parties, other than reading certain reports of audits of these outside parties' reports that had been performed by issuer personnel and reading the minutes of monthly meetings at which management discussed the segment's financial results.
- For the other segment, the Firm failed to test the data reported by the issuer's brokers, which the issuer used to record revenue and claims. Although the Firm tested the operating effectiveness of controls for the underwriting of contracts for this segment, the Firm failed to identify and test controls related to the completeness and accuracy of the issuer's revenue and claims reported by brokers arising from the contracts. The Firm also did not substantively test the claims information reported by these brokers.

Issuer B

In this audit, due to deficiencies in auditing revenue and the fair value of investments, the Firm failed to obtain sufficient competent evidential matter to support its audit opinions on the issuer's financial statements and internal control over financial reporting.

The issuer recognizes revenue under different policies depending upon the nature of the revenue-generating transaction. The deficiencies related to auditing revenue were as follows:

- The issuer entered into customer contracts that include multiple elements, and it disclosed that it allocated revenues to the separate elements based upon their relative fair values. The Firm failed to sufficiently test whether the average selling prices that the issuer used to indicate the elements' fair values were accurate, as it tested only a small number of transactions where the elements were sold separately. In addition, the Firm failed to test the issuer's assertion that the average selling prices were representative of fair value. For certain contracts that were sold at a discount, the issuer applied this discount to one element rather than to all elements of the arrangement based on their relative fair

values. The Firm failed to determine whether the effect of this inappropriate practice was material to the financial statements.

- For two types of revenue, the Firm failed to (i) obtain an understanding of certain aspects of the underlying revenue recognition model, (ii) identify and test relevant internal controls, and (iii) evaluate whether the timing of the recognition of revenue was appropriate.
- For revenues recorded under the proportional performance method of accounting, the Firm obtained an issuer-prepared schedule of individual contracts with changes in excess of a certain threshold during the year and an analysis of the average rate per service unit for those contracts. The Firm failed to test the completeness and accuracy of the underlying data used in the analysis. In addition, the Firm failed to include in its evaluation open contracts at year end and to consider whether there were any changes after year end to estimates related to those contracts that should have affected the revenue recorded for the contracts during the year under audit.
- In addition, as a result of the preceding deficiencies, the Firm failed to appropriately address the risk of fraud and other specific risks that it had identified related to these types of revenue.

The issuer recorded significant amounts of investments in securities that it described as level 2 securities. The issuer based its valuation of these investments on the statements prepared by the investment managers that held the securities. The audit deficiencies related to these investment securities were as follows:

- The Firm failed to obtain an understanding of how the fair value measurements provided by the investment managers to the issuer were determined.
- The Firm failed to perform substantive procedures to test the valuation of the level 2 securities.
- The Firm failed to test any controls pertaining to the issuer's valuation of its investments.
- The Firm obtained a service auditor's report related to one of the investment managers; however, the Firm failed to (i) evaluate the effects of the control

deficiencies identified in the report or to identify and test the issuer's controls that were intended to address those risks, and (ii) failed to perform procedures to update its understanding of controls in operation at the investment manager to cover the significant period from the date of the report to the end of the year.

Issuer C

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion—

- The Firm failed to adequately test certain significant adjustments to the goodwill previously recorded by the issuer. Specifically -
 - The Firm failed to perform procedures beyond inquiry to test the underlying data and to evaluate the reasonableness of the assumptions the issuer used to record significant increases to (1) the estimated fair value of contingent liabilities assumed in connection with the acquisition of a business that had occurred a year earlier and (2) the goodwill related to that acquisition.
 - Other than two signed-off audit program steps that were general in nature, an issuer-prepared list of adjustments to goodwill that did not indicate that any specific audit work was performed, and a general statement in a memorandum that all acquisitions had been reviewed for potential purchase price adjustments, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the appropriateness of the amount and classification of certain tax-related adjustments the issuer had made to reduce the goodwill that related to businesses acquired in a prior year.
- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had determined the reasons for the net decrease in the issuer's deferred tax valuation allowance that exceeded the net decrease in the issuer's deferred tax assets. Furthermore, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed audit procedures on the issuer's tax provision, the underlying tax schedules, or the assumptions made by management underlying certain tax amounts, including the provision for international taxes, other than signed-off audit programs that were general in nature, certain issuer-prepared schedules and memoranda, and

general statements in a memorandum that the Firm had performed various reconciliations and reviews.

Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- The Firm failed to adequately audit the fair value assigned to preferred stock issued in connection with a significant business combination. Specifically, the Firm failed to evaluate, beyond inquiry, the reasonableness of the method and assumptions that the issuer's valuation specialist used and failed to test the inputs used in the valuation specialist's model to determine the fair value assigned to the preferred stock.
- The issuer identified various finite-lived intangible assets that it had acquired as part of two significant business combinations during the year. The issuer provided certain financial projections and assumptions, including forecasted revenue growth rates, add-backs due to anticipated synergies, and effective tax rates, to its valuation specialist in order to estimate the fair values of the intangible assets. The Firm's specialist also used those projections and assumptions to evaluate the estimated fair values. The Firm prepared certain analyses to assess the reasonableness of the revenue projections, but these analyses addressed only the first year of the projections, and the Firm failed to follow up on the fact that the revenue amounts computed in the analyses fell short of the projection. Other than these analyses, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed any procedures to evaluate those projections and assumptions. Also, the Firm failed to test the customer attrition data that the issuer provided to its valuation specialist to value customer relationships. In addition, for one of the acquisitions, the Firm failed to evaluate the reasonableness of (i) the assumptions that the issuer provided to its valuation specialist to value an acquired database and (ii) the estimated useful life of the database.

Issuer E

In this audit, the Firm failed to perform sufficient procedures to evaluate the reasonableness of a significant assumption management used to calculate the gain on the sale of a business. The issuer compared the cash received from the sale with the

carrying value, including goodwill, of the sold business when determining whether a gain or loss had occurred on the sale. In order to determine how much of its goodwill to allocate to the disposed business, the issuer estimated the fair value of its entire business to be double the issuer's market capitalization at the time. According to the Firm, the issuer believed that the market price of its stock did not reflect the stock's value, and the issuer used the market value of four other companies to derive the value used to calculate the gain. The issuer's use of this derived value resulted in an allocation of goodwill to the sold business that was approximately half of the amount that would have been allocated had the issuer used its actual market capitalization. As a result, the issuer recorded a significant gain on the sale, rather than a loss.

There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested, beyond inquiry of management, whether management's use of a value equal to double the issuer's market capitalization was reasonable. In addition, the Firm failed to evaluate whether certain companies that the issuer used for comparison when determining that amount were, in fact, comparable in light of the difficulties experienced by the issuer but not by the other companies. On the same audit, in a different analysis prepared later in the year, the issuer used a nominal market premium to adjust the market capitalization and a specialist engaged by the Firm concluded that a premium of five percent was reasonable. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered the significant difference between the value using a five percent premium and the value used in the allocation of the goodwill to the sold unit.

Issuer F

In this audit, the Firm failed to perform adequate audit procedures to test the allowance for loan losses. Specifically, the Firm failed to evaluate the reasonableness of the issuer applying the same loss factors in its loan grading system as in the prior two years despite significant increases in the average net charge-offs, the total net charge-offs, and the level of non-performing loans, as well as significant adverse changes in the economic environment.

Issuer G

In this audit, the Firm failed to identify a departure from GAAP that it should have identified and addressed before issuing its audit report. The issuer incorrectly recognized a gain on the contribution of certain intangible assets to a joint venture.

Issuer H

In this audit, the Firm failed to adequately test the underlying data provided to a specialist for use in the calculation and amortization of the issuer's deferred costs. Specifically, the Firm did not test the completeness of investment data uploaded to a modeling tool used in estimating future gross profits.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (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 clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

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

APPENDIX B

THE INSPECTION PROCESS

The inspection process was designed and performed to provide a basis for assessing the degree of compliance by the Firm with applicable requirements related to auditing issuers. This process included reviews of components of selected issuer audits completed by the Firm. These reviews were intended both to identify deficiencies, if any, in those components of the audits and to determine whether the results of those reviews indicated deficiencies in the design or operation of the Firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

1. Review of Selected Audits

The inspection team reviewed aspects of selected audits of financial statements and ICFR, which it chose according to the Board's criteria. The Firm was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review.

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenue, fair value measurements, financial instruments, income taxes, reserves or estimated liabilities, inventories, consideration of fraud, supervision of work performed by foreign affiliates, and assessment of risk by the engagement team. The inspection team also analyzed potential adjustments to the issuer's financial statements that were identified during the audit but not corrected. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the Firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other documentation, the inspection team issued a comment form on the matter and the Firm provided a written response to the comment form.

2. Review of Firm Management and Monitoring Processes Related to Audit Quality Control

The inspection team's approach to its review of the Firm's system of quality control was intended to further its understanding of how the Firm manages audit quality, so as to enhance its basis for assessing, in this year and in future years, whether that system is appropriately designed and implemented to achieve the goal of conducting audits that are in compliance with applicable standards. The inspection team also continued its assessment of the Firm's processes and controls that relate to certain specific functional areas that relate to audit performance. The overall approach was designed to identify possible defects in the design or operation of the Firm's system of quality control, while also continuing and enhancing the evaluation of the Firm's ability to respond effectively to indications of possible defects in its system of quality control.

