

Report on
2013 Inspection of KPMG LLP
(Headquartered in New York, NY)

Issued by the
Public Company Accounting Oversight Board

September 24, 2014

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**

2013 INSPECTION OF KPMG LLP

Preface

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KPMG LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.C of this report (which also contains additional information concerning the PCAOB inspections generally). Overall, the inspection process included reviews of portions of selected issuer audits completed by the Firm. These reviews were intended to identify whether deficiencies existed in those portions of the inspected audits, and whether such deficiencies indicated defects or potential 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 Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, portions of Appendix C, and Appendix D. Appendix C includes the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the Firm's system of quality control, those discussions also could eventually be made public, but only to the extent the Firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures^{1/} for the inspection from December 2012 through February 2014. The inspection team performed field work at the Firm's National Office and at 25 of its approximately 82 U.S. practice offices.

A. Review of Audit Engagements

The 2013 inspection of the Firm included reviews of portions of 48 audits performed by the Firm and a review of the Firm's audit work on two other issuer audit engagements in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix D to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in the references to the auditing standards in this sub-Part, unless the lack of compliance with these standards

^{1/} For this purpose, the time span for "primary procedures" includes field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. The time span does not include inspection planning, which may commence months before the primary procedures, and inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

Certain of the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable financial reporting framework and/or its opinion about whether the issuer had maintained, in all material respects, effective internal control over financial reporting ("ICFR"). In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement and/or the issuer maintained effective ICFR.

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

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.^{2/}

^{2/} Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and the inspections staff may include in its procedures monitoring or assessing a firm's compliance.

The audit deficiencies that reached this level of significance are described below.

A.1. Issuer A

The Firm was engaged by the principal auditor of the issuer to audit the financial statements and ICFR of a component of the issuer, excluding certain centrally coordinated areas, to support the principal auditor's opinions on the consolidated financial statements and ICFR of the issuer. The Firm failed in the following respects to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in the audit

—

- The Firm failed to perform sufficient tests of controls with respect to the mortgage repurchase reserve and the related litigation reserve. Specifically, the only controls over the completeness and disclosure of certain components of the mortgage repurchase reserve and related litigation reserve that the Firm identified and tested were controls that compared certain internally generated data to other such data. These controls did not address the completeness of such data or the significant assumptions underlying the reserves, nor did they address the completeness and accuracy of, and the disclosures related to, those reserves. (AS No. 5, paragraph 39)
- The Firm failed to perform sufficient substantive procedures to test the mortgage repurchase reserve and the related litigation reserve. Specifically –
 - The Firm failed to sufficiently test the completeness of certain components of the mortgage repurchase reserve and the related litigation reserve. Specifically, it failed to evaluate the completeness of the outstanding claims and evaluate the appropriateness of the issuer's assertion that no reserve was necessary for certain unasserted claims. Further, the Firm failed to perform sufficient procedures to determine the extent of, and evaluate the effects of, the representations and warranties made in connection with the issuer's sales of loans, and to sufficiently evaluate the issuer's review of the implications of those representations and warranties,

- as it limited its testing to much less than one percent of the population of loans sold. (AU 342, paragraph .11)
- The Firm failed to test the appropriateness of certain significant assumptions the issuer used to estimate certain components of the mortgage repurