

**PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD**

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In the Matter of )  
BDO USA, LLP's ) PCAOB Release No.104-2015-189  
Quality Control Remediation )  
Submissions )  
November 4, 2015

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**I.**

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.<sup>1</sup>

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

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<sup>1</sup> 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

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Phoebe W. Brown  
Secretary

November 4, 2015



**Statement of BDO USA, LLP on the PCAOB's November 4, 2015 Release No.104-2015-189**

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**  
**2012 Inspection of BDO USA, LLP**  
**(Headquartered in Chicago, Illinois)**

**Issued by the**  
**Public Company Accounting Oversight Board**

**October 22, 2013**

**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**

## 2012 INSPECTION OF BDO USA, LLP

### Preface

In 2012, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm BDO USA, LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").<sup>1/</sup>

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. The inspection process included reviews of aspects of selected issuer audits completed by the Firm. The reviews were intended to identify whether deficiencies existed in those aspects of the audits, and whether such deficiencies indicated 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.

The issuer audits and aspects of those audits inspected were selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in this report are not necessarily representative of the Firm's issuer audit practice.

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 and portions of Appendix C. Appendix C includes the Firm's comments, if any, on a draft of the report. 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.

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<sup>1/</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>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.

## PART I

### INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from September 2012 through December 2012. 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 12 of the Firm's approximately 35 U.S. assurance practice offices.

#### A. Review of Audit Engagements

The 2012 inspection of the Firm included reviews of aspects of 20 audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the audits it reviewed.

The inspection team considered certain of the deficiencies that it observed to be audit failures. As used in PCAOB inspection reports, the term "audit failure" refers to a circumstance where the inspection team identified one or more deficiencies in an audit that 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.<sup>3/</sup>

##### A.1. Issuer A

The Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR —

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<sup>3/</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. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

- The Firm failed to perform sufficient procedures to test controls over revenue and accounts receivable. Specifically —
  - The Firm tested Information Technology General Controls ("ITGCs") over the issuer's general ledger system and certain other systems that the issuer used to process and record revenue transactions, and relied on ITGCs when testing controls over revenue and accounts receivable. As a result of the deficiencies in the ITGC testing described below, however, the Firm's conclusion that it could rely on ITGCs was not supported, and the Firm's testing of certain controls was insufficient. Specifically, the Firm limited its tests of the operating effectiveness of two application controls to only one item for each application.

The specific deficiencies in testing ITGCs are as follows —

- The Firm identified control deficiencies related to inappropriate access to certain systems, including a lack of segregation of incompatible duties. The Firm identified certain review controls that it asserted mitigated the deficiencies; however, the owners of these controls were the individuals who had inappropriate access.
- The Firm identified control deficiencies related to management of program changes. While the Firm identified an automated control, related to the backup of system data, that it asserted mitigated this deficiency, the identified control did not appear to have been designed to detect or prevent unauthorized program changes and, further, the Firm did not test the operating effectiveness of this control.
- The Firm identified the following exceptions in its testing of ITGCs: (a) program developers had the ability to make changes to significant financial applications used to initiate, process, and record revenue and accounts receivable transactions, and (b) multiple information technology personnel had access to those financial applications through a shared account. The Firm failed to evaluate whether these

exceptions were control deficiencies and whether they should have affected the Firm's testing strategy.

- The Firm tested a control in the period-end financial reporting process that it asserted addressed the risks of material misstatement related to revenue and accounts receivable, but, in testing this control, the Firm (a) relied on ITGCs, which was unwarranted, as noted above, and (b) did not test other controls over the accuracy and completeness of data used in the operation of the control.
- The Firm tested certain application controls over revenue recognition, but, in testing these controls, it (a) relied on ITGCs, which was unwarranted, as noted above, and (b) did not test other controls over the accuracy and completeness of system-generated information used in these controls.
- The issuer used a service organization to process one type of revenue transaction. The Firm failed to identify and test necessary user controls that were identified in the relevant service auditor's report.
- The Firm failed to perform sufficient substantive procedures to test revenue and deferred revenue. Specifically —
  - The Firm failed to test the accuracy and completeness of certain data used in its substantive testing.
  - For a significant portion of revenue, the Firm's test of details was insufficient, as the Firm's sample size was too small to provide the necessary level of assurance given the significant risk it had identified.

