The Public Company Accounting Oversight Board ("Board" or "PCAOB") has evaluated the submissions of BDO USA, LLP ("the Firm") pursuant to PCAOB Rule 4009(a) for the remediation periods ended December 18, 2013 and October 22, 2014 concerning the Firm's efforts to address certain quality control criticisms included in the nonpublic portions of the Board's December 18, 2012 and October 22, 2013 inspection reports on the Firm ("the Reports"). The Board has determined that as of December 18, 2013 and October 22, 2014, respectively, the Firm had not addressed certain criticisms in the Reports to the Board's satisfaction. Accordingly, pursuant to Section 104(g)(2) of the Sarbanes-Oxley Act of 2002 ("the Act") and PCAOB Rule 4009(d), the Board is making public the portions of the Reports that deal with those criticisms.¹

The Firm has notified the Board that it will not seek Securities and Exchange Commission review of the determination, which the Firm has a right to do under the Act and Commission rules. The Firm has requested that a related statement by the Firm be attached as an Appendix to this release, and the Board has granted that request. By allowing the Firm's statement to be attached as an

¹ Those portions of the Report are now included in the version of the Report that is publicly available on the Board's web site. Observations in Board inspection reports 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.
Appendix to this release, however, the Board is not endorsing, confirming, or adopting as the Board's view any element of the Firm's statement.

II.

The quality control remediation process is central to the Board's efforts to cause firms to improve the quality of their audits and thereby better protect investors. The Board therefore takes very seriously the importance of firms making sufficient progress on quality control issues identified in an inspection report in the 12 months following the report. Particularly with the largest firms, which are inspected annually, the Board devotes considerable time and resources to critically evaluating whether the firm did in fact make sufficient progress in that period. The Board makes the relevant criticisms public when a firm has failed to do so to the Board's satisfaction.

It is not unusual for an inspection report to include nonpublic criticisms of several aspects of a firm's system of quality control. Any Board judgment that results in later public disclosure is a judgment about whether the firm made sufficient effort and progress to address the particular criticisms articulated in the report on that firm in the 12 months immediately following the report date. It is not a broad judgment about the effectiveness of a firm's system of quality control compared to those of other firms, and it does not signify anything about the merits of any additional efforts a firm may have made to address the criticisms after the 12-month period.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown
Phoebe W. Brown
Secretary

November 4, 2015

BDO USA is committed to audit quality and continuous improvement to serve our clients and all of the stakeholders in the capital markets system. The firm regularly dedicates time and resources to the ongoing enhancement of our quality control programs and the audit services we provide our clients. For these reasons, BDO has always been supportive of the PCAOB’s inspection process and its goal of protecting investors and building confidence in the audit profession.

Accountability is among the core values that define how we work at BDO. The PCAOB informed us of its determination to make public portions of Part II of our 2011 and 2012 annual PCAOB inspection reports (the “Reports”). This determination was based on the PCAOB’s conclusion that our efforts to satisfactorily address certain criticisms raised by the PCAOB within the 12-month remediation periods, following the issuance of those Reports, were insufficient. We accept that determination.

We have taken steps to address the areas cited in the public portions of Part II of our Reports, which include investments in our training, tools, and resources. We continue to develop these and other areas, demonstrating our ongoing commitment to audit quality to our clients, professionals, stakeholders, and the PCAOB.
Report on

2011 Inspection of BDO USA, LLP
(Headquartered in Chicago, Illinois)

Issued by the
Public Company Accounting Oversight Board

December 18, 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
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.
In 2011, 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").

The Board is issuing this report in accordance with the requirements of the Act.\(^1\) The Board is releasing to the public Part I of the report, Appendix C, and portions of Appendix D. Appendix C provides an overview of the inspection process for annually inspected firms.\(^2\) Appendix D includes the Firm's comments, if any, on a draft of the report.\(^3\) 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.

\(^1\) 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.

\(^2\) 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.

\(^3\) 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. 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 audit work is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's 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. 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 auditing deficiencies are present, rather than through a process intended to identify a representative sample.

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4/ 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.

5/ 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 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. 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 2011 through December 2011. 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 2011 inspection of the Firm included reviews of aspects of 23 audits performed by the Firm. 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 audits 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,6/ 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.7/  

6/ 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.

