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Report on
2016 Inspection of Ernst & Young LLP
(Headquartered in New York, New York)

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Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002**

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2016 INSPECTION OF ERNST & YOUNG LLP

Preface

In 2016, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Ernst & Young LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

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

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

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 became effective as of December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

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EXECUTIVE SUMMARY

This summary sets out certain key information from the 2016 inspection of Ernst & Young LLP ("the Firm"). The inspection procedures included reviews of portions of 55 issuer audits performed by the Firm. Fifty-three of the 55 engagements were integrated audits of both internal control and the financial statements. Part 1.C of this report provides certain demographic information about the audits inspected, and Part 1.D describes the general procedures applied in the PCAOB's 2016 inspections of annually inspected registered firms.

The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In 15 audits, 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 conformity 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"). These deficiencies are described in Part I.A of the report.

Effects of Audit Deficiencies on Audit Opinions

Of the 15 issuer audits that appear in Part I.A, deficiencies in 14 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in 14 audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the 14 audits in which substantive testing deficiencies were identified, five 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	<u>13 Audits</u> : Issuers A, B, C, D, E, F, G, H, I, J, L, M, and N
Deficiencies included in Part I.A related to the ICFR audit only	<u>1 Audit</u> : Issuer O
Deficiencies included in Part I.A related to the financial	<u>1 Audit</u> : Issuer K

	Number of Audits
statement audit only	
Total	15

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>11 Audits</u> : Issuers A, B, F, G, H, I, J, L, M, N, and O
Failure to sufficiently evaluate significant assumptions that the issuer used in developing an estimate	<u>9 Audits</u> : Issuers A, B, F, G, J, K, L, M, and N
Failure to sufficiently test controls over or sufficiently test the accuracy and completeness of data or reports	<u>8 Audits</u> : Issuers A, B, C, D, G, H, I, and J

Areas in which Audit Deficiencies Were Most Frequently Identified

The following table lists, in summary form, the financial statement accounts or auditing areas in which the deficiencies that are included in Part I.A of this report most frequently occurred. The table includes only the three most frequently identified areas that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Area	Part I.A Audits
Revenue, including accounts receivable, deferred revenue, and allowances	<u>8 Audits</u> : Issuers A, C, F, G, H, I, J, and K
Inventory and related reserves	<u>5 Audits</u> : Issuers A, B, D, H, and I
Long-lived assets, including amortization, depreciation, or depletion	<u>4 Audits</u> : Issuers J, L, M, and N

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures¹ for the inspection from November 2015 to June 2017. The inspection team performed field work at the Firm's National Office and at 34 of its approximately 70 U.S. practice offices.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 55 issuer audits performed by the Firm. One of the deficiencies related to auditing aspects of an issuer's financial statements to which the issuer made substantial adjustments after the primary inspection procedures.² In addition, for two of the audits described below, after the primary inspection procedures, the Firm revised its opinion on the effectiveness of the issuer's 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 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

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 2016 inspection did not include review of any additional audit work related to the adjustments.

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

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

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

³ Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the

The audit deficiencies that reached this level of significance are described in Parts I.A.1 through I.A.15, below.

Audit Deficiencies

A.1. Issuer A

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

- The Firm failed to perform sufficient procedures related to the completeness of revenue at four of the issuer's business units, which represented most of the issuer's revenue, as follows –
 - The issuer initially recorded this revenue upon delivery of its products to customers. For certain transactions, the issuer used shipping terms that transferred the risk of loss to customers prior to delivery. To address these transactions, the issuer performed a control that was designed to test whether revenue was recognized appropriately for transactions that exceeded certain monetary thresholds and occurred during certain time periods. The Firm selected this control for testing to address the completeness of revenue but failed to evaluate whether the parameters the control owner used for the selection of transactions were sufficient to address the risk of material misstatement related to transactions that had terms other than recognition on delivery. (AS 2201.42)

adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

- The Firm's substantive procedures to test the completeness of this revenue were insufficient, as the Firm tested only one revenue transaction recorded after year end. (AS 2301.08)
- The Firm failed to perform sufficient procedures related to the valuation of trade accounts receivable at three of the issuer's business units, which represented the majority of trade accounts receivable. The issuer determined the amount of the allowance for doubtful accounts ("AFDA") by (1) establishing a full allowance for any trade account receivable for which the issuer had determined the related customer was experiencing financial hardship, (2) applying various loss factors to certain of the past-due remaining trade accounts receivable based on aging, and (3) establishing an additional allowance for certain other customers. The Firm's procedures were insufficient in the following respects –
 - The Firm selected for testing two controls over the AFDA. The first control consisted of the quarterly preparation of a list for each business unit of certain past-due amounts that included commentary related to the past-due amounts ("the watchlists"); the second control consisted of the quarterly review of the watchlists and the AFDA calculation. The Firm's procedures were limited to (1) inquiring of issuer personnel; (2) reconciling the underlying reports used to prepare the watchlists to the general ledger; (3) inspecting emails or documents with signatures or other notations that indicated reviews and/or certain other actions performed as part of the controls had occurred; and (4) for one quarter, comparing the allowance recommended by the reviewer for one customer to the AFDA spreadsheet. With respect to the second of these controls, the Firm failed to evaluate the nature of the review procedures that the control owner performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to test any controls that addressed the completeness of the population of customers that the issuer had identified as experiencing financial hardship. (AS 2201.39, .42, and .44)

- The Firm failed to perform sufficient substantive testing of the AFDA at these three business units. Specifically, the Firm's procedures were limited to (1) reconciling the amount of the AFDA from the issuer's calculation to the general ledger, (2) testing the accuracy of the issuer's aging for a sample of past-due receivables, (3) recalculating the AFDA using the issuer's established methodology, (4) for a sample of customers on the watchlists, (a) testing the accuracy of the amount by verifying that the amount included on the watchlist agreed to the customer detail and (b) reading the commentary that the issuer documented on the watchlist, and (5) for one business unit, obtaining information from external parties about credit ratings or bankruptcies for certain large customers. Reading the issuer's commentary included on the watchlists provided little to no substantive assurance as to the adequacy of the related AFDA, as this commentary was limited to the issuer's action plan and/or collection status for a given customer. In addition, the Firm failed to evaluate whether (1) the population of customers that the issuer identified as experiencing financial hardship was complete and (2) the loss factors used to determine the AFDA for certain customers, based on aging, were reasonable. (AS 2501.11)
- The Firm failed to perform sufficient procedures related to the valuation of three categories of inventory. Specifically –
 - The Firm selected for testing a control over the allowance for lower-of-cost-or-market ("LCM") established for this inventory and identified a control deficiency related to a lack of controls over the accuracy and completeness of the report used in the performance of this control. The Firm identified two controls that it believed would compensate for this deficiency. The Firm's conclusion that these two controls had a mitigating effect was inappropriate because (1) the Firm had determined that one of these controls was ineffective and (2) the other control, which consisted of the retrospective review of the allowance for excess and obsolete inventory, did not address the risks presented by the deficiency. (AS 2201.68)

- The Firm failed to perform sufficient substantive tests of the LCM allowance established for this inventory, as follows –
 - For one of the issuer's business units, the Firm determined its sample size to test this allowance based on the recorded amount of the LCM reserve, rather than the population of inventory to which the LCM reserve applied. In addition, the Firm failed to select a sample that was representative of this inventory, as it limited its selection of sample items to only one of the three categories of this inventory and to only items that the issuer tested in the performance of the control over the LCM allowance that is discussed above. (AS 2315.17 and .24)
 - For certain other business units, the Firm failed to perform any substantive procedures to test the LCM allowance. (AS 2501.07)
- For certain business units that the issuer acquired during the year, which the Firm excluded from its assessment of ICFR, the Firm failed to perform sufficient substantive procedures to test revenue, accounts receivable, and/or inventory; the total amounts of such revenue, accounts receivable, and inventory were multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement. The Firm limited its procedures to test revenue, accounts receivable, and/or inventory for these business units to analytical procedures. These analytical procedures provided little to no substantive assurance, as the Firm simply compared certain current-year data at the business-unit level to corresponding data for prior periods, without obtaining evidence that the prior-period amounts could be expected to be predictive of the current-period amounts. In addition, the Firm failed to obtain corroboration for most of management's explanations for the differences that the Firm identified for investigation. (AS 2101.11-.12; AS 2305.17 and .21)
- The Firm identified and tested controls over the issuer's acquisition process and the related accounting. For two of the acquisitions discussed

above, the Firm failed to perform sufficient procedures related to the existence and valuation of certain acquired assets. Specifically –

