

**Report on**

**2010 Inspection of BDO USA, LLP  
(Headquartered in Chicago, Illinois)**

**Issued by the**

**Public Company Accounting Oversight Board**

**January 31, 2012**

**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. 104-2012-071

**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 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 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 financial statement misstatements, including failures to comply with 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 apparent misstatements 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 whether an issuer's financial statements are misstated or fail to comply with Commission disclosure requirements, rests with the Commission. Any description, in this report, of financial statement misstatements or failures to comply with 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.

## 2010 INSPECTION OF BDO USA, LLP

### Preface

In 2010, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm BDO USA, LLP ("BDO" or "the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").<sup>1/</sup>

The Board is issuing this report in accordance with the requirements of the Act.<sup>2/</sup> 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 for annually inspected firms.<sup>3/</sup> Appendix C includes the Firm's comments, if any, on a draft of the report.<sup>4/</sup> A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system) is nonpublic, unless the firm fails to make sufficient progress in addressing those criticisms.

---

<sup>1/</sup> The Firm has issued audit reports under the name of BDO Seidman, LLP. Effective July 1, 2010, the Firm's statutory name is BDO USA, LLP.

<sup>2/</sup> In its Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions.

<sup>3/</sup> The Act requires the Board to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers.

<sup>4/</sup> 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.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm performs audit work.<sup>5/</sup> To achieve that goal, Board inspections include reviews of certain aspects of selected audit work performed by the firm and reviews of certain aspects of the firm's quality control system. It is not the purpose of an inspection, however, to review all of a firm's audit work or to identify every respect in which reviewed work is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm audit work, or the relevant issuers' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

If the Board inspection team identifies deficiencies that exceed a certain significance threshold in the audit work it reviews, those deficiencies are summarized in the public portion of the Board's inspection report.<sup>6/</sup> The Board cautions, however, against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout the Firm's practice. Audit work is selected for inspection largely on the basis of an analysis of factors that, in the inspection team's view, heighten the possibility that audit deficiencies are present, rather than through a process intended to identify a representative sample.

---

<sup>5/</sup> 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.

<sup>6/</sup> Inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. 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. 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. The inspection team may review, either in the same inspection or in subsequent inspections, the adequacy of the firm's compliance with these requirements. 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.

## PART I

### INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from August 2010 through December 2010. The inspection team performed field work at the Firm's national and practice offices in New York and Chicago, its Center of Information Management in Grand Rapids, and at an additional 13 of its approximately 35 U.S. assurance practice offices.

#### A. Review of Audit Engagements

The 2010 inspection of the Firm included reviews of aspects of 31 audits. The inspection team selected the audits and aspects to review, and the Firm was not allowed an opportunity to limit or influence the selections.

The inspection team identified matters that it considered to be deficiencies in the performance of the audit work it reviewed. Those deficiencies included failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,<sup>7/</sup> as well as 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 was based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claimed to have performed the procedure.<sup>8/</sup>

---

<sup>7/</sup> 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 applicable accounting principles, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

<sup>8/</sup> PCAOB Auditing Standard No. 3, *Audit Documentation*, provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.

The inspection team considered certain of the deficiencies that it observed to be audit failures. Specifically, certain of the identified deficiencies were of such significance that it appeared that the Firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The audit deficiencies that reached this level of significance are described below.<sup>9/</sup>

1. Issuer A

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

- The issuer identified goodwill impairment indicators for all of its reporting units and determined, based on a comparison of its consolidated market capitalization plus debt ("enterprise value") to the recorded value of its net assets, that an impairment charge for the full balance of goodwill for all of its reporting units should be recorded. The Firm failed to evaluate the issuer's assertion that the enterprise value was the most appropriate fair value estimation approach for its three reporting units and to consider why none of the alternative valuation methods that the issuer had used in the prior year's analysis was employed in the current year. Furthermore, in testing the issuer's measurement of the impairment, the Firm failed to evaluate the issuer's assertion that the book value of its consolidated net assets approximated their fair value as of the impairment date, and failed to evaluate whether the issuer's approach was in conformity with GAAP.

2. Issuer B

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

- The Firm failed to perform sufficient procedures in relation to a significant multi-year sales contract. Specifically, the Firm failed to evaluate whether the

---

<sup>9/</sup> 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.

issuer had identified the accounting elements arising from the various deliverables specified in the arrangement and whether the contract consideration was appropriately measured and allocated to the deliverables.

- The Firm failed to perform sufficient procedures to test the valuation of inventory. Specifically, the Firm failed to evaluate the issuer's key assumptions underlying the determination of the reserve for excess and obsolete inventory for certain significant subsidiaries. Further, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested certain significant inputs to the calculations of the inventory reserve.

3. Issuer C

In this audit of a new client, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion –

- The Firm failed to perform sufficient procedures to evaluate the issuer's determination that certain long-lived assets were not impaired. At year end, the issuer performed an analysis of undiscounted cash flows to evaluate its long-lived assets for possible impairment. This analysis incorporated projections of revenue growth and gross margin that were significantly different from the issuer's historical results. The Firm failed to evaluate, beyond inquiry, the reasonableness of the issuer's assumptions used in the analysis. In addition, the Firm failed to evaluate, beyond inquiry, the reasonableness of the issuer's determination that the reporting unit level represented the lowest level of identifiable cash flows.
- The issuer identified goodwill impairment indicators for two of its reporting units during the year. Based on a comparison of discounted cash flows to the carrying values of the reporting units, but without performing the "step 2" evaluation set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 350, *Goodwill and Other Intangibles*, the issuer determined that an interim impairment charge for the full balance should be recorded. The Firm failed to perform sufficient procedures to evaluate the reasonableness of certain significant assumptions that the issuer used in developing its analysis of discounted cash flows. Specifically, the Firm failed to test the revenue growth and the discount rate

assumptions that the issuer used in the analysis and to evaluate the appropriateness of changes in those assumptions that the issuer had made since the previous year-end impairment test. In addition, the Firm failed to evaluate whether the issuer had appropriately determined the amount of the impairment charge.