7/ 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 and/or on the effectiveness of internal control over financial reporting ("ICFR"). The audit deficiencies that reached this level of significance are described below.8/

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 the effectiveness of ICFR —

- The Firm failed to perform sufficient procedures to test important controls and to evaluate the severity of identified control deficiencies. Specifically –
  - The Firm determined that certain finance managers within one of the issuer's significant business segments had access to all or to multiple financial processes within the segment's accounting system. The Firm assessed this lack of segregation of incompatible duties as a significant deficiency, and relied on certain review controls to mitigate the risks associated with the identified deficiency. The Firm's testing, however, did not establish that these controls would mitigate the risks, as:
    - The Firm failed to take into account that the control owner of one of these controls, an access review control, was one of the individuals with a segregation of duties conflict;

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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.
The Firm's procedures to test the other controls were limited to confirming that the review had occurred, without evaluating the effectiveness of the review; and

A journal entry review control identified by the Firm did not encompass journal entries entered into the system affected by the segregation of duties conflicts.

- The Firm's testing of certain other controls related to revenue, accounts receivable, inventory, and cost of sales was not sufficient, as the procedures were limited to determining whether the reviews took place and did not include evaluating the effectiveness of the reviews.

- The Firm failed to sufficiently test information technology general controls ("ITGCs") related to change management at two of the issuer's significant business segments, as it failed to perform any procedures beyond inquiry to test controls over changes to the configuration of the IT system at these two segments. As a result, the Firm's selection of only one item to test the operating effectiveness of certain automated and IT-dependent controls related to revenue, accounts receivable, inventory, and cost of sales for these segments was not sufficient.

The Firm failed to perform sufficient substantive procedures to test revenue and accounts receivable. Specifically –

- The Firm designed its substantive procedures based on a level of reliance on internal control that was excessive, due to the deficiencies discussed above.

- The Firm's analytical procedures provided little to no substantive assurance, because in most of the procedures, the Firm failed to develop appropriate expectations, in that the expectations were based on the annual recorded amounts without the Firm having tested those amounts and, in some of the procedures, the Firm failed to obtain corroboration of the issuer's explanations for identified variances.
The Firm failed to sufficiently evaluate a significant new contract in order to determine whether it had been accounted for appropriately, as the Firm's procedures were limited to reading a small number of excerpts from the contract and inquiring of management.

- The Firm failed to perform sufficient substantive procedures to test inventory and cost of sales. Specifically –
  - For one of the issuer's significant business segments, the Firm designed its procedures based on a level of reliance on internal control that was excessive, due to the deficiencies discussed above.
  - For another of the issuer's significant business segments, the Firm failed to sufficiently test whether the issuer's decision not to establish a reserve for excess and obsolete inventory was appropriate. Specifically, the Firm failed to evaluate the reasonableness of the assumptions the issuer used to identify slow-moving inventory, and failed to evaluate the possible need for a reserve due to the effect of newly introduced products on the market for existing products.

- The Firm failed to perform sufficient procedures to address the risk of potential material misstatement due to fraud at the significant business segment with the segregation of duties issues described above. Specifically, the Firm failed to test any journal entries made to the accounting system for this business segment.

A.2. Issuer B

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures related to its control testing with respect to revenue and accounts receivable, and its control and substantive testing with respect to inventory, cost of sales, and the valuation of long-lived assets and definite-lived intangible assets –
The Firm failed to identify and test controls that sufficiently addressed the risks related to revenue and accounts receivable, as it failed to identify and test any controls over ordering, shipping, invoicing, revenue recognition, and cash receipts. In addition, the Firm failed to test any controls that addressed the specific fraud risks it had identified related to revenue recognition.

The Firm failed to identify and test controls that sufficiently addressed the risks related to inventory and cost of sales. The Firm tested certain review controls related to inventory and cost of sales; however, the Firm's procedures to test these controls were not sufficient, as they were limited to observing signatures on certain documents and comparing certain information in the documents reviewed to journal entries and information in the issuer's systems, without evaluating the effectiveness of the review.

The Firm failed to identify and test any controls over the issuer's process for assessing the possible impairment of long-lived assets and definite-lived intangible assets.

The Firm failed to perform sufficient substantive procedures to test inventory and cost of sales, as follows –

- In reviewing and testing management's processes, the Firm failed to test the completeness and accuracy of certain data the issuer used to determine inventory costing, cost of sales, and the reserve for excess and obsolete inventory.