- For both of these acquisitions, the Firm failed to perform sufficient procedures related to the valuation of certain acquired intangible assets. Specifically, the Firm failed to identify and test any controls over, and to perform any substantive procedures related to, the accuracy and completeness of certain data that (1) the issuer used to determine a significant assumption underlying the value of these intangible assets and (2) the Firm used in its testing of the reasonableness of this assumption. (AS 2201.39; AS 2502.39)
- For one of these acquisitions, the Firm failed to perform sufficient procedures related to the existence of the acquired inventory, which was multiple times the Firm's established level of materiality. Specifically, the Firm failed to identify and test any controls over this inventory at the acquisition date, and it limited its substantive procedures related to this inventory to reading a checklist. (AS 2201.39; AS 2301.08)

A.2. Issuer B

In this audit of a retailer, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to inventory. Specifically –

- The issuer recorded the initial cost of its retail inventory using information that was provided by its vendors. The majority of this information was received electronically and processed through various systems. The Firm's procedures related to these initial costs were insufficient in the following respects –
 - The Firm selected for testing a control that consisted of a review of a comparison of the cost information in the inventory cost database to electronic invoice information. The cost information in the inventory cost database originated from, and the electronic invoice

information was recorded in, systems for which the Firm did not test any controls. Because the Firm did not test controls that addressed the reliability of the information when it resided in these untested systems, the Firm lacked a basis to conclude that the control that it had tested effectively addressed the accuracy and completeness of the cost information. (AS 2201.39)

- The Firm designed its sample sizes to test these inventory costs based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of controls that is discussed above. As a result, the samples that the Firm used for its testing of the valuation of the inventory at cost, which it performed as of the end of the third quarter and the year end, were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm selected for testing a control that consisted of the performance of quarterly physical inventory counts at retail locations, including procedures for the identification and recording of received inventory that was excluded from the physical inventory counts at these locations. The Firm, however, failed to sufficiently test the aspect of this control related to the received inventory excluded from the physical inventory counts, as its procedures were limited to inquiring of issuer personnel and observing that certain of this inventory had been segregated. (AS 2201.42 and .44)
- The issuer valued most of its inventory using the retail last-in-first-out ("LIFO") method and used an external party to value its LIFO inventory and calculate the related LIFO reserve. The issuer aggregated its inventory into various categories and, for each category, provided the external party with certain inventory data, including inventory at retail and inventory cost factors, that the external party used to value the LIFO inventory. The issuer determined its inventory at retail by applying these inventory cost factors to its inventory at cost as of a date that was one month prior to the issuer's year end. In calculating these inventory cost factors, the issuer excluded all rebates and used a one-month time period that resulted in the exclusion of most of the inventory purchases during the year.

- The Firm's testing of controls over the valuation of inventory was insufficient in the following respects –
 - The Firm selected for testing a control that included the control owner's review of the inventory data, including the calculation of the inventory cost factors, provided to the external party as well as the inventory at cost. The Firm, however, failed to evaluate whether this control, or any other control that the Firm tested, addressed the reasonableness of the issuer's exclusion of most of the inventory purchases and a significant amount of rebates from the calculation of the inventory cost factors. (AS 2201.42)
 - The Firm failed to identify and test any controls over the issuer's classification of inventory within each of the LIFO categories. (AS 2201.39)
 - For inventory held at retail locations, the Firm tested the quarterly physical inventory count control, as discussed above, but failed to either (1) determine that this control would also operate as of the interim month end or (2) identify and test any controls that addressed inventory activity between the last quarterly inventory count and the date as of which the issuer determined its inventory cost. For inventory held at distribution centers, the Firm identified that there was a daily cycle-count control but failed to test this control. (AS 2201.39)
- The Firm failed to perform sufficient substantive procedures to test the inventory data that the issuer provided to the external party. Specifically –
 - The Firm failed to perform any substantive procedures to test the issuer's classification of inventory within each LIFO category. (AS 2501.11)

- The Firm failed to sufficiently test the inventory cost factors, which the issuer calculated using inventory retail prices and inventory at cost, as follows –
 - Although the Firm tested retail prices in its revenue testing, its procedures did not address whether these prices were accurately recorded and maintained in the separate inventory system that was used to calculate the inventory cost factors. (AS 2501.11)
 - Although the Firm tested inventory at cost as of the end of the third quarter and year end as described above, it failed to test inventory activity for the period between the dates of its testing and the date as of which the issuer determined its inventory at cost, which was one month prior to year end. (AS 2501.11)
 - The Firm failed to evaluate the effect of including only one month of inventory purchases in, and excluding a significant amount of rebates from, the calculation of the inventory cost factors. (AS 2501.11)

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 –

- The Firm failed to sufficiently evaluate whether certain identified and uncorrected misstatements associated with one group of accounts ("the associated misstatements") were material, individually or in the aggregate, as it failed to sufficiently evaluate all of the relevant quantitative and qualitative factors. Specifically, the Firm's procedures were limited to (1) combining the associated misstatements into one net misstatement and determining the mathematical effect of that net misstatement, when aggregated with other identified misstatements, on the consolidated financial statement accounts, including net income; (2) completing a checklist; and (3) reading and reperforming the issuer's evaluation of the

materiality of a small portion of the misstatements. (AS 2810.17 and .B2)

- The Firm identified a single control deficiency related to all of the associated misstatements and concluded that this deficiency represented a significant deficiency. The Firm, however, failed to sufficiently evaluate the severity of this control deficiency. While the Firm concluded that the misstatements were not due to fraud and that the actual net amount of the misstatements was not material, it had no rationale for its conclusion related to fraud and failed to evaluate the magnitude of the potential misstatement resulting from this deficiency. In addition, the Firm documented that the related aspect of the period-end financial reporting process was not completed in time to facilitate an adequate review by management, but failed to take this information into account when evaluating whether there was a reasonable possibility that the issuer's controls would fail to prevent or detect a misstatement that could be material on a timely basis. (AS 2201.63 and .65)
- The Firm's procedures to test controls over one type of revenue and deferred revenue were insufficient. The Firm selected for testing two automated controls consisting of the calculation and recording of revenue and deferred revenue based upon underlying transaction data recorded in the revenue system. The Firm, however, failed to sufficiently test controls over the accuracy and completeness of the underlying data. Specifically, the Firm identified that numerous individuals, including sales personnel, had access to modify the underlying data, but it limited its procedures to evaluate whether this access was appropriate to inquiry of management. As a result, the Firm did not have a sufficient basis to rely on the controls over the underlying data. (AS 2201.42 and .44)

A.4. Issuer D

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

- The Firm failed to identify, and evaluate the significance to the financial statements of, a departure from generally accepted accounting principles ("GAAP") in the issuer's accounting for a certain matter. (AS 2810.30)
- The Firm's procedures to test the existence of, and controls over the existence of, inventory held at a significant location and managed by an external party were insufficient, as described below. This inventory was processed through the external party's data warehouse system and then recorded in the issuer's perpetual inventory system.
 - The Firm selected for testing a control that consisted of the issuer's daily cycle counts, including the recording of adjustments based on the results of those counts. To test the design and operating effectiveness of this control, the Firm selected a sample of cycle counts and observed a small number of these counts. For the remaining cycle counts in the sample, the Firm's procedures consisted of (1) inquiring of management regarding the performance of the counts, (2) inspecting reports generated by the data warehouse system that listed the results of all daily counts performed during the month, and (3) determining that adjustments were investigated and recorded. The Firm failed to perform sufficient procedures to test the design and operating effectiveness of this control, as it failed to test the accuracy and completeness of the reports generated by the data warehouse system that the Firm used in its testing of the unobserved counts or, in the alternative, test controls over the data in this system and those reports. (AS 1105.10)
 - The Firm selected for testing a control consisting of the issuer's review of the cycle-count results, and the Firm identified a control deficiency related to a lack of controls over the accuracy and completeness of the reports that were generated by the data warehouse system and used in the operation of this control. The Firm, however, failed to sufficiently evaluate the severity of this deficiency, as it limited its evaluation to considering the results of its substantive testing of these reports. (AS 2201.63 and .65)

- Due to the deficiencies described above, the Firm failed to obtain sufficient evidence that the cycle-count procedures the issuer used for this inventory were sufficiently reliable to produce results substantially the same as those that would be obtained by a count of all items each year. (AS 2510.11)