A.2. Issuer B

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

- The issuer generated revenue from the provision of services and from the manufacture and sale of products, which included transactions structured as multiple-deliverable arrangements and transactions that involved nonstandard shipping or acceptance terms. The Firm failed to identify and test controls that sufficiently addressed the risks related to revenue recognition. Specifically —
  - For certain product and service revenue, the Firm tested system-configuration and IT-dependent manual controls that addressed the recording of orders and shipments. The Firm, however, did not test controls that addressed whether all the applicable revenue recognition criteria had been met.
  - The Firm identified review controls that it asserted addressed the risk of material misstatement related to the valuation of revenue from transactions involving multiple elements. The Firm's testing of these controls, however, was insufficient because the procedures were limited to confirming that the reviews had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements.
- The Firm failed to perform sufficient substantive procedures to test revenue. Specifically —
  - For certain categories of both product and service revenue, the Firm designed its substantive procedures based on a level of reliance on internal control that was excessive, due to the deficiencies discussed above. As a result, the samples the Firm used to test this revenue were too small to obtain the necessary level of assurance.
  - The Firm identified a fraud risk related to revenue recognition and assessed the risk of material misstatement related to the occurrence of revenue as significant. The Firm used the results of procedures performed by the issuer's internal audit group for some of its audit evidence related to revenue recognition for one category of product revenue. The extent of the Firm's use of the internal audit group's work, however, was inappropriate, given (a) the significance of this revenue and the existence of non-standard

terms, (b) the assessed fraud risk and other significant risks related to revenue, and (c) the fact that the Firm itself tested only a small number of items.

- For service revenue, the Firm excluded revenue generated from the issuer's foreign operations from its tests of details. The Firm relied on an analytical procedure to test this revenue, but this procedure provided little to no substantive assurance, as the Firm failed to (a) establish an expectation and a threshold for investigating differences that were precise enough to detect a potential material misstatement, and (b) investigate the differences it identified, beyond inquiring of management.
- The Firm failed to perform sufficient substantive procedures to test the issuer's accounting for certain business combinations completed during the year. Specifically —
  - The Firm failed to test the data used to develop the customer attrition rate assumptions that management provided to an external valuation specialist to determine the fair value of an intangible asset related to acquired customer relationships; and
  - The Firm failed to consider these attrition rate assumptions when it assessed the reasonableness of the issuer's adoption of the straight-line amortization method for these intangible assets.

### 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 —

- For two significant segments, the Firm failed to perform sufficient procedures to test revenue from contracts that were accounted for using the percentage-of-completion method. Specifically, the Firm compared estimated total costs and gross margins for individual contracts for various periods and evaluated significant variations in these metrics from period to period. The Firm's procedures to evaluate the variations, however, were limited to (a) obtaining change orders related to significant variations in estimated total costs, and (b) inquiring of management, and performing

observations and inquiry of personnel at site visits, without obtaining corroboration.

- The Firm failed to perform sufficient procedures to test the valuation of certain assets acquired and liabilities assumed in two business combinations that occurred during the year. Specifically, the Firm failed to sufficiently evaluate the reasonableness of certain assumptions that the issuer used to estimate the fair values, as the Firm's procedures to evaluate projected revenue growth rates and projected profit margins were limited to comparing the projections to those for peer companies. In addition, the Firm failed to address differences it noted between certain of these assumptions and the corresponding assumptions for the peer companies. For a business combination that occurred in a previous period, the Firm failed to test, beyond obtaining and reading an issuer-prepared analysis, any of the issuer's fair value estimates of contingent consideration.
- The Firm failed to sufficiently test the issuer's presentation and disclosure of reportable segments. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated, beyond discussing the issuer's analysis with management, whether disparities in the revenue growth rates and gross margins among individual operating segments were inconsistent with the issuer's conclusion that the issuer's operating segments had economic characteristics that were similar enough to allow them to be aggregated into one reporting segment.

#### A.4. Issuer D

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 the issuer's annual evaluation of the possible impairment of goodwill. Specifically —
  - The Firm failed to evaluate whether the issuer had identified all the reporting units within each operating segment that should have been separately tested for impairment.