- The Firm failed to perform any procedures to test whether inventory shipments were recorded in the appropriate period.

- The Firm failed to perform any procedures to test certain significant work-in-process and finished goods inventory.

- The Firm performed analytical procedures to test inventory and cost of sales, but these procedures provided little to no substantive assurance, as the Firm (a) failed to test the completeness and accuracy of the data it used in the procedures, and (b) in some instances, failed to investigate significant differences between
expected and actual results and, in other instances, failed to obtain corroboration of management's explanations for such differences.

- The Firm failed to perform sufficient substantive procedures to evaluate the issuer's assertion that long-lived tangible assets and definite-lived intangible assets were not impaired. The Firm identified the fact that the issuer experienced operating losses in the year under audit and the prior year as an indicator of possible impairment of these assets and, to test these assets' valuation, the Firm conducted a sensitivity analysis at the consolidated level. The Firm, however, failed to perform procedures to determine whether the analysis was performed at the appropriate level. In addition, the Firm's analysis excluded certain expenses, assets, and liabilities.

A.3. Issuer C

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

- The Firm failed to perform sufficient procedures to test revenue from contracts accounted for using the percentage-of-completion method. Specifically, the Firm failed to sufficiently test the estimated costs to complete open projects, as its procedures were limited to obtaining an understanding of certain controls, testing the mathematical accuracy of certain schedules, and making inquiries of accounting personnel regarding significant fluctuations in the gross margin for individual contracts from period to period.

- The issuer had previously recorded a valuation allowance for its deferred tax assets on the basis that it was more likely than not that the related tax benefit would not be realized. The Firm failed to perform sufficient procedures to test whether the amount of the valuation allowance was reasonable. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had –

  o Evaluated certain available evidence, such as the issuer's backlog and three-year history of backlogs, the issuer's realization of deferred tax assets in each of the past three years, and external
forecasts predicting long-term growth in the issuer's industry, that indicated the issuer's deferred tax assets may be recoverable;

- Considered that the issuer's calculation of cumulative historical losses, which was used to support the continued need for a valuation allowance, included loss years dating back several years that were not indicative of current operations; and

- Addressed apparent inconsistencies between certain information that the issuer used to support the continued need for a valuation allowance and information that the issuer presented to investors.

- The Firm failed to perform sufficient procedures to test the accrual for warranty liabilities. Specifically, the Firm (a) failed to evaluate the reasonableness of certain significant assumptions the issuer used to develop the estimate for warranty liabilities; (b) failed to sufficiently test certain warranty claims it had selected for testing, as it limited its procedures to inquiry; and (c) performed certain analytical procedures that provided little to no substantive assurance, as the Firm did not establish an expectation, and did not establish a threshold for investigation of differences.

A.4. Issuer D

In this audit, the Firm failed to perform sufficient procedures to test the issuer's accrual for liabilities related to its customer incentive programs. Specifically –

- The Firm failed to sufficiently test the only control over customer incentive program liabilities that it relied on. Specifically, the Firm's procedures to test this control were limited to verifying that recorded adjustments were consistent with supporting detail and observing evidence that management reviews had occurred, without evaluating the effectiveness of the reviews.

- The Firm's substantive procedures to test the accrual were not sufficient in that (a) the Firm failed to evaluate the reasonableness of the assumptions the issuer used in estimating the customer incentive program liabilities; (b) although the Firm tested certain subsequent payments, it failed to
determine to which incentive programs the payments applied; and (c) the Firm's analytical procedures related to customer incentive liabilities were not precise enough to detect a misstatement that could be material, as they were limited to comparisons with prior years, with general, high-level explanations for certain differences.

- The Firm failed to evaluate whether the issuer's significant adjustments to the accruals during the year under audit, the total of which represented more than one quarter of the issuer's income before taxes resulted from errors or indicated possible management bias.

A.5. Issuer E

In this audit, the Firm failed to perform sufficient procedures to test the estimated costs to complete for contracts accounted for using the percentage-of-completion method in order to assess the implications on revenue. Specifically, the Firm failed to evaluate, beyond inquiry of management, whether the significant variances it identified in the estimated costs to complete from the estimates in prior periods were a result of a failure to appropriately consider all relevant information when determining the prior estimates.