A.5. Issuer E

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and the effectiveness of ICFR. The Firm failed to identify, and evaluate the significance to the financial statements and the effect on the Firm's conclusions regarding ICFR of, departures from GAAP in the issuer's accounting for various significant accounts affected by a transaction. (AS 2201.B8; AS 2810.30)

A.6. Issuer F

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

- The issuer generated revenue at numerous locations, where certain types of routine transactions were initiated and processed. The Firm identified a fraud risk related to the potential manipulation of revenue through journal entries. The Firm's testing related to revenue was insufficient in the following respects –
 - With respect to controls for certain of the issuer's locations, the Firm relied solely on its testing of an entity-level control; an important aspect of this control was the review of the comparison of monthly operating results to budgeted and forecasted amounts. The total revenue at these locations was multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement. The Firm, however, failed to sufficiently test this entity-level control, as it failed to identify and test any controls over the reliability of budgeted amounts and

reasonableness of forecasted amounts that were used in the performance of this control. (AS 2201.39)

- The Firm failed to perform sufficient substantive procedures to address the identified fraud risk. Specifically, while the Firm performed journal entry testing to address the fraud risk at certain of the issuer's locations, it failed to perform any procedures to address the fraud risk at other locations that the Firm had assessed as presenting a reasonable possibility of material misstatement either individually or in the aggregate. (AS 2101.11-.12; AS 2301.13)
- The Firm failed to perform sufficient procedures related to the issuer's assessment of the possible impairment of goodwill, as follows –
 - The Firm selected for testing two controls; an important aspect of these controls was the review of the revenue forecasts used in the issuer's assessment of the possible impairment of goodwill. The Firm, however, failed to sufficiently test this aspect of the controls. Specifically, the Firm's procedures were limited to inquiring of management, attending certain meetings, and inspecting emails and other documents indicating that reviews and/or certain other actions performed as part of the controls had occurred. The Firm failed to evaluate the nature of the review procedures that the control owners performed to assess the reasonableness of the revenue forecasts, including the criteria used to identify items for follow up and whether those items were appropriately addressed. (AS 2201.42 and .44)
 - For two of the issuer's reporting units, the Firm failed to perform sufficient procedures to evaluate the reasonableness of the assumptions underlying the revenue forecasts used in the issuer's assessment of the possible impairment of goodwill. Specifically, the Firm's procedures to evaluate these assumptions were limited to inquiring of management, comparing the revenue forecasts for the first year to the issuer's current-year results, and comparing the issuer's forecasted revenue growth rates to certain market

participants' historical and forecasted growth rates, which indicated a wide range of values. The Firm noted that there had been a decline in revenue for these two reporting units in the current year. The Firm concluded that the issuer's revenue forecasts were reasonable without performing any additional procedures to evaluate whether the assumptions underlying the revenue forecasts were consistent with the past experience of the issuer and relevant current market conditions and whether the issuer had the ability to achieve these forecasts. (AS 2502.26, .28, .31, and .36)

A.7. Issuer G

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

- The issuer initiated and processed sales transactions at numerous locations. As described below, the Firm's procedures related to revenue and accounts receivable at certain of the issuer's locations were insufficient; the total revenue and accounts receivable at these locations were multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement.
 - With respect to controls for these locations, which were all within the issuer's two main operating segments, the Firm relied on its testing of two entity-level controls, one at each of these operating segments. The Firm, however, failed to sufficiently test these controls. Specifically –
 - The controls consisted of a review of the segment's monthly operating results in which those results were compared to the budget, forecasts, or corresponding results for prior periods. The Firm's procedures to test these controls were limited to (1) inquiring of the control owners, (2) inspecting documents used in the performance of the controls that indicated reviews or other activities that were part of the controls had occurred, and (3) inspecting emails that

contained responses to control owners' inquiries. For one control, the Firm failed to evaluate the nature of the review procedures that the control owner performed, including the criteria used to identify matters for follow up. For both controls, the Firm's testing did not address whether the matters identified for follow up were appropriately resolved. (AS 2201.42 and .44)

- The issuer maintained and updated budget and forecast information, which was used in the operation of the controls described above, in an information-technology system. The Firm's strategy to address the accuracy and completeness of that information included testing controls over access to the system. The Firm, however, failed to test controls over end-user access; deficiencies in these controls could result in unauthorized changes to the budget and forecast information. (AS 2201.42 and .44)
- Based on the Firm's reliance on entity-level controls, which was not supported due to the deficiencies that are discussed above, the Firm limited its procedures to test revenue and accounts receivable for the above-noted locations to analytical procedures. These analytical procedures provided little to no substantive assurance, as the Firm failed to obtain corroboration of management's explanations for most of the differences that the Firm identified for investigation. (AS 2101.11-.12; AS 2305.21)
- The Firm failed to perform sufficient procedures related to a significant self-insurance reserve. Specifically –
 - The Firm's procedures to test controls over significant loss-run data, which consisted of (1) the issuer's initial estimate of the amount for which it would settle open claims ("open claims amounts") and (2) data related to closed claims, that the issuer provided to its external actuary for use in determining this self-insurance reserve were insufficient, as follows –

- The Firm selected for testing a control that consisted of the review of open claims amounts by a claims committee. The Firm's procedures to test this control were limited to (1) inspecting meeting notes and other documents that indicated reviews and certain other actions performed as part of the control had occurred and (2) comparing certain amounts from these documents to a report provided to the actuary. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)
- The Firm concluded that two other controls that it had selected to address the accuracy and completeness of the loss-run data were ineffective for most of the year. The loss-run data that related to the period during which these two controls were ineffective were significant inputs into the external actuary's estimate of the self-insurance reserve, but the Firm failed to identify and test any other controls over the accuracy and completeness of the loss-run data that related to this period. (AS 2201.39)
- The Firm failed to perform sufficient substantive testing of this self-insurance reserve. The Firm used the open claims amounts described above in developing its own independent estimate of this self-insurance reserve. The Firm, however, limited its procedures to test the open claims amounts to tracing samples of claims to the report used by the external actuary, without evaluating the reasonableness of the assumptions that were made in determining the open claims amounts. (AS 2501.12)

A.8. Issuer H

In this audit of a manufacturer, 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 initiated and processed transactions related to sales

and inventory at numerous locations. The Firm's testing related to revenue, accounts receivable, and inventory was insufficient in the following respects –

- With respect to controls for certain of the issuer's locations, the Firm relied solely on its testing of certain entity-level controls. The total revenue, accounts receivable, and inventory at these locations were multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement. The Firm, however, failed to sufficiently test three important entity-level controls that it selected for testing. (The other entity-level controls that the Firm selected for testing consisted of a review of the issuer's financial statement disclosure checklist; the calculation of certain intercompany amounts; and certain controls, related to the control environment, that had an indirect effect on the likelihood that a misstatement would be detected or prevented on a timely basis.) The Firm's testing of the three important entity-level controls was insufficient in the following respects –
 - Two of these controls consisted of reviews of (1) each location's financial results, including comparisons of monthly operating results to the budget and the prior month, and (2) quarterly revenue cut-off analyses for each location and on a summarized basis. The third control consisted of a review of the balance sheets of certain locations, but that control applied to only a small number of locations. The Firm's procedures to test the first two controls were limited to inquiring of issuer personnel, inspecting certain presentations and schedules used in the operation of the controls, testing the mathematical accuracy of certain calculations, and inspecting documents with comments or other notations that indicated reviews or other activities that were part of the controls had occurred. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)
 - The Firm failed to identify and test any controls over the accuracy and completeness of the data used in the operation of all three controls. (AS 2201.39)