- The issuer prepared discounted cash flow analyses that it used in its impairment evaluation for the goodwill assigned to the issuer's reporting units. The Firm failed to test important assumptions used in this analysis for one significant reporting unit. Specifically, the Firm failed to (a) evaluate the reasonableness of the revenue growth assumptions, beyond performing a sensitivity analysis, consisting of changing the revenue growth rate and the discount rate used in the issuer's analysis to determine the effect of those changes on the calculated fair value; (b) evaluate the reasonableness of the assumptions used to estimate future expenses; and (c) evaluate the appropriateness of the issuer's addition of a control premium to the results of the analysis in order to estimate the fair value.
- The sum of the fair values of the issuer's reporting units estimated through the discounted cash flow analyses exceeded the issuer's market capitalization at the date of the impairment test by a significant amount. In addressing this significant difference, the issuer pointed to the volatility of the issuer's stock price and its view that investors may not have understood the value of certain of the issuer's operating segments. The issuer also compared the results of the discounted cash flow analyses to the average of the stock price over an extended period of time (which was significantly higher than the stock price at the date of the impairment test). The Firm failed to sufficiently evaluate the significant difference and the issuer's explanation for it, as, in addition to the failures described above, it failed to evaluate to what extent these factors contributed to the significant difference and to consider the fact that the issuer's stock price remained in a lower range through the issuance of the audit opinion.
- The Firm failed to perform sufficient procedures to test the valuation of definite-lived intangible assets, as it failed to evaluate whether the issuer's restructuring activities, which included ceasing its operations in one country and implementing workforce reductions in another country, were potential indicators of impairment.

A.5. Issuer E

In this audit, the Firm failed to perform sufficient procedures to test goodwill. During the prior year, the issuer acquired a business and consolidated it with some of its existing operations to form a new operating segment. The issuer restructured this operating segment during the year under audit and, as part of the restructuring, discontinued the operations of the acquired business. The issuer considered the restructuring to be a triggering event and, following a goodwill impairment analysis, wrote off all of the goodwill associated with the acquired business. The Firm failed to assess whether the issuer's evaluation of goodwill for impairment at one level below the operating segment level was appropriate. In addition, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested whether any of the goodwill that was written off should have been allocated to the other reporting unit in the operating segment.

A.6. Issuer F

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

- The Firm failed to perform sufficient procedures to test inventory. Specifically, the Firm failed to test whether the issuer's cycle-count procedures addressed that (a) all inventory items were subject to counting at appropriate intervals, (b) the cycle counts occurred as frequently as planned, and (c) the counts were sufficiently precise. In addition, the Firm failed to perform sufficient substantive procedures to test inventory, as it designed those procedures based upon the unsupported conclusion that the perpetual inventory system was reliable.
- The Firm failed to sufficiently test controls over the issuer's liability for trade allowances. The Firm identified and tested only one control, but this control did not address the significant risk identified by the Firm related to the completeness of the liability. In addition, the testing of this control was not sufficient, because (a) the procedures to test the control were limited to obtaining evidence that the control had occurred without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements, and (b) the Firm failed to test the completeness of certain data it used in testing this control.

- The Firm failed to perform sufficient substantive procedures to test the issuer's liability for trade allowances, as it 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 procedures were limited to (a) inquiring of management; (b) comparing certain amounts used to calculate the trade allowance liability to issuer-prepared schedules; and (c) performing analytical procedures that provided little to no substantive assurance, as the Firm (i) used the account balances from the prior year as the basis for its expectations of current-year amounts, but failed to evaluate whether the prior-year balances could be expected to be predictive of current-year results and (ii) failed to establish a threshold for investigation of differences.

A.7. Issuer G

In this audit, the Firm failed to perform sufficient procedures to evaluate the issuer's conclusion that goodwill related to a recent acquisition was impaired. Specifically, the Firm failed to sufficiently evaluate the reasonableness of the issuer's reliance solely on the use of an income approach to estimate the fair value of the acquired business in light of readily available market data that indicated a higher fair value. In addition, the Firm failed to evaluate the appropriateness of the issuer's performing an impairment test on the goodwill related to the acquired business on a stand-alone basis in light of evidence indicating that the impairment test should have been performed on a combined basis at the operating segment level.