A.6. Issuer F

In this audit, the Firm failed to perform sufficient procedures to test revenue from contracts accounted for using the percentage-of-completion method. Specifically, for open contracts, the Firm's testing of the estimated costs to complete, which was an important component of the issuer's calculation of revenue that could be recognized, was limited to comparing the estimated costs used in the calculation to an issuer-prepared schedule.

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 the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to identify and test controls over variable interest entities ("VIEs"), in that it failed to evaluate whether the controls it identified met the relevant control objectives and
operated at a level of precision that would prevent or detect a potential material misstatement.

- The Firm failed to test whether certain unconsolidated joint ventures were VIEs, which would require additional disclosure and could be subject to consolidation.

A.8. Issuer H

In this audit, the Firm failed to sufficiently test the customer receivables and payables. The Firm sent requests for positive confirmation, as of an interim date, to a sample of customers with outstanding balances. The Firm did not receive responses to approximately 60 percent of those requests. The Firm failed to perform sufficient alternative procedures to determine whether the amounts related to the non-responding customers were correct, as its procedures were limited to determining that the customer's signature was on file and that the issuer had approved the establishment of the account.

A.9. Issuer I

In this audit, the Firm failed to perform sufficient procedures to test the issuer's reserve for excess and obsolete inventory. The issuer had various contractual provisions with its customers that required the customers, under certain circumstances, to pay the issuer for inventory that the issuer had purchased in order to meet its obligations with respect to the customer ("protection clauses"). The Firm selected a sample of contracts and verified that a protection clause was included in each contract selected. The Firm also observed that the issuer had enforced certain protection clauses in the past. The Firm, however, failed to determine whether any of the issuer's existing inventory had been acquired under circumstances covered by protection clauses.

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; (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
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 contains a discussion of criticisms of and 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 identified deficiencies in audit performance. These deficiencies, whether alone or when aggregated, may indicate respects in which a firm's system has failed to assure quality in the performance of engagements. 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. In addition, reviews specifically focused on aspects of a firm's system of quality control may indicate a significant defect in that system.

As described below, an analysis of the inspection results reported by the inspection team indicates that the Firm's system of quality control requires remedial action in order to provide sufficient assurance that the Firm's audit work will meet applicable standards and requirements.

* * * *

Failure to Apply Appropriate Professional Skepticism

The inspection results provide cause for concern regarding the Firm's application of appropriate professional skepticism in the performance of audits. The inspection team identified nine audits with deficiencies, seven of which are included in Part I.A of this report. This report's description of quality control issues is based on the inspection team's observations during the primary inspection procedures. Any changes or improvements that the Firm may have made in its system of quality control since that time may not be 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.

Issuers A, C, D, E, F, G, I, J, and K
this report,\textsuperscript{11/} that appear to be caused, in part, by the failure to apply appropriate professional skepticism. In these audits, the inspection team noted that, in certain areas involving significant management estimates, the Firm failed to (a) adequately evaluate issuer methodologies and processes related to the estimates, including the underlying assumptions,\textsuperscript{12/} and/or (b) adequately evaluate contradictory information, including information that might indicate management bias.\textsuperscript{13/} These deficiencies occurred even in areas where the Firm had identified a risk of fraud.\textsuperscript{14/}

In many of the audits noted in this section,\textsuperscript{15/} it appeared that the engagement team sought only to obtain evidence that would support significant judgments or representations made by management, rather than to critically assess the reasonableness of the judgments or representations. Often, the Firm's evidential support for significant management estimates consisted of management's calculations or memoranda, or responses to Firm inquiries, with minimal corroborating evidence or independent analysis by the engagement team.

The inspection results suggest that the Firm's personnel may have a bias toward rationalizing or supporting management's perspective, rather than objectively evaluating the evidence obtained or whether management's conclusions are reasonable. The Firm should perform an analysis of the root causes of its personnel's apparent failure to apply appropriate professional skepticism in areas of significant management estimates. The results of the root cause analysis should be used to establish processes or programs designed to provide for the application of appropriate professional skepticism.