- Based on the Firm's reliance on entity-level controls, which was not supported due to the deficiencies that are discussed above, the Firm limited its procedures to test revenue, accounts receivable, and inventory for the above-noted locations to analytical procedures. The analytical procedures that the Firm performed, however, provided little to no substantive assurance. In these procedures, the Firm compared certain current-year account balances at the location level to corresponding balances for prior periods, but the Firm failed to perform procedures to determine whether the prior-period balances could be expected to be predictive of the issuer's current-year balances. In addition, the Firm failed to obtain corroboration of management's explanations for most of the differences that the Firm identified for investigation. (AS 2101.11-.12; AS 2305.17 and .21)
- At a significant location for which the Firm selected transaction-level controls for testing, the Firm failed to perform sufficient procedures related to revenue and accounts receivable. Specifically –
 - The Firm selected for testing an automated control within the general ledger system that was designed to generate invoices and recognize revenue based upon shipping dates and related terms that were imported from another system. The Firm's procedures to test this control were limited to, for a sample of transactions, comparing invoice dates from the general ledger to shipment dates in the other system. The Firm's procedures were insufficient to support a conclusion that the automated control was designed and operating effectively, as the Firm failed to obtain an understanding of, and test, how the issuer's general ledger system performed this control. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the shipment dates that were used in the performance of this control or, in the alternative, to test controls over the system that produced the shipment dates. (AS 2201.39, .42, and .44)
 - The Firm's substantive procedures to test revenue and accounts receivable for this location consisted of tests of details for certain samples of transactions. The Firm's procedures were insufficient,

as the Firm determined its 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 samples that the Firm used to test revenue and accounts receivable were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.9. Issuer I

In this audit of a manufacturer, 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 initiated and processed transactions related to sales and inventory at numerous locations. The Firm's procedures related to revenue, accounts receivable, and inventory at certain of the issuer's locations were insufficient as described below; the total revenue, accounts receivable, and inventory at these locations were multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement.
 - With respect to controls at these locations, the Firm relied solely on its testing of an entity-level control that consisted of a review of each location's balance sheet; each of the issuer's locations was subject to this entity-level control once per year. The Firm failed to sufficiently test this control. Specifically, the Firm's procedures were limited to (1) inquiring of the control owners; (2) inspecting the instructions that the control owners sent to each location; (3) for a sample of locations, inspecting signatures or notations to indicate that the reviews performed as part of the control had occurred and verifying that certain adjustments identified as part of the review were recorded; and (4) for one location, inspecting emails related to an item that the control owners had identified for follow up. The Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- Based on the Firm's reliance on this entity-level control, which was not supported due to the deficiency that is discussed above, the Firm limited its procedures to test revenue, accounts receivable, and inventory for these locations to analytical procedures that were performed at an operating-segment level. The analytical procedures that the Firm performed provided little to no substantive assurance, as described below. (AS 2101.11-.12; AS 2305.13-.14, .17, and .20-.21)
 - The analytical procedures involved amounts that were aggregated at the level of the issuer's three operating segments; therefore, they were not precise enough to identify misstatements that could be material.
 - The Firm failed to establish appropriate expectations, as it simply compared current-year amounts to prior-year amounts, without obtaining evidence as to why these prior-year amounts could be predictive of the current-year results.
 - The Firm used a threshold for investigation of differences that could have resulted in its acceptance, without investigation, of differences in excess of the Firm's established level of materiality.
 - The Firm failed to obtain corroboration of management's explanations for certain differences that the Firm identified for investigation.
- The issuer held certain inventory that was subject to cycle counts in numerous locations. The Firm's procedures to test the existence of, and controls over the existence of, this inventory were insufficient, as follows –
 - The Firm selected for testing a control that consisted of the issuer's daily cycle counts, including the recording of adjustments based on the results of those counts. To test the design and operating effectiveness of this control, the Firm selected a sample of locations. For certain locations within this sample, the Firm

observed certain daily cycle counts. For the remaining locations in the sample, the Firm documented that it (1) inspected documentation from a cycle count performed for the location and (2) determined that the variances identified during the cycle count were recorded in the issuer's system. For these locations in the Firm's sample, however, the Firm failed to evaluate whether the cycle-count documentation it inspected provided sufficient evidence that all important steps related to the counts were performed as designed. (AS 2201.44)

- For certain locations, the issuer used an inventory management system to record the results of its cycle counts; these results were then entered into the issuer's perpetual inventory system. The Firm selected for testing a control that involved the review of various system-generated reports in order to monitor the results of the cycle counts. Because the cycle-count information contained in these reports for certain locations originated from the inventory management system, for which controls were not tested, the Firm's testing did not provide sufficient evidence about controls over the accuracy and completeness of certain of the reports that the issuer used in the operation of this control. (AS 2201.39)
- Due to the deficiencies described above, the Firm failed to obtain sufficient evidence that the cycle-count procedures the issuer used for this inventory were sufficiently reliable to produce results substantially the same as those that would be obtained by a count of all items each year. (AS 2510.11)

A.10. Issuer J

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 one type of the issuer's revenue were insufficient. Specifically –

- For both of the issuer's operating segments, the Firm selected for testing a control that consisted of the daily reconciliation of various amounts that the issuer used to calculate revenue to supporting documentation. The Firm designed its procedures to test this control by selecting a sample at each operating segment for dual-purpose testing; for each item in these samples, the Firm planned to reperform certain control procedures, as well as to test the amount of revenue recognized. The Firm's procedures were insufficient as, for all but two items in each sample, the Firm limited its procedures to (1) inspecting checklists indicating that certain procedures performed as part of the control had occurred and (2) noting that the control owners had maintained certain documentation used in the performance of the control. For these items, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested (1) whether the other specific control procedures had been performed and (2) the amount of the related revenue recognized by the issuer. (AS 2201.44; AS 2315.25 and .40)
- The Firm's substantive procedures to test this revenue included (1) its dual-purpose testing, which was deficient as described above, and (2) analytical procedures. The Firm's analytical procedures provided little to no substantive assurance, as the Firm failed to obtain sufficient corroboration of management's explanations for differences that the Firm identified for investigation. Specifically, the Firm's procedures to obtain corroboration of management's explanations of differences were limited to comparing the differences to various ratios and revenue data that were derived from the revenue recorded in the general ledger that the Firm was testing with these procedures. (AS 2305.21)
- The Firm failed to perform sufficient procedures related to the valuation of one type of accounts receivable. Specifically –
 - The Firm selected for testing two controls that included reviews of (1) certain of these accounts receivable and (2) an allowance that the issuer established for this type of accounts receivable. The

Firm, however, failed to identify and test any controls over the accuracy and completeness of certain reports that the issuer used in the performance of these controls. (AS 2201.39)

- For one of the issuer's operating segments, the Firm's substantive procedures to test the allowance for this type of accounts receivable included (1) inquiring of management to confirm its understanding of the issuer's process and to determine whether there were any changes to the process and (2) obtaining the issuer's allowance reconciliation as of an interim date, comparing the balances to various issuer reports and to the general ledger, and testing the mathematical accuracy of certain calculations. These two procedures did not provide evidence about the reasonableness of the assumptions underlying the allowance. The Firm also vouched a sample of reductions in the allowance to supporting documentation, but this procedure addressed only the risk of overstatement of the allowance and did not provide direct evidence about the underlying assumptions. In addition, the Firm performed analytical procedures, but, due to deficiencies in these procedures, they provided little to no substantive assurance. Specifically, the Firm relied on information in the reports described above to obtain corroboration of management's explanations for differences that the Firm identified for investigation, but the Firm failed to identify and test any controls over, or perform any substantive procedures to test, the accuracy and completeness of these reports. (AS 1105.10; AS 2501.11)
- The issuer disclosed certain adverse events and conditions that included (1) a significant current-period decline in revenue and earnings for one of the issuer's operating segments and (2) adverse economic and regulatory factors affecting this segment's market and customers. The Firm selected for testing three controls related to the possible impairment of property and equipment that consisted of (1) the preparation and review, at least annually, of a memorandum documenting the issuer's assessment of possible indicators of impairment; (2) the audit committee's review of certain accounting and operational matters; and (3) the disclosure committee's review of draft financial statements. The Firm's procedures to

test these controls were insufficient, as its procedures were limited to, for the first control, (1) inquiring of management; (2) observing the control owner search for relevant authoritative guidance; and (3) inspecting the issuer's memorandum, as well as issuer documentation that supported certain information included in the memorandum, and for the other two controls, attending certain meetings that constituted part of the operation of these controls and inspecting the related meeting minutes. For all three controls, the Firm failed to evaluate the nature of the review procedures that the control owners performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. In addition, the Firm failed to test the aspects of these controls, or test any alternative controls, that addressed whether all events or changes in circumstances contemplated in Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") Subtopic 360-10, *Property, Plant, and Equipment – Overall* ("Subtopic 360-10") had been identified. (AS 2201.42 and .44)

A.11. Issuer K

In this audit of an issuer in the construction and engineering industry, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test revenue from contracts accounted for using the percentage-of-completion ("POC") method were insufficient. The Firm identified a fraud risk related to the estimated costs to complete these contracts, which were significant inputs in the issuer's application of the POC method, but it failed to perform any tests of details related to those estimated costs to complete. The Firm's procedures to test the estimated costs to complete were limited to (1) for a sample of projects, comparing the year-end POC and gross margin to corresponding amounts from a prior period, (2) for a sample of projects, comparing the estimated costs at year end to the costs estimated at the inception of the contract, both in total and for certain categories of costs, (3) obtaining the issuer's comparison of current-year gross margins to the prior-year and prior-period gross margins, and (4) inquiring of management regarding certain changes identified in these comparisons and regarding the issuer's process for determining the estimated costs to complete the contracts. (AS 2301.13; AS 2501.07)

A.12. Issuer L

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to the valuation of the majority of the issuer's property and equipment. Specifically –

- The Firm selected for testing three controls related to the assessment of the possible impairment of this property and equipment. These controls consisted of the preparation and review of quarterly impairment memoranda, meetings to discuss various matters that could have an effect on accounting, and operational meetings relating to this property and equipment. The Firm failed to sufficiently test these controls, as the Firm limited its procedures to inquiring of the control owners, obtaining evidence that reviews and/or certain other actions performed as part of the controls had occurred, attending certain meetings, and reading the issuer's impairment memoranda. The Firm failed to ascertain and evaluate the nature of the review procedures that the control owners performed and whether these controls, or any other control that the Firm tested, was designed to address whether all events or changes in circumstances contemplated in FASB ASC Subtopic 360-10 had been identified. (AS 2201.42 and .44)
- The Firm failed to perform sufficient substantive procedures to test the valuation of this property and equipment. Specifically, the Firm's procedures to evaluate whether impairment indicators existed were limited to inquiring of management and reading the issuer's quarterly impairment memoranda. For two of the quarters, the memorandum was limited to a statement that there were no indicators of possible impairment; for the other two quarters, the memorandum consisted of a high-level summary of management's conclusions regarding possible impairment related to a specific change in circumstances. (AS 2501.11)

A.13. Issuer M

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

as it failed to perform sufficient procedures related to the valuation of one category of the issuer's long-lived assets, which consisted of various asset groups. Specifically –

- The issuer evaluated this category of long-lived assets for possible impairment by performing an undiscounted cash-flow analysis for each of the related asset groups. The Firm selected for testing a control that included the review of significant assumptions underlying these analyses. With respect to this category of assets, the Firm failed to sufficiently test this aspect of the control, as its procedures were limited to inquiring of management, inspecting the analyses used in the operation of the control, and reading memoranda that briefly summarized certain of the control owners' procedures, questions, and comments. The Firm failed to evaluate the nature of the specific review procedures that the control owners performed to evaluate the significant assumptions, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)
- To substantively test the valuation of this category of long-lived assets, the Firm selected a sample of six of the asset groups. The Firm failed to sufficiently evaluate the reasonableness of the significant assumptions underlying the undiscounted cash-flow analyses that the issuer used in evaluating these asset groups for possible impairment. Specifically, for five of the asset groups, the Firm's procedures were limited to inquiring of management and inspecting the issuer's sensitivity analyses. The Firm noted that the sensitivity analyses showed that reducing one key assumption by a small amount indicated that three of these asset groups might be impaired, but the Firm concluded that the issuer's conclusion that the carrying value of these asset groups was recoverable was reasonable without performing any additional procedures. The Firm's procedures for the remaining asset group consisted of, in addition to the procedures described above, comparing certain sales assumptions used in the undiscounted cash-flow analysis to the issuer's current-year sales data; the Firm concluded that these assumptions were reasonable without evaluating certain significant differences that it had identified. (AS 2501.11)

A.14. Issuer N

In this audit of a manufacturer, 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 disclosed the following adverse events and conditions that could have indicated that the carrying value of the issuer's property, plant, and equipment ("PPE") was not recoverable: (1) current-period operating losses and a forecast of continued operating losses, (2) excess capacity and declining prices within the issuer's industry, and (3) downturns in certain of the markets for the issuer's products. In addition, the Firm noted that the issuer failed to meet its forecast for revenue for the most recent year. The Firm's procedures related to the valuation of PPE were insufficient, as follows –

- The Firm selected for testing two controls related to the possible impairment of PPE. One of these controls consisted of the review and approval of the issuer's long-term forecast, which was a significant input to the undiscounted cash-flow analysis that the issuer used to assess the possible impairment of PPE. The other control was a review of the undiscounted cash-flow analysis that included (1) a comparison of certain forecast amounts to historical data for the issuer and peer companies and (2) a sensitivity analysis that was performed for certain significant assumptions. The Firm failed to sufficiently test these controls. Specifically, the Firm limited its procedures to inquiring of management; inspecting the undiscounted cash-flow analysis, peer-company comparison, sensitivity analysis, drafts of the long-term forecast, and emails and other documents indicating that reviews performed as part of these controls had occurred; and verifying that certain adjustments identified in the review of the long-term forecast were made to the final forecast. The Firm failed to ascertain and evaluate the specific nature of the review procedures that the control owners performed, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)
- The Firm failed to sufficiently evaluate the reasonableness of the significant assumptions underlying the undiscounted cash-flow analysis that the issuer used in evaluating PPE for possible impairment. Specifically, the Firm's procedures were limited to inquiring of

management, testing the mathematical accuracy of the calculations, inspecting the issuer's sensitivity analysis, comparing the forecasted amounts included in the undiscounted cash-flow analysis to the issuer's long-term forecast, and comparing certain forecasted amounts in the undiscounted cash-flow analysis to historical data for the issuer and peer companies. The Firm identified that there was a significant range of growth rates in the issuer's and peer companies' historical data, and also noted the continued downturn in the issuer's customer's markets. In evaluating the reasonableness of the issuer's conclusion that the carrying value of PP&E was recoverable, the Firm failed to perform any procedures to consider whether the assumptions underlying the undiscounted cash-flow analysis were consistent with relevant current market conditions and whether the issuer had the ability to achieve the projections. (AS 2501.11)

A.15. Issuer O

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as its testing of controls over a significant portion of the real estate assets that the issuer acquired during the year was insufficient. Specifically, the Firm failed to sufficiently test an important aspect of a control that it selected for testing; this aspect was the review of a significant assumption that the issuer used in the valuation of these acquired real estate assets. The Firm's procedures to test this aspect of the control were limited to inquiring of management and inspecting documents with signatures and other notations that indicated certain reviews had occurred. The Firm failed to evaluate the criteria that the control owner used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are those that most directly relate to the deficiency. The deficiencies also 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. Paragraphs .02, .05, and .06 of AS 1015, *Due Professional Care in the Performance of Work*, require the independent auditor to plan and perform his or her work with due professional care and set forth aspects of that requirement. AS 1015.07-.09, and paragraph .07 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, 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 2301.03, .05, and .08 require the auditor to design and implement audit responses that address the risks of material misstatement. Paragraph .04 of AS 1105, *Audit Evidence*, 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 1105, <i>Audit Evidence</i>	Issuer D	1
	Issuer J	1
AS 2101, <i>Audit Planning</i>	Issuer A	1
	Issuer F	1
	Issuer G	1
	Issuer H	1
	Issuer I	1
AS 2201, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>	Issuer A	5
	Issuer B	5
	Issuer C	2
	Issuer D	1
	Issuer E	1
	Issuer F	2
	Issuer G	4
	Issuer H	4
	Issuer I	3
	Issuer J	3
	Issuer L	1
	Issuer M	1
	Issuer N	1
	Issuer O	1
AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	Issuer A	2
	Issuer B	1
	Issuer F	1
	Issuer H	1
	Issuer K	1
AS 2305, <i>Substantive Analytical Procedures</i>	Issuer A	1
	Issuer G	1
	Issuer H	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer I	1
	Issuer J	1
AS 2315, Audit Sampling	Issuer A	1
	Issuer B	1
	Issuer H	1
	Issuer J	1
AS 2501, Auditing Accounting Estimates	Issuer A	2
	Issuer B	4
	Issuer G	1
	Issuer J	1
	Issuer K	1
	Issuer L	1
	Issuer M	1
	Issuer N	1
AS 2502, Auditing Fair Value Measurements and Disclosures	Issuer A	1
	Issuer F	1
AS 2510, Auditing Inventories	Issuer D	1
	Issuer I	1
AS 2810, Evaluating Audit Results	Issuer C	1
	Issuer D	1
	Issuer E	1

