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Report on
2009 Inspection of PricewaterhouseCoopers LLP
(Headquartered in New York, New York)

Issued by the
Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

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

PCAOB RELEASE NO. 104-2010-131A
(Includes portions of Part II of the full report that
were not included in PCAOB Release No. 104-2010-131)



Preface to Reports Concerning Annually Inspected Firms

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

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

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

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



Notes Concerning this Report

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



2009 INSPECTION OF PRICEWATERHOUSECOOPERS LLP

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

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

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

^{1/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

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

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from October 2008 through October 2009. The inspection team performed field work at the Firm's National Office and at 34 of its approximately 61 U.S. assurance practice offices.

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

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

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

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

A. Review of Audit Engagements

The inspection procedures included reviews of aspects of 76 audits performed by the Firm. The scope of this review was determined according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the scope.

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

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

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

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

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

^{7/} See AU 390, *Consideration of Omitted Procedures After the Report Date*, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T), and PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over*

and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers, and in one instance, follow-up between the Firm and the issuer led to a change in the issuer's accounting and disclosure practices.^{8/}

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements or internal control over financial reporting ("ICFR"). The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis, with the exception of similar deficiencies that were observed in multiple audits and are therefore grouped together.

Deficiencies in testing fair values of investment securities and derivatives (four audits)

In four audits, due to deficiencies in its testing of the fair values of investment securities and/or derivatives, the Firm failed to obtain sufficient competent evidential matter to support its audit opinion. The deficiencies are as follows:

- One issuer estimated the fair values of certain investment securities that were not actively traded using a weighted average of two fair value estimates. One estimate was determined using a discounted cash flow model and the other was obtained from an external pricing service. For the fair value estimate determined using the discounted cash flow model, the Firm failed to test certain key assumptions underlying the cash flow projections. For the fair value estimate obtained from an external pricing service, the Firm failed to evaluate the reasonableness of the assumptions the external pricing service had used in its models to estimate the fair values of the investment securities. Further, the Firm failed to resolve its specialist's questions regarding the

Financial Reporting That Is Integrated with An Audit of Financial Statements ("AS No. 5"), ¶ 98.

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

appropriateness of the weighting of the two estimates that were used to estimate the fair value. (Issuer A)

- In one audit, the engagement team had requested that the Firm's internal investment securities pricing group obtain third-party pricing information to corroborate the issuer's fair value estimates for its investment securities. The Firm's internal investment securities pricing group was unable to obtain pricing information for a portion of the issuer's investment securities. The engagement team performed alternative procedures to test the issuer's estimated fair value of certain types of these securities, but it failed to perform alternative procedures to test the issuer's estimated fair value of certain other types of these securities whose recorded values were significant. (Issuer B)
- One issuer held investments in auction rate securities that had failed at auction. As a result, the issuer used a discounted cash flow model to estimate the fair value of these securities at year end. The issuer's discounted cash flow model, which used the same discount rate for all of the auction rate securities that the issuer held, resulted in an aggregate estimated fair value for the securities that was slightly above par value. As a result of the failed auctions, the interest rates for each of the auction rate securities had changed to specified contractual maximum rates. In some cases, these maximum rates were as much as twice the discount rate used by the issuer in its discounted cash flow model. The Firm failed to evaluate the reasonableness of the discount rate the issuer used in light of the contractual maximum rates and the credit and liquidity risks that suggested the discount rate should have been considerably higher. (Issuer C)
- In one audit, the Firm failed to perform adequate audit procedures to evaluate the fair values of various types of the issuer's investment securities and derivatives as described below:
 - For one of the portfolios of investment securities that the issuer held, the issuer obtained valuation data from pricing services for 100 percent of the portfolio and obtained broker quotes for only 54 percent of the portfolio. The issuer used the pricing services' data to value more than 98 percent of the portfolio. The Firm's valuation specialists tested the valuation of a small number of the securities in the portfolio and formed the view that, in all but one of the cases they tested, the broker quotes were more indicative of fair value than the pricing services' data. The Firm

nevertheless accepted the issuer's valuation without performing additional tests to determine whether it was reasonable to value the securities using the data from the pricing services.