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

The objectives of the inspection procedures in this area were (a) to update the inspection team's understanding of how the Firm's management is structured and operates the Firm's business, and the implications that the management structure and processes have on audit performance and (b) to continue assessing whether actions and communications by the Firm's leadership – the Firm's "tone at the top" – demonstrate a commitment to audit quality. Toward those ends, the inspection team interviewed members of the Firm's national leadership to obtain an understanding of any significant changes in the Firm's approach to, and processes for, its management, including the various management committees or other mechanisms, formal or informal, that relate to assessing and monitoring audit performance, or that otherwise affect audit performance.

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

The objectives of the inspection procedures in this area were (a) to continue to assess whether the design and application of 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 compared to marketing or other activities of the Firm; (b) to assess the Firm's quality controls over the allocation of its partner resources; and (c) to identify and assess the accountability and responsibilities of the different levels of Firm management with respect to partner management. The inspection team interviewed members of the Firm's management and reviewed and also evaluated documentation regarding certain of these topics.

In addition, the inspection team reviewed a sample of partners' personnel files, including files of partners who resigned and partners who had significant negative inspection results from recent internal and PCAOB inspections.

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

The objectives of the inspection procedures in this area were to continue to assess whether the Firm appropriately considers and addresses the risks involved in accepting and retaining clients in the particular circumstances and to assess the Firm's responses to the risks identified, including the extent to which an observable link exists between the identified risks of material misstatement and the audit procedures performed. Toward those objectives, the inspection team obtained an understanding of any changes in the acceptance and retention processes, evaluated the Firm's policies and procedures relating to the Firm's risk-rating systems, and interviewed members of the Firm's management.

- d. Review of Processes Related to the Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audit Clients

The inspection team performed procedures in this area with respect to the processes the Firm uses to ensure that the audit work that its foreign affiliates perform

on the foreign operations of U.S. issuers is effective and in accordance with applicable standards. For its procedures in this area, the inspection team reviewed the Firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the operations of U.S. issuer clients, reviewed available information relating to the most recent foreign affiliated firms' internal inspections, and reviewed the U.S. engagement teams' supervision and control procedures concerning the audit work that the Firm's foreign affiliates performed on a sample of audits.

- e. Review of the Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Weaknesses in Quality Control
 - (i) Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

The objective of the inspection procedures in this area was to continue to identify and assess the monitoring processes that the Firm considers to be significant to its ability to monitor audit quality for individual engagements and for the Firm as a whole. Toward that objective, the inspection team interviewed members of the Firm's management and reviewed certain documents to build on its understanding of how the Firm identifies, evaluates, and responds to possible indicators of deficiencies in audit performance, including internal inspection findings, PCAOB inspection observations, restatements, and litigation. In addition, the inspection team reviewed documents related to the design, operation, and evaluation of findings of the Firm's internal inspection program. The inspection team also reviewed certain audits that the Firm had inspected and compared the results to those of the Firm.

- (ii) Review of Response to Weaknesses in Quality Control

The objectives of the inspection procedures in this area were to assess the design and test the effectiveness of the Firm's processes for addressing possible deficiencies in the Firm's system of quality control, including any deficiencies in the Firm's system of quality control that were noted in prior PCAOB inspection reports. Toward those objectives, the inspection team reviewed steps the Firm has taken in the past several years to address possible quality control deficiencies. The inspection team interviewed members of the Firm's national and regional leadership and conducted focused inspections of audits to assess the design and effectiveness of the processes

identified. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the Firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

(iii) Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

In this area, the procedures included obtaining an update of the inspection team's understanding of policies, procedures, and guidance related to aspects of the Firm's independence requirements and its consultation processes and the Firm's compliance with them. In addition, the inspection team reviewed documents, including certain newly issued audit policies and procedures, and interviewed Firm management to update its understanding of the Firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

APPENDIX C

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{9/}

^{9/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.



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July 20, 2010

Mr. George H. Diacont
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

**Re: Response to Part I of the Draft Report on the 2009 Inspection of BDO USA, LLP
(formerly BDO Seidman, LLP)**

Dear Mr. Diacont:

We welcome this opportunity to provide our response to Part I of the draft Report of the Public Company Accounting Oversight Board ("PCAOB") on the 2009 inspection of BDO USA, LLP ("the Firm"). We support the PCAOB's goal of improving audit quality and, consequently, the reliability of financial reporting.

We acknowledge that considerable value is derived from the inspection process. We are continually focused on improvement in all aspects of our audit practice, and the results of the PCAOB inspections are an important contribution to that effort.

We have evaluated each of the matters described in Part I of the draft Report. In that regard, we have considered whether it was necessary to perform additional procedures in accordance with AU 390, *Consideration of Omitted Procedures After the Report Date*, and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* and, where appropriate, performed such procedures. None of the matters identified by the PCAOB or the results of procedures subsequently performed impacted our previously issued reports on the financial statements.

We want to reiterate the seriousness with which we view the inspection comments and that we are committed to improving our performance wherever possible.

We appreciate this opportunity to provide our response to the Board and we look forward to continuing to work with the PCAOB on the most effective means of enhancing audit quality.

Respectfully submitted,

BDO USA, LLP