A.8. Issuer H

In this audit, the Firm failed to sufficiently test the issuer's revenue recognition, for which the Firm had identified a fraud risk. Specifically —

- The issuer delivered services electronically, and certain of its revenue transactions were processed by an internally developed software application that interfaced with a second application that, in turn, stored and reported transaction data. The Firm's testing of this revenue was insufficient, as the Firm relied on data and reports from these applications in its testing of revenue, but failed to test the accuracy and completeness of such information. The Firm relied on controls over such information, but this reliance was inappropriate, as it (a) had identified deficiencies in ITGCs over the first application, (b) did not test application controls for the

first application, and (c) did not test controls over the interface between the two applications.

- Certain of the issuer's other revenue transactions were processed by a service organization. The Firm's testing of this other revenue was also insufficient. Specifically, the Firm obtained a service auditor's report that described user controls that needed to be addressed in order for the data in the service organization's reports to be considered accurate and complete. The Firm, however, failed to address those controls or to perform other procedures to test the accuracy and completeness of the information the issuer received from the service organization.

A.9. Issuer I

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

- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had identified and tested any controls over the issuer's process for evaluating customer-relationship intangible assets for possible impairment.
- The Firm failed to sufficiently test the valuation of customer-relationship intangible assets. Specifically, the Firm failed to evaluate the reasonableness of certain assumptions the issuer used in its impairment analyses related to these assets.

A.10. Issuer J

In this audit, the Firm failed to perform sufficient procedures to test the issuer's reserve for sales returns, which consisted primarily of specific reserves for individual products. The Firm tested the reserve by developing an independent estimate of the required reserve for a sample of ten products that had high sales volumes. This testing did not provide sufficient assurance about the recorded reserve, as the sample was not selected in a manner designed to produce a representative sample, and it constituted only approximately 15 percent of the recorded reserve. In addition, the Firm failed to (a) evaluate the implications of significant differences it identified between the issuer's

recorded specific reserves and the independent estimates the Firm calculated for the individual products it tested, and (b) test the accuracy and completeness of the data and reports it obtained from the issuer and used to develop its independent estimates, beyond comparing a small number of items to a report that it did not test.

A.11. Issuer K

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. Specifically, the Firm selected for testing certain controls that it asserted were relevant to the valuation of certain categories of investment securities. The controls consisted of comparisons of investment statements to the general ledger and reviews of financial statement fluctuations. These controls did not address the risks related to the valuation of these securities.

**B. Auditing Standards**

Each of the deficiencies described in Part I.A of this report represents circumstances in which the Firm failed to comply with the requirement to obtain sufficient appropriate evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable accounting principles, and/or for its opinion concerning whether the issuer maintained, in all material respects, effective internal control over financial reporting. Each deficiency relates to several applicable standards that govern the conduct of audits.

AU 230, *Due Professional Care in the Performance of Work* ("AU 230") requires the independent auditor to plan and perform his or her work with due professional care. AU 230 and Auditing Standard ("AS") AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13") specify that due professional care includes the exercise of professional skepticism. This is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13 requires the auditor to design and implement audit responses that address the identified risks of material misstatement, and AS No. 15, *Audit Evidence* ("AS No. 15") requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement and the quality of the audit evidence

obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* ("AS No. 5") and AS No. 13 establish requirements regarding testing and evaluating internal control over financial reporting. In an audit of internal control over financial reporting in an integrated audit, AS No. 5 requires the auditor to plan and perform the audit to obtain appropriate evidence that is sufficient to support the auditor's opinion on internal control over financial reporting as of the date of that opinion. AS No. 13 requires that, if the auditor plans to assess control risk at less than the maximum and to base the nature, timing, and extent of substantive audit procedures on that lower assessment, the auditor must obtain evidence that the controls tested were designed and operating effectively during the entire period for which the auditor plans to rely on controls to modify the substantive procedures.

The deficiencies described in Part I.A of this report relate to one or more of the provisions referenced above, and in many cases also relate to the failure to perform, or to perform sufficiently, certain specific audit procedures that are required by other applicable auditing standards. The table below lists the specific auditing standards that are primarily implicated by the deficiencies identified in Part I.A of this report. The broadly applicable aspects of AS No. 5, AS No. 13, AS No. 15, and AU 230 discussed above are not repeated in the table below.<sup>4/</sup>

<b>PCAOB Auditing Standards</b>	<b>Issuers</b>
AS No. 5, <i>An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements</i>	A, B, F, I, and K
AS No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	A, B, and F
AS No. 14, <i>Evaluating Audit Results</i>	C
AS No. 15, <i>Audit Evidence</i>	A, B, G, and H
AU Section 322, <i>The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i>	B

<sup>4/</sup> This table does not necessarily include reference to every auditing standard that may have been implicated by the deficiencies included in Part I.A.