- For one type of high-risk derivative, the issuer used certain external pricing information and values calculated by its valuation model in its valuation process. The issuer's documentation indicated that the external pricing information was obtained from multiple pricing sources. Although there was a heightened risk of fraud and the Firm identified a significant audit adjustment and deficiencies in controls in this area, the Firm failed to obtain corroboration of the accuracy of this pricing information from independent sources outside the issuer. In addition, the Firm failed to test the reasonableness of certain of the significant assumptions that the issuer made regarding this external pricing information and regarding the values calculated by the issuer's valuation model. The Firm also failed to perform substantive procedures to evaluate the reasonableness of certain higher-risk pricing inputs to the issuer's valuation model. (Issuer D)

Issuer E

In this audit, the Firm failed to sufficiently test certain assumptions and key inputs used to develop a significant portion of the issuer's loan loss allowance. Specifically, the Firm tested one of the inputs through inquiry only on a few loans. In addition, the Firm used the work of the issuer's internal loan review group to test certain key inputs; however, it did not reperform any of the group's testing or perform its own independent testing of these inputs. Further, the Firm failed to evaluate the reasonableness of certain significant assumptions used to calculate one component of this portion of the issuer's loan loss allowance and failed to test certain key inputs to the calculation of this component beyond inquiry.

Issuer F

One issuer had a deficiency in its internal control over financial reporting at year end that the Firm and the issuer classified as a significant deficiency. The deficiency resulted from the aggregation of access control deficiencies regarding information technology systems that maintained the contract pricing of sales transactions, customer account set-up, and the financial reporting system. The Firm's tests of revenue and accounts receivable were not sufficient given the existence of this deficiency. Specifically, the Firm failed to test the completeness and accuracy of the data that the

issuer used in an important entity-level control as well as the data that the Firm used in the performance of certain of its analytical procedures. It also failed to sufficiently test the entity-level control, as the Firm's testing of the control was limited to a walkthrough and verification that management prepared certain reports, reviewed them, and investigated variances. While the Firm performed certain other control and substantive test procedures, the controls and substantive testing did not address the risk that critical data in the issuer's systems related to the pricing of the issuer's services could have been changed inappropriately at any point in the year.

In addition, while the Firm tested certain revenue transactions that occurred during the first seven months of the year, it failed to perform roll-forward procedures for the remaining five months of the year or to adequately test revenues and accounts receivable at year end as the year-end procedures were limited to analytical procedures and certain cash receipts testing. The analytical procedures, however, were not disaggregated to an appropriate level of precision to detect whether there was a material misstatement in the financial statements and the Firm failed to test the completeness and accuracy of the data used in the analytical procedures and cash receipts testing.

Issuer G

One issuer had numerous foreign locations, which accounted for over 20 percent of the issuer's revenue. The Firm did not visit any of the foreign locations in connection with the audit, nor did it use the work of its international affiliates or other auditors in reporting on the issuer's financial statements in the year under audit. The issuer's foreign locations did not have common information technology systems, processes, or controls. With respect to these locations, the Firm's procedures were limited to testing the issuer's entity-level controls, the performance of analytical procedures for a few of the locations, and inquiry of management. The Firm failed to properly test revenue from the foreign locations in the following respects –

- The Firm's audit approach placed significant reliance on the issuer's performance of entity-level controls related to these foreign locations. The Firm failed to test the integrity of the data that the issuer used in performing the entity-level controls. The Firm also failed to sufficiently test those entity-level controls in order to determine whether they would prevent or detect a material misstatement of revenue at the issuer's foreign locations, as the Firm's testing of the operating effectiveness of such controls was limited to verifying that management had signed off as having completed the procedure.

- For the foreign locations for which the Firm planned to perform substantive analytical procedures, the Firm failed to appropriately develop expectations that were sufficiently precise to identify for investigation differences that may be potential material misstatements, individually or when aggregated with other misstatements. Specifically, for some locations the expectations were limited to whether the Firm expected the balance to increase or decrease as compared to prior periods, and for the others, the expectations were that the balances would be consistent with budgets and forecasts. In addition, the Firm failed to test the completeness and accuracy of the information used in the analytical procedures.
- The Firm excluded journal entries relating to the foreign locations from its journal entry testing.

Issuer H

One issuer had numerous foreign locations. For certain of the issuer's foreign locations, which represented 29 percent of its revenues, the Firm's planned approach placed significant reliance on certain entity-level controls and the performance of substantive analytical procedures for a few of the foreign locations. The Firm failed to properly test revenue from these foreign locations in the following respects –

- The Firm failed to test the issuer's entity-level controls, which had no defined precision levels, at a sufficient depth to determine whether they would prevent or detect a material misstatement of revenue at the issuer's foreign locations. Specifically, the Firm's testing was limited to performing a walkthrough, obtaining issuer-prepared documents to be used at certain meetings of members of the issuer's management that constituted the entity-level controls, reviewing evidence that such meetings occurred, and performing inquiries of management. The Firm also failed to test the completeness and accuracy of the data that the issuer used in performing the entity-level controls.
- For the foreign locations for which the Firm planned to perform substantive analytical procedures, the Firm's expectations were not sufficiently precise as the expectations only consisted of whether the amounts would increase or decrease. The results at these locations were different from expectations, and the Firm failed to obtain corroboration of management's explanations of the significant unexpected differences between expected and actual revenues at these locations.

In addition, the Firm's plan to test revenue for a significant number of the issuer's domestic divisions included the performance of substantive analytical procedures on a quarterly basis. The Firm failed to develop appropriate expectations to be used in these procedures, as the Firm's expectations were based on previous quarters' sales data, despite significant negative economic developments following those quarters. In addition, the Firm failed to define a threshold for significant differences at a level that would identify misstatements that had the potential to be material to the financial statements. Further, the Firm failed to obtain corroboration of management's explanations of significant unexpected differences between expected and actual revenues.

Issuer I

In this audit, the Firm identified a significant error at year end in the issuer's calculation of impairment for one of its asset groups. In the prior year, a material weakness had existed in the internal control over the calculation of impairment for assets in a similar asset group. A control implemented by the issuer to remediate the prior year's material weakness failed to detect the error discovered in the current year. The Firm determined that a compensating control existed that reduced the severity of the control deficiency to a significant deficiency. The Firm, however, did not test the operating effectiveness of this compensating control. Accordingly, the Firm had not obtained sufficient competent evidential matter to support its opinion on internal control over financial reporting.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures,



and processes for responding to weaknesses in quality control. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I



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PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED
FROM THIS PUBLIC DOCUMENT

PART II

ISSUES RELATED TO QUALITY CONTROLS

This Part II describes the Board's concerns about potential defects in the Firm's quality control system. Assessment of a firm's quality control system rests both on review of a firm's stated quality control policies and procedures and on inferences that can be drawn from respects in which a firm's system has failed to assure quality in the actual performance of engagements. On the basis of the information reported by the inspection team, the Board has the following concerns about aspects of the Firm's system of quality control.^{9/}

A. Audit Performance

A firm's system of quality control should provide reasonable assurance that the firm's audit work will meet professional standards and regulatory requirements. Not every deficiency in an audit indicates that a firm's quality control system is insufficient to provide that assurance, and this report does not discuss every auditing deficiency observed by the inspection team. On the other hand, some deficiencies, or repeated instances of similar deficiencies, may indicate a significant defect in a firm's quality control system even when the deficiency has not resulted in an insufficiently supported audit opinion. As described below, some deficiencies reported by the inspection team do suggest that the Firm's system of quality control may in some respects fail to provide sufficient assurance that the Firm's audit work will meet applicable standards and requirements.

^{9/} This report's description of quality control issues is based on the inspection team's observations during the inspection field work, which concluded in October 2009. Any changes or improvements that the Firm may have made in its system of quality control since that time are not reflected in this report, but will be taken into account by the Board during the 12-month remediation process following the issuance of this report.

1. Specific Categories of Deficiencies
 - a. Auditing Fair Value Measurements

The engagement reviews provide cause for concern about the effectiveness of the Firm's quality controls with respect to auditing fair value measurements. The specific deficiencies are described below.

* * * *

Assets in Connection with Impairment Tests

The inspection team identified two audits^{10/} with deficiencies in this area. In one audit,^{11/} there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested the data and cash flow projections that the issuer had used to evaluate certain long-lived assets for possible impairment. In the other audit,^{12/} the Firm failed to identify that the issuer had incorrectly estimated future cash flows for certain of its reporting units in connection with evaluating and measuring goodwill for impairment.

- b. Integrated Audit – Sufficiency of Audit Evidence

The inspection team identified deficiencies in four engagements discussed in Part I.A^{13/} where the Firm failed to perform sufficient procedures, or include in its work papers sufficient evidence, to support its opinion on internal control over financial reporting or its controls-reliance strategy when conducting integrated audits. In three of these audits,^{14/} the deficiency resulted from the Firm's failure to appropriately perform several audit procedures, including both controls-related and substantive, in a single

^{10/} Issuers K and L

^{11/} Issuer K

^{12/} Issuer L

^{13/} Issuers F, G, H, and I

^{14/} Issuers F, G, and H

audit area, that, when aggregated, rendered the evidence obtained insufficient to support the audit opinion on the financial statements. In addition to the engagements described above, the inspection team identified five engagements^{15/} with deficiencies in this area. The specific concerns in this area that were identified through the review of the nine engagements are described below.