B.3. Audit Deficiencies by Industry

The table below lists the industries⁴ of the issuers for which audit deficiencies were discussed in Part I.A of this report and cross references the issuers to the specific auditing standards related to the deficiencies.⁵

	AS 1105	AS 2101	AS 2201	AS 2301	AS 2305	AS 2315	AS 2501	AS 2502	AS 2510	AS 2810
Consumer Discretionary	J		J, M		J	J	J, M			
Consumer Staples			B	B		B	B			
Financial Services			O							
Health Care		G	G		G		G			
Industrials		A, F, H, I	A, F, H, I, L	A, F, H, K	A, H, I	A, H	A, K, L	A, F	I	
Materials			N				N			
Other	D		C, D, E						D	C, D, E

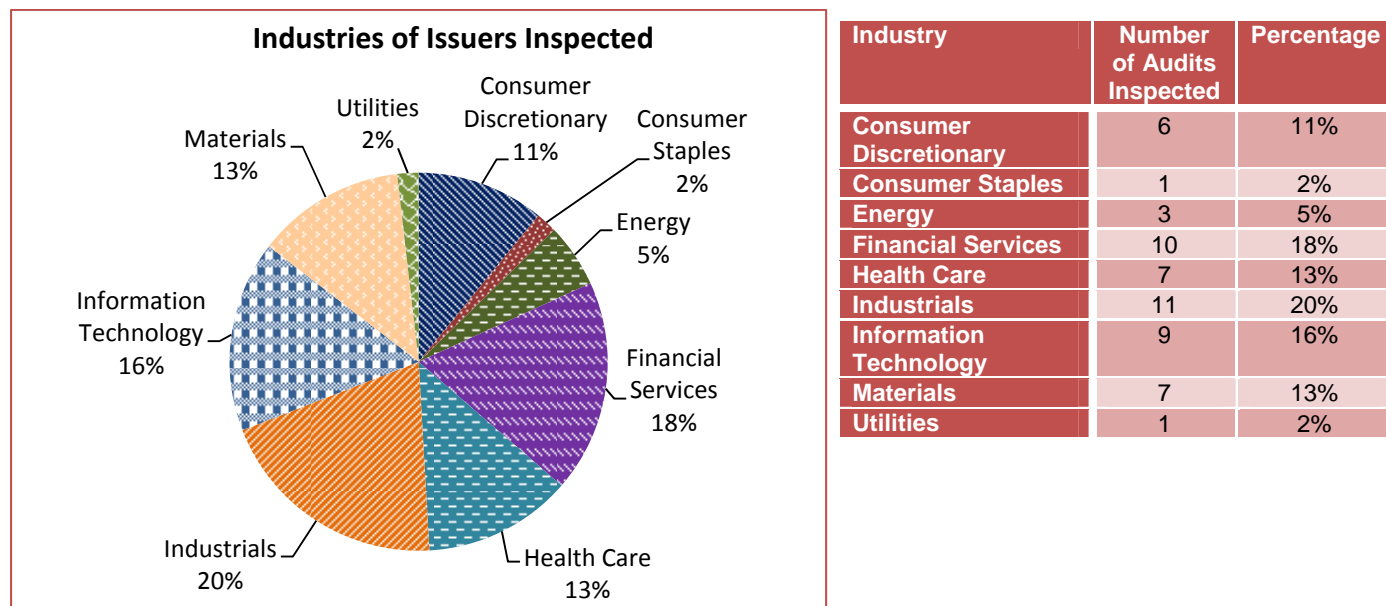
⁴ The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

⁵ 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.

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

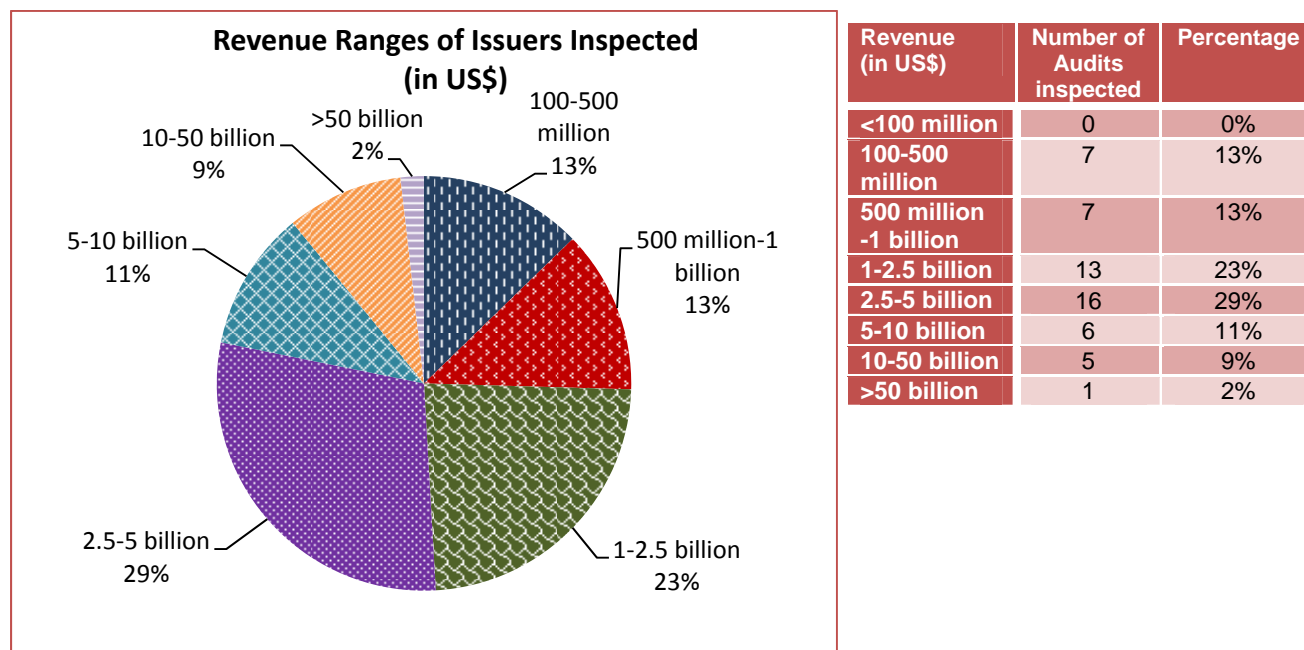
The chart below categorizes the 55 issuers whose audits were inspected in 2016, based on the issuer's industry.⁶



⁶ See Footnote 4 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 55 issuers whose audits were inspected in 2016.⁷ 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.



⁷ The revenue amounts reflected in the chart are for the issuer's fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.

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

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

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. 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. For each specific portion of the audit that is selected, the inspection team 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. 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.⁸

⁸ 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

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,⁹ as well as a firm's failure to perform, or to perform sufficiently, certain necessary tests of controls and substantive audit procedures. An inspection of an annually inspected firm does not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In reaching its conclusions about whether a deficiency exists, 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 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 1215, *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

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.

⁹ 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.

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 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.

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

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

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

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a

firm's quality control system.¹⁰ If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;¹¹ 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

¹⁰ 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.

¹¹ 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.

quality control. A description of the procedures generally applied to these areas is below.

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

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



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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.¹²

¹² The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.



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December 11, 2017

Response to Part I of the Draft Report on the 2016 Inspection of Ernst & Young LLP

Dear Ms. Munter:

We are pleased to provide our response to the Public Company Accounting Oversight Board (the "PCAOB") regarding Part I of the Draft Report on the 2016 Inspection of Ernst & Young LLP (the "Report").

We have thoroughly evaluated the matters described in Part I – *Inspection Procedures and Certain Observations* of the Report and have taken actions to address findings in accordance with PCAOB standards and our policies.

The PCAOB's inspection process assists us in identifying areas where we can continue to improve audit quality. We respect and benefit from this process as it aids us in fulfilling our responsibilities to investors, other stakeholders, and the capital markets generally.

We appreciate the opportunity to provide our response to the Report and look forward to continuing to work with the PCAOB on matters of interest to our public company auditing practice.