\* \* \* \*

\textsuperscript{11/} Issuers A, C, D, E, F, G, and I
\textsuperscript{12/} Issuers A, C, D, E, F, G, I, and J
\textsuperscript{13/} Issuers C, D, E, J, and K
\textsuperscript{14/} Issuers C, E, F, and J
\textsuperscript{15/} Issuers A, C, E, F, G, I, and J
Deficiencies in the Firm's Internal Inspection Program

Failure to Identify and Timely Resolve Significant Audit Deficiencies

In 2011, the Firm's internal inspection program identified three audits that the Firm rated as "unsatisfactory"\(^{16/}\) (12 percent) in the 25 audits that were internally inspected. Although this may indicate improvement in the internal inspection process from the prior three years, in each of which the Firm did not identify any "unsatisfactory" audits, there continues to be a significant gap between the Firm's results and the percentage of PCAOB-reviewed audits in which the PCAOB inspection team determined that the Firm lacked sufficient support for its audit opinion, which ranged from a low of 18 percent to a high of 39 percent during the same four years. While the Firm's process for selecting audits to inspect differs from the PCAOB's inspection process, the implications of this significant disparity need to be carefully considered. The PCAOB inspection team inspected five audits that the internal inspectors reviewed in 2011. In one of these audits,\(^{17/}\) the PCAOB inspection team identified two deficiencies that were not identified by the internal inspectors but were of such significance that they are included in Part I.A of this report.

The above discrepancies may suggest that the Firm's internal inspectors do not always apply appropriate professional skepticism to the performance of internal inspections, or to the evaluation of their results. In addition, it appears that a contributing factor to the discrepancies may be that the Firm's internal inspectors have a similar perspective on the nature and extent of evidence necessary to support an audit opinion as that of the rest of the Firm's audit professionals and, therefore, sometimes

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\(^{16/}\) The Firm's classification of an audit as "unsatisfactory" indicates that the files reviewed contained significant professional standards deficiencies. Remedial actions are required to correct significant professional standards deficiencies (e.g., addition of significant documentation to work papers necessary to support the Firm's opinion, performance of additional procedures, restatement of the financial statements, and/or reissuance or withdrawal of the Firm's audit opinion).

\(^{17/}\) Issuer C. The Firm's internal inspectors rated this engagement as "unsatisfactory," but did not identify two of the three deficiencies that are in Part I, even though they reviewed the relevant audit areas. The Firm's failure to identify significant deficiencies in the areas reviewed has consequences beyond the rating of the engagement, as the engagement would remediate only the identified deficiencies.
fail to sufficiently challenge the engagement teams' decisions in performing the audit. The Firm should perform an analysis of the reasons for the discrepancies described above, and should implement appropriate corrective actions as necessary.

Further, for one of these audits, the internal inspectors identified significant deficiencies, which they ultimately concluded required an unsatisfactory rating for the audit. Nonetheless, a four-month period elapsed between the time of the internal inspection and the resolution of the identified deficiencies. The length of time between the Firm's identification of deficiencies and the resolution of those issues in this instance raises concerns that audit failures identified through the Firm's internal reviews will not always be evaluated and remediated on a timely basis. The Firm should (i) evaluate its process for finalizing the resolution of findings from the internal inspection program, (ii) identify the factors that inhibit a timely resolution of identified inspection issues, and (iii) implement appropriate remedial actions.

* * * *

Lack of Adequate Process for Evaluating the Effectiveness of the Internal Inspection Program

In 2011, the Firm compared the findings from its internal inspections with the results of the PCAOB inspections. Based upon this analysis, the Firm made certain modifications to the planned internal inspections program for 2012. While these modifications represent an improvement to the program, they were made without the benefit or insight that could be gained from the performance of a thorough analysis of the effectiveness of the internal inspection program. The Firm should perform a comprehensive assessment of the effectiveness of the program, evaluate the root causes of deficiencies in the program, and take appropriate actions to address them.

* * * *
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 2011 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 2011 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.

2.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.

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 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.


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.


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.

2.e.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.

2.e.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.

2.e.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.\(^{18/}\)

\(^{18/}\) 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.
December 6, 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 2011 Inspection of BDO USA, LLP

Dear Ms. Munter:

We appreciate this opportunity to provide our response to Part I of the draft Report of the Public Company Accounting Oversight Board (“PCAOB”) on the 2011 inspection of BDO USA, LLP. 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 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. We have concluded that 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 our underlying quality control systems. We look forward to continuing to work with the PCAOB on the most effective means of achieving this objective.

Respectfully submitted,

BDO USA, LLP