Entity-level controls

In a number of instances, the Firm identified entity-level controls as a significant or primary source of audit assurance. Typically, these entity-level controls were business performance reviews, and the Firm reduced its testing of transaction-level controls or the assurance it planned to obtain from substantive procedures by relying on the operating effectiveness of these entity-level controls. In four audits,^{16/} the inspection team identified deficiencies in the testing of these entity-level controls. Specifically, the Firm failed to 1) test that the entity-level control would operate at a level of precision sufficient to prevent or detect a material misstatement in the financial statements,^{17/} 2) test the completeness and accuracy of the data used in the performance of the control,^{18/} or 3) perform procedures, beyond confirming the occurrence of a meeting or observing evidence that the issuer's management had reviewed meeting documents, to test the operation of the control.^{19/}

Use of the work of others

The inspection team identified deficiencies in the Firm's use of the work of others. For example, in one audit,^{20/} the Firm used the work of the issuer's internal audit group as a source of assurance, including for substantive audit evidence, but there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm

^{15/} Issuers K, M, N, O, and P

^{16/} Issuers F, G, H, and O

^{17/} Issuers G, H, and O

^{18/} Issuers F, G, and H

^{19/} Issuers F and H

^{20/} Issuer H

had assessed the competence and objectivity of this group or the quality and effectiveness of the internal auditors' work. In addition, in reviewing this audit, the inspection team identified deficiencies in the internal auditors' testing, which further suggests that the Firm failed to sufficiently review and evaluate the internal auditors' testing. In one audit,^{21/} for an area identified in the Firm's work papers as a key risk, the Firm used the work of the issuer's internal audit group to test the majority of the controls identified as high risk, including the most complex controls, without an apparent justification for doing so.

The inspection team also observed a number of engagements where the audit work papers failed to describe the nature, timing, and extent of the work performed by others, such as the procedures performed, the population tested, the sampling methodology used, the test results, or the conclusions reached. The Firm's policy does not require engagement teams to document the nature, timing, and extent of the work of others, unless that work was performed in direct assistance to the engagement team. Such a policy appears not to provide sufficient assurance that the Firm will comply with Auditing Standard No. 3, *Audit Documentation*, as it appears not to require engagement teams to retain sufficient documentation to allow an experienced auditor with no previous connection to the engagement to understand the basis for the conclusions reached by the Firm regarding the adequacy and results of the work of others.

Controls testing and evaluation

In addition to two audits discussed in Part I.A,^{22/} the inspection team identified two additional audits^{23/} with deficiencies in this area. In one of these audits,^{24/} the Firm was aware of certain deficiencies in the issuer's controls over revenue in the first half of the year; however, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had (1) assessed the effect that the control deficiencies should have had on the nature, timing, and extent of its procedures, including its ability to rely on the controls during the period that the controls had failed, and (2) re-performed or reviewed the work performed by others on which the Firm relied

^{21/} Issuer O

^{22/} Issuers F and I

^{23/} Issuers N and O

^{24/} Issuer O

to determine that the controls were remediated, or performed its own testing, beyond a walkthrough, of the controls. In the other audit,^{25/} the Firm raised significant questions regarding the issuer's determination of the fair value of one of the issuer's reporting units. The Firm communicated its questions to the issuer before the issuer's controls that were designed to either prevent or detect these issues had fully operated. Although the Firm, as a result, did not test certain relevant aspects of the operating effectiveness of these controls, the Firm concluded that the controls were operating effectively.

In addition, the inspection team observed six instances,^{26/} which are also discussed elsewhere in the report, in which certain substantive tests and/or the operating effectiveness of certain internal controls relied on system-generated and other data. The Firm's testing, however, did not provide a sufficient basis for reliance on the data as the engagement teams failed to test the completeness and accuracy of the data or the controls over the data.

Certain of the observations in the preceding paragraphs suggest that some engagement teams are not placing appropriate emphasis on tests of controls. In addition, these observations suggest that the Firm's methodology regarding controls testing may not be clear enough or sufficiently well understood by the Firm's professionals.

c. Auditing Estimates

The engagement reviews provide cause for concern about the effectiveness of the Firm's quality controls with respect to auditing management's estimates. In addition to one audit discussed in Part I.A,^{27/} the inspection team identified four audits^{28/} with deficiencies in this area. In one audit,^{29/} the Firm failed to sufficiently test the issuer's calculation of the last-in first-out inventory reserve as it failed to (1) test certain of the data used in the calculations and (2) quantify the effect of the omission of certain

^{25/} Issuer N

^{26/} Issuers F, G, H, K, M, and P

^{27/} Issuer E

^{28/} Issuers F, M, P, and Q

^{29/} Issuer M



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components from the calculations for one of the issuer's divisions and determine whether a similar omission existed in the calculations for another division. In the second audit,^{30/} the Firm failed to test the loss percentages the issuer used as inputs to estimate the allowance for doubtful accounts. In the third audit,^{31/} the Firm failed to test certain key data that the issuer had provided to an outside specialist for use in determining the amount to be recorded for unsettled insurance receivables. In the fourth audit,^{32/} the Firm failed to test the completeness and accuracy of the data used in determining an idle plant expense.