Respectfully submitted,

Stephen R. Howe, Jr.
Chairman and Managing Partner

Francis C. Mahoney
Vice Chair Assurance Services

APPENDIX D

AUDITING STANDARDS REFERENCED IN PART I

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

AS 1105, <i>Audit Evidence</i>		
SUFFICIENT APPROPRIATE AUDIT EVIDENCE		
Using Information Produced by the Company		
AS 1105.10	<p>When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:³</p> <ul style="list-style-type: none"> ▪ Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and ▪ Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. 	Issuers D and J
<p><u>Footnote to AS 1105.10</u></p> <p>³ When using the work of a specialist engaged or employed by management, see AS 1210, <i>Using the Work of a Specialist</i>. When using information produced by a service organization or a service auditor's report as audit evidence, see AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i>, and for integrated audits, see AS 2201, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>.</p>		

AS 2101, Audit Planning		
PLANNING AN AUDIT		
Multi-Location Engagements		
AS 2101.11	In an audit of the financial statements of a company with operations in multiple locations or business units, ¹³ the auditor should determine the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient appropriate evidence to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. This includes determining the locations or business units at which to perform audit procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual locations or business units. The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit.	Issuers A, F, G, H, and I
AS 2101.12	<p>Factors that are relevant to the assessment of the risks of material misstatement associated with a particular location or business unit and the determination of the necessary audit procedures include:</p> <ul style="list-style-type: none"> a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;¹⁴ b. The materiality of the location or business unit;¹⁵ c. The specific risks associated with the location or business unit that present a reasonable possibility¹⁶ of material misstatement to the company's consolidated financial statements; d. Whether the risks of material misstatement associated with the location or business unit apply to other locations or business units such that, in combination, they present a reasonable possibility of material misstatement to the company's consolidated financial statements; e. The degree of centralization of records or 	Issuers A, F, G, H, and I

AS 2101, Audit Planning		
	<p>information processing;</p> <p>f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and</p> <p>g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.</p> <p>Note: When performing an audit of internal control over financial reporting, refer to Appendix B, Special Topics, of AS 2201¹⁷ for considerations when a company has multiple locations or business units.</p>	
<u>Footnotes to AS 2101.12</u>		
14	Paragraph .66 of AS 2401, <i>Consideration of Fraud in a Financial Statement Audit</i> .	
15	AS 2105.10 describes the consideration of materiality in planning and performing audit procedures at an individual location or business unit.	
16	There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.	
17	AS 2201.B10-.B16.	

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS 2201.39	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, F, G, H, I, and J
TESTING CONTROLS		
Testing Design Effectiveness		

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
AS 2201.42	<p>The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.</p> <p>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.</p>	Issuers A, B, C, F, G, H, I, J, L, M, N, and O
Testing Operating Effectiveness		
AS 2201.44	<p>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.</p> <p>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.</p>	Issuers A, B, C, F, G, H, I, J, L, M, N, and O
EVALUATING IDENTIFIED DEFICIENCIES		
AS 2201.63	<p>The severity of a deficiency depends on –</p> <ul style="list-style-type: none"> ▪ Whether there is a reasonable possibility that the company's controls will fail to prevent or detect a misstatement of an account balance or disclosure; and ▪ The magnitude of the potential misstatement 	Issuers C and D

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

	resulting from the deficiency or deficiencies.	
AS 2201.65	<p>Risk factors affect whether there is a reasonable possibility that a deficiency, or a combination of deficiencies, will result in a misstatement of an account balance or disclosure. The factors include, but are not limited to, the following –</p> <ul style="list-style-type: none"> ▪ The nature of the financial statement accounts, disclosures, and assertions involved; ▪ The susceptibility of the related asset or liability to loss or fraud; ▪ The subjectivity, complexity, or extent of judgment required to determine the amount involved; ▪ The interaction or relationship of the control with other controls, including whether they are interdependent or redundant; ▪ The interaction of the deficiencies; and ▪ The possible future consequences of the deficiency. <p>Note: The evaluation of whether a control deficiency presents a reasonable possibility of misstatement can be made without quantifying the probability of occurrence as a specific percentage or range.</p> <p>Note: Multiple control deficiencies that affect the same financial statement account balance or disclosure increase the likelihood of misstatement and may, in combination, constitute a material weakness, even though such deficiencies may individually be less severe. Therefore, the auditor should determine whether individual control deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness.</p>	Issuers C and D
AS 2201.68	<p>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.</p>	Issuer A

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
APPENDIX B - Special Topics		
INTEGRATION OF AUDITS		
AS 2201.B8	<p><i>Effect of Substantive Procedures on the Auditor's Conclusions About the Operating Effectiveness of Controls.</i> In an audit of internal control over financial reporting, the auditor should evaluate the effect of the findings of the substantive auditing procedures performed in the audit of financial statements on the effectiveness of internal control over financial reporting. This evaluation should include, at a minimum –</p> <ul style="list-style-type: none"> ▪ The auditor's risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud. ▪ Findings with respect to illegal acts and related party transactions. ▪ Indications of management bias in making accounting estimates and in selecting accounting principles. ▪ Misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls. 	Issuer E

AS 2301, The Auditor's Responses to the Risks of Material Misstatement		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS 2301.08	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuer A
Responses to Fraud Risks		
AS 2301.13	<i>Addressing Fraud Risks in the Audit of Financial Statements.</i> In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in	Issuers F and K

AS 2301, The Auditor's Responses to the Risks of Material Misstatement		
	accordance with paragraphs .16-.17 of this standard, the auditor should perform tests of those controls.	
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS 2301.16	<i>Controls to be Tested.</i> If the auditor plans to assess control risk at less than the maximum by relying on controls, ¹² and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance . ¹³ However, the auditor is not required to assess control risk at less than the maximum for <i>all</i> relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	Issuers B and H
<u>Footnotes to AS 2301.16</u>		
<p>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.</p> <p>¹³ Terms defined in Appendix A, <i>Definitions</i>, are set in boldface type the first time they appear.</p>		
AS 2301.18	<i>Evidence about the Effectiveness of Controls in the Audit of Financial Statements.</i> In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers B and H
SUBSTANTIVE PROCEDURES		

AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i>		
AS 2301.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	Issuers B and H

AS 2305, <i>Substantive Analytical Procedures</i>		
Plausibility and Predictability of the Relationship		
AS 2305.13	It is important for the auditor to understand the reasons that make relationships plausible because data sometimes appear to be related when they are not, which could lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship can provide important evidence when appropriately scrutinized.	Issuer I
AS 2305.14	As higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation. Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts since income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion are sometimes less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.	Issuer I
Precision of the Expectation		
AS 2305.17	The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the	Issuers A, H, and I

AS 2305, Substantive Analytical Procedures		
	likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.	
Investigation and Evaluation of Significant Differences		
AS 2305.20	In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.	Issuer I
AS 2305.21	The auditor should evaluate significant unexpected differences. Reconsidering the methods and factors used in developing the expectation and inquiry of management may assist the auditor in this regard. Management responses, however, should ordinarily be corroborated with other evidential matter. In those cases when an explanation for the difference cannot be obtained, the auditor should obtain sufficient evidence about the assertion by performing other audit procedures to satisfy himself as to whether the difference is a misstatement. In designing such other procedures, the auditor should consider that unexplained differences may indicate an increased risk of material misstatement. (See AS 2810.)	Issuers A, G, H, I, and J

AS 2315, Audit Sampling		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AS 2315.17	When planning a particular sample, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures, to be applied will achieve that	Issuer A

AS 2315, Audit Sampling		
	<p>objective. The auditor should determine that the population from which he draws the sample is appropriate for the specific audit objective. For example, an auditor would not be able to detect understatements of an account due to omitted items by sampling the recorded items. An appropriate sampling plan for detecting such understatements would involve selecting from a source in which the omitted items are included. To illustrate, subsequent cash disbursements might be sampled to test recorded accounts payable for understatement because of omitted purchases, or shipping documents might be sampled for understatement of sales due to shipments made but not recorded as sales.</p>	
AS 2315.19	<p>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.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.</p>	Issuers B and H
<p><u>Footnote to AS 2315.19</u></p> <p>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.</p>		
AS 2315.23	<p>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.</p>	Issuers B and H

AS 2315, Audit Sampling		
AS 2315.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.	Issuers B and H
Sample Selection		
AS 2315.24	Sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. For example, haphazard and random-based selection of items represents two means of obtaining such samples. ⁴	Issuer A
<u>Footnote to AS 2315.24</u>		
<p>⁴ Random-based selection includes, for example, random sampling, stratified random sampling, sampling with probability proportional to size, and systematic sampling (for example, every hundredth item) with one or more random starts.</p>		
Performance and Evaluation		
AS 2315.25	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 J