4. Issuer D

In this audit, in evaluating the issuer's assessment of the possible impairment of goodwill, the Firm failed to detect a misallocation of debt to the net book value of one of the issuer's reporting units. Had this misallocation not occurred, the unit's calculated carrying value would have exceeded its calculated fair value.

5. Issuer E

In this audit, the Firm failed to perform sufficient procedures to test revenue related to contracts accounted for under the percentage-of-completion method. Specifically, the Firm failed to perform procedures, beyond inquiry, to test the estimated costs to complete open projects.

6. Issuer F

In this audit, the Firm failed to sufficiently test the completeness, existence, and valuation of customer receivables and payables. The Firm sent requests for positive written confirmations to customers for selected customer receivables and payables. The Firm failed to perform sufficient alternative procedures to address the approximately 74 percent of the confirmation requests that were not returned, as its procedures were limited to comparing closing and opening balances on successive monthly statements prepared by the issuer's service organization and inquiring of the issuer regarding accounts with no activity.

7. Issuer G

In this audit, the Firm failed to perform sufficient procedures regarding income taxes. Specifically, other than signed-off audit programs that were general in nature, the inclusion of certain issuer-prepared schedules and memoranda in the Firm's work papers, and general statements in a memorandum prepared by the Firm's tax department, there was no evidence in the audit documentation, and no persuasive other



evidence, that the Firm had tested the issuer's income tax provision, including the underlying assumptions, and the related tax schedules.

8. Issuer H

In this audit, the Firm failed to sufficiently test the fair value measurements of financial instruments without readily determinable fair values ("hard-to-value securities"), including asset-backed securities, commercial mortgage-backed securities, and other mortgage-backed securities. Specifically, the Firm failed to obtain an understanding of the specific methods and/or assumptions underlying certain fair value measurements obtained from pricing services and used in the Firm's testing of the fair value of the hard-to-value financial instruments.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

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

## **APPENDIX B**

### **THE INSPECTION PROCESS FOR ANNUALLY INSPECTED FIRMS**

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. This appendix describes the inspection process for those annually inspected firms that have multiple practice offices and a national office structure. While this appendix describes the general inspection process applied in the 2010 inspections of these firms, the process was customized to each firm's inspection, bearing in mind the firm's structure, past inspection observations, observations during the course of the 2010 inspection, and other factors. Accordingly, procedures described in this Appendix, while generally applicable to annual inspections, may not have been applied, or may not have been applied fully, in the inspection of any individual firm, and additional procedures, not described in this appendix, may have been applied in the inspection of an individual firm.

The inspection process included reviews of aspects of selected issuer audits completed by the inspected firm. These reviews were intended both to identify deficiencies, if any, in those aspects of the audits and to determine whether those deficiencies indicated weaknesses or defects in 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**

Inspections include reviews of aspects of selected audits of financial statements and ICFR. For each audit selected, the inspection team reviewed certain of the issuer's SEC filings. The inspection team selected certain aspects of the audits for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those aspects. 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 and, for some engagements, the inspection team 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 was allowed the opportunity to provide a written response to the comment form.

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

The inspection team's review of a firm's system of quality control was intended to provide a basis for assessing whether that system was appropriately designed and implemented to achieve the goal of conducting audits that are in compliance with applicable standards. This review included an 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

Procedures in this area were designed to focus on (a) 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) whether actions and communications by the firm's leadership – the "tone at the top" – demonstrate a commitment to audit quality. The inspection team interviewed members of the firm's leadership to obtain an understanding of any significant changes in the firm's approach to, and processes for, its management, including the mechanisms, formal or informal, that assess, monitor, or affect audit performance. The inspection team also 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

Procedures in this area were designed to focus on (a) 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 compared to marketing or other activities of the firm; (b) the firm's processes for allocating its partner resources; and (c) 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 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 a client 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 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 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. In some cases, 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

Procedures in this area were 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 interviewed members of the firm's management and reviewed documents regarding 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 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

The inspection team assessed 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 consider 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.<sup>10/</sup>

---

<sup>10/</sup> 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.



Tel: 212-885-8000  
Fax: 212-697-1299  
www.bdo.com

100 Park Avenue  
New York, NY 10017

January 16, 2012

Ms. Helen A. Munter  
Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006

**Re: Response to Part I of the Draft Report on the 2010 Inspection of BDO USA, LLP**

Dear Ms. Munter:

We welcome this opportunity to provide our response to Part I of the draft Report of the Public Company Accounting Oversight Board ("PCAOB") on the 2010 inspection of BDO USA, LLP ("the Firm"). We continue to support the PCAOB's goal of improving audit quality in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports.

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

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

We remain committed to improving our audit performance and underlying quality control systems, wherever possible. We look forward to continuing to work with the PCAOB on the most effective means of achieving this objective.

Respectfully submitted,

*BDO USA, LLP*