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^{30/} Issuer F

^{31/} Issuer Q

^{32/} Issuer P

APPENDIX B

THE INSPECTION PROCESS

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

1. Review of Selected Audits

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

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenue, fair value measurements, derivatives, pension and other postretirement benefits, income taxes, reserves or estimated liabilities, inventories, consideration of fraud, consideration of an issuer's ability to continue as a going concern, impairment considerations, supervision of work performed by foreign affiliates, and assessment of risk by the engagement team. The inspection team also analyzed potential adjustments to the issuer's financial statements that were identified during the audit but not corrected. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other

documentation, the inspection team issued a comment form on the matter and the Firm provided a written response to the comment form.

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

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

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

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

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

The objectives of the inspection procedures in this area were (a) to continue to assess whether the design and application of the Firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm; (b) to assess the Firm's quality controls over the allocation of its partner resources; and (c) to identify and assess the accountability and responsibilities of the different levels of Firm management with respect to partner management. The inspection team interviewed members of the Firm's management and also reviewed and evaluated documentation related to certain of these topics. In addition, the inspection team's interviews of audit partners included questions regarding their responsibilities and allocation of time and the interviews of Firm management included the performance of partners being inspected, the evaluation and compensation process, any disciplinary actions, and any situations where client management requested a change in the lead audit partner. In addition, the inspection team reviewed a sample of partners' personnel files, including files of partners who resigned or took early retirement and partners who had significant negative inspection results from recent internal and PCAOB inspections.

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

The objectives of the inspection procedures in this area were to continue to assess whether the Firm appropriately considers and addresses the risks involved in accepting and retaining clients in the particular circumstances and to assess the Firm's responses to the risks identified, including the extent to which an observable link exists between the identified risks of material misstatement and the audit procedures performed. Toward those objectives, the inspection team selected certain issuer audits to (a) evaluate compliance with the Firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the client and (b) observe whether the audit procedures were responsive to the risks identified during the process.

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

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

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

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

(ii) Review of Response to Weaknesses in Quality Control

The objectives of the inspection procedures in this area were to assess the design and test the effectiveness of the Firm's processes for addressing possible deficiencies in the Firm's system of quality control, including any deficiencies in the Firm's system of quality control that were noted in prior PCAOB inspection reports. Toward those objectives, the inspection team reviewed steps the Firm has taken in the past several years to address possible quality control deficiencies. The inspection team then assessed the design and evaluated the effectiveness of the processes identified. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the Firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

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

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

APPENDIX C

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{33/}

^{33/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

July 16, 2010

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

Re: PricewaterhouseCoopers LLP Response to Draft Report on 2009 Inspection of PricewaterhouseCoopers LLP

Dear Mr. Diacont:

We are pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Draft Report on the 2009 Inspection of our Firm's 2008 audits (the "Report").

We continue to support the PCAOB and we wish to convey our sincere appreciation for the professional efforts of the PCAOB Staff. The on-going communication and interactions between the PCAOB Inspections Staff and our Firm continue to contribute to improvements in our audit quality. We remain highly focused on both performing quality audits and our system of quality control, the importance of which is even further underscored in today's difficult economic environment.

We appreciate the objectivity and perspective that the PCAOB's inspection process brings to our Firm. As with any audit process, judgements are necessarily involved in the inspection process and professionals can reach different conclusions about the adequacy of audit evidence in a particular circumstance. We have evaluated each of the findings set forth in *Part I - Inspection Procedures and Certain Observations* of your Report and taken appropriate actions under both PCAOB standards and our policies. Our evaluation included those steps necessary to comply with AU 390, *Consideration of Omitted Procedures After the Report Date*, and where applicable, AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditors Report*. In no instance did our evaluation result in a change to our audit opinion or restatement of the issuer's financial statements.



We appreciate this opportunity to formally respond to the PCAOB's 2009 Draft Inspection Report. We remain committed to working with the PCAOB in support of our continuous improvement efforts and our unwavering commitment to audit quality. We would be pleased to discuss any aspect of our response or any further questions you may have.

Sincerely,

PricewaterhouseCoopers LLP