AS 2315, Audit Sampling		
SAMPLING IN TESTS OF CONTROLS		
Performance and Evaluation		
AS 2315.40	Auditing procedures that are appropriate to achieve the objective of the test of controls should be applied to each sample item. If the auditor is not able to apply the planned audit procedures or appropriate alternative procedures to selected items, he should consider the reasons for this limitation, and he should ordinarily consider those selected items to be deviations from the prescribed policy or procedure for the purpose of evaluating the sample.	Issuer J

AS 2501, Auditing Accounting Estimates		
EVALUATING ACCOUNTING ESTIMATES		
AS 2501.07	<p>The auditor's objective when evaluating accounting estimates is to obtain sufficient appropriate evidential matter to provide reasonable assurance that—</p> <ul style="list-style-type: none"> a. All accounting estimates that could be material to the financial statements have been developed. b. Those accounting estimates are reasonable in the circumstances. c. The accounting estimates are presented in conformity with applicable accounting principles² and are properly disclosed.³ 	Issuers A and K
<p><u>Footnotes to AS 2501.07</u></p> <p>² AS 2815, <i>The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles,"</i> discusses the auditor's responsibility for evaluating conformity with generally accepted accounting principles.</p> <p>³ See paragraph .31 of AS 2810, <i>Evaluating Audit Results</i>.</p>		
EVALUATING REASONABLENESS		
AS 2501.11	Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the	Issuers A, B, J, L, M, and N

AS 2501, Auditing Accounting Estimates		
	<p>process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:</p> <ol style="list-style-type: none"> 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 (AS 1210, <i>Using the Work of a Specialist</i>). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate. 	
AS 2501.12	<p><i>Develop an expectation.</i> Based on the auditor's understanding of the facts and circumstances, he may independently develop an expectation as to the estimate by using other key factors or alternative assumptions about those factors.</p>	Issuer G

AS 2502, Auditing Fair Value Measurements and Disclosures		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AS 2502.26	<p>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:</p> <ul style="list-style-type: none"> 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. 	Issuer F
AS 2502.28	<p>Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.</p>	Issuer F
AS 2502.31	<p>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.</p>	Issuer F
AS 2502.36	<p>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),⁵ individually and taken as a whole, need to be realistic and consistent with:</p> <ul style="list-style-type: none"> 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; 	Issuer F

AS 2502, Auditing Fair Value Measurements and Disclosures		
	<p>d. Assumptions made in prior periods, if appropriate;</p> <p>e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable;</p> <p>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</p> <p>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.</p> <p>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.</p>	
<p><u>Footnote to AS 2502.36</u></p> <p>⁵ The auditor also should consider requirements of GAAP that may influence the selection of assumptions (see FASB Concepts Statement No. 7).</p>		
AS 2502.39	<p>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.</p>	Issuer A

AS 2510, Auditing Inventories		
INVENTORIES		
AS 2510.11	<p>In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in</p>	Issuers D and I

AS 2510, Auditing Inventories		
	<p>determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances.</p>	

AS 2810, Evaluating Audit Results		
Accumulating and Evaluating Identified Misstatements		
AS 2810.17	<p><i>Evaluation of the Effect of Uncorrected Misstatements.</i> The auditor should evaluate whether uncorrected misstatements are material, individually or in combination with other misstatements. In making this evaluation, the auditor should evaluate the misstatements in relation to the specific accounts and disclosures involved and to the financial statements as a whole, taking into account relevant quantitative and qualitative factors.⁷ (See Appendix B.)</p> <p>Note: In interpreting the federal securities laws, the Supreme Court of the United States has held that a fact is material if there is "a substantial likelihood that the ...fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."⁸ As the Supreme Court has noted, determinations of materiality require "delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him"⁹</p> <p>Note: As a result of the interaction of quantitative and qualitative considerations in materiality judgments, uncorrected misstatements of relatively small amounts could have a material effect on the financial statements. For example, an illegal payment of an otherwise immaterial amount could be material if there</p>	Issuer C

AS 2810, Evaluating Audit Results		
	<p>is a reasonable possibility¹⁰ that it could lead to a material contingent liability or a material loss of revenue.¹¹ Also, a misstatement made intentionally could be material for qualitative reasons, even if relatively small in amount.</p> <p>Note: If the reevaluation of the established materiality level or levels, as set forth in Auditing Standard No. 11,¹² results in a lower amount for the materiality level or levels, the auditor should take into account that lower materiality level or levels in the evaluation of uncorrected misstatements.</p>	
Footnotes to AS 2810.17		
<p>⁷ If the financial statements contain material misstatements, AS 3101, <i>Reports on Audited Financial Statements</i>, indicates that the auditor should issue a qualified or an adverse opinion on the financial statements. AS 3101.35 discusses situations in which the financial statements are materially affected by a departure from the applicable financial reporting framework.</p> <p>⁸ <i>TSC Industries v. Northway, Inc.</i>, 426 U.S. 438, 449 (1976). See also <i>Basic, Inc. v. Levinson</i>, 485 U.S. 224 (1988).</p> <p>⁹ <i>TSC Industries</i>, 426 U.S. at 450.</p> <p>¹⁰ There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.</p> <p>¹¹ AS 2405, <i>Illegal Acts by Clients</i>.</p> <p>¹² AS 2105.11-.12.</p>		
Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS 2810.30	<p>The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.</p> <p>Note: AS 2815, <i>The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles,"</i> establishes requirements for</p>	Issuers D and E

AS 2810, Evaluating Audit Results		
	<p>evaluating the presentation of the financial statements. AS 2820, <i>Evaluating Consistency of Financial Statements</i>, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.</p> <p>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.</p>	
APPENDIX B - Qualitative Factors Related to the Evaluation of the Materiality of Uncorrected Misstatements		
AS 2810.B2	<p>Qualitative factors to consider in the auditor's evaluation of the materiality of uncorrected misstatements, if relevant, include the following:</p> <ol style="list-style-type: none"> a. The potential effect of the misstatement on trends, especially trends in profitability. b. A misstatement that changes a loss into income or vice versa. c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies. d. The potential effect of the misstatement on the company's compliance with loan covenants, other contractual agreements, and regulatory provisions. e. The existence of statutory or regulatory reporting requirements that affect materiality thresholds. f. A misstatement that has the effect of increasing management's compensation, for example, by satisfying the requirements for the award of bonuses or other forms of incentive compensation. g. The sensitivity of the circumstances surrounding the misstatement, for example, the implications of misstatements involving fraud and possible illegal acts, violations of contractual provisions, and conflicts of interest. h. The significance of the financial statement element affected by the misstatement, for example, a misstatement affecting recurring earnings as contrasted to one involving a non- 	Issuer C

AS 2810, Evaluating Audit Results

	<p>recurring charge or credit, such as an extraordinary item.</p> <p>i. The effects of misclassifications, for example, misclassification between operating and non-operating income or recurring and non-recurring income items.</p> <p>j. The significance of the misstatement or disclosures relative to known user needs, for example:</p> <ul style="list-style-type: none"> • The significance of earnings and earnings per share to public company investors. • The magnifying effects of a misstatement on the calculation of purchase price in a transfer of interests (buy/sell agreement). • The effect of misstatements of earnings when contrasted with expectations. <p>k. The definitive character of the misstatement, for example, the precision of an error that is objectively determinable as contrasted with a misstatement that unavoidably involves a degree of subjectivity through estimation, allocation, or uncertainty.</p> <p>l. The motivation of management with respect to the misstatement, for example, (i) an indication of a possible pattern of bias by management when developing and accumulating accounting estimates or (ii) a misstatement precipitated by management's continued unwillingness to correct weaknesses in the financial reporting process.</p> <p>m. The existence of offsetting effects of individually significant but different misstatements.</p> <p>n. The likelihood that a misstatement that is currently immaterial may have a material effect in future periods because of a cumulative effect, for example, that builds over several periods.</p> <p>o. The cost of making the correction—it may not be cost-beneficial for the client to develop a system to calculate a basis to record the effect of an immaterial misstatement. On the other hand, if management appears to have developed a system to calculate an amount that represents an immaterial misstatement, it may reflect a motivation of management as noted in paragraph .B2l above.</p> <p>p. The risk that possible additional undetected misstatements would affect the auditor's evaluation.</p>	
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