<b>PCAOB Auditing Standards</b>	<b>Issuers</b>
AU Section 328, <i>Auditing Fair Value Measurements and Disclosures</i>	C, D, G, and I
AU Section 329, <i>Substantive Analytical Procedures</i>	B
AU Section 336, <i>Using the Work of a Specialist</i>	B
AU Section 342, <i>Auditing Accounting Estimates</i>	C, D, E, F, and J
AU Section 350, <i>Audit Sampling</i>	A and J

### **C. General Information Concerning PCAOB Inspections**

Board inspections are designed to identify whether weaknesses and deficiencies exist related to how a firm conducts audits and to address any such weaknesses and deficiencies. To achieve that goal, 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. The 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. Further, the inclusion in an inspection report of certain deficiencies and potential deficiencies should not be construed as an indication that the Board has made any determination about other aspects of the firm's systems, policies, procedures, practices, or conduct not included within the report.

The inspection team selects the audits and aspects to review, and the Firm is not allowed an opportunity to limit or influence the selections. In the course of reviewing aspects of selected audits, the inspection team may identify matters that it considers to be deficiencies in the performance of the work it reviews. Those deficiencies may include failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,<sup>5/</sup> as well as

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<sup>5/</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 Securities and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to determine proper accounting in issuers' financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures. 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 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.

In some cases, the conclusion that a 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 claimed to have performed the procedure. AS 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.

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.<sup>6/</sup>

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<sup>6/</sup> 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

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 processes 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.

END OF PART I

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responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.



PCAOB Release No. 104-2013-265A  
Inspection of BDO USA, LLP  
October 22, 2013  
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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 contains a discussion of criticisms of and potential defects in the Firm's quality control system.<sup>7/</sup> QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* ("QC 20") provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of clients and engagements; (4) engagement performance; and (5) monitoring.

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 areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect in a firm's quality control system.<sup>8/</sup> Defects in a firm's quality control system may also be identified through inspection procedures that are specifically focused on aspects of the firm's system of quality control.

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.

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<sup>7/</sup> 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.

<sup>8/</sup> Not every audit deficiency suggests a possible defect in a firm's quality control system, and this report does not discuss every audit deficiency the inspection team identified.

## **Deficiencies in Quality Controls Related to the Application of Professional Skepticism**

The inspection results continue to provide cause for concern regarding the Firm's application of professional skepticism in the performance of audits. The inspection team identified eight audits with deficiencies,<sup>9/</sup> all of which are included in Part I.A of this report, that appear to be caused, at least in part, by the failure to appropriately apply professional skepticism. The inspection team also identified two additional such deficiencies in one of these audits.<sup>10/</sup> In these audits, in areas involving significant management judgment, including estimates, the Firm failed to adequately evaluate the methodology, approach, or support the issuer used in reaching its judgment, including in many cases the significant assumptions underlying estimates. In certain of these engagements,<sup>11/</sup> the Firm failed to adequately evaluate contradictory or potentially inconsistent information, including in some instances information that might indicate management bias. These deficiencies occurred even in areas where the Firm had identified a risk of fraud.<sup>12/</sup>

In many of the audits reviewed, 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. This suggests that certain of the Firm's personnel are overly focused on rationalizing or supporting management's perspective.

In late 2012, the Firm provided additional training on applying professional skepticism to its professionals and released practice aids to assist in auditing certain areas requiring significant judgment. The Firm should assess whether the practice aids and training have had the necessary effect of improving its professionals' application of

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<sup>9/</sup> Issuers B, C, D, E, F, G, I, and J

<sup>10/</sup> Issuer J

<sup>11/</sup> Issuers B, C, D, E, G, and J

<sup>12/</sup> Issuers B and C

professional skepticism. In addition, the Firm should assess the root causes of the deficiencies in this area and implement additional appropriate remedial actions in response to this assessment.

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### **Deficiencies in Quality Controls Related to the Firm's Internal Inspection Program**

The PCAOB inspection results continue to indicate that the Firm's internal inspection program should be improved. \* \* \* \*

#### Failure to Identify Significant Audit Deficiencies

There continues to be a significant gap between the internal inspection program results, as they relate to issuer audits, and the results of PCAOB inspections. In 2012, the Firm's internal inspection program identified two audits that the Firm rated as "unsatisfactory,"<sup>13/</sup> which represented nine percent of the 22 issuer audits that were internally inspected. In 2011, the Firm's internal inspection program identified three audits that the Firm rated as "unsatisfactory," which represented 12 percent of the 25 issuer audits that were internally inspected. Although these results may suggest progress in the program from the prior three years, in which the Firm did not identify any "unsatisfactory" audits, the percentage of audits in which the PCAOB inspectors determined that the Firm lacked sufficient support for its audit opinion continues to be significantly higher. That percentage ranged from a low of 18 percent to a high of 55 percent during the same five years. While the Firm's process<sup>14/</sup> for selecting audits to

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<sup>13/</sup> The Firm's classification of an audit as "unsatisfactory" indicates that the files reviewed contained significant professional standards deficiencies and that remedial actions are required to correct significant professional standards deficiencies (e.g., addition of significant documentation to the 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).

<sup>14/</sup> Prior to 2011, the Firm selected issuer audits for internal inspection based primarily on a periodic office rotation criterion. In 2011 and 2012, the Firm selected one issuer and eight issuers, respectively, using office-specific and partner-specific selection criteria.

inspect differs from the PCAOB's selection process, the implications of this significant disparity in inspection results need to be carefully considered.

In 2012, the PCAOB inspection team inspected three audits<sup>15/</sup> that the internal inspection team had reviewed, including two audits<sup>16/</sup> that the internal inspection team had rated as "unsatisfactory." In each of these three audits, the PCAOB inspection team identified one or more deficiencies that were not identified by the internal inspectors but are of such significance that they are included in Part I.A of this report. The inspection team identified a total of six such deficiencies in these audits that were not identified by the internal inspectors, even though they had reviewed the relevant area.

The above discrepancies may suggest that the Firm's internal inspection teams do not always appropriately apply professional skepticism to the performance of internal inspections or to the evaluation of the results of those inspections. In addition, it appears that a contributing factor to the discrepancies may be that the Firm's internal inspection teams 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 fail to sufficiently challenge the engagement teams' decisions in performing the audit.

In 2011 and 2012, the Firm compared the findings from its internal inspections with the results of the PCAOB inspections. Based upon the 2011 analysis, the Firm made certain modifications to the internal inspection program for 2012. While these modifications may 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, which the Firm has not completed in recent years.

The Firm should perform an assessment of the effectiveness of the program, evaluate the causes of deficiencies in the program, and take appropriate actions to

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<sup>15/</sup> Issuers D, F, and H

<sup>16/</sup> Issuers D and F. The Firm's internal inspectors rated these engagements as "unsatisfactory," but did not identify five 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 team would remediate only the identified deficiencies.

address them. As part of this assessment, the Firm should perform an analysis of the reasons for the discrepancies described in this subpart.

\* \* \* \*

Failure to Evaluate Internal Firm Specialists

The Firm responds to unsatisfactory internal inspection results by preparing individual action plans for the audit engagement partner, the manager, and the concurring review partner. The Firm does not include internal Firm specialists who may have contributed to the unsatisfactory inspection findings. By failing to consider the performance of internal Firm specialists, the Firm may not recognize, and implement actions to address, any systemic deficiencies that may exist in its specialist network and processes. The Firm should develop a consistent process in which it considers all individuals associated with the deficiency when developing corrective action plans.

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## **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>1/</sup>

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<sup>1/</sup> The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In some cases, the result may be that none of a firm's response is made publicly available. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.



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October 14, 2013

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 2012 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 2012 inspection of BDO USA, LLP. We support the PCAOB's inspection process and their goal of improving audit quality.

We have evaluated each of the matters described in Part I of the draft Report and have taken appropriate actions under both PCAOB standards and our policies, including steps we considered 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 Auditor's Report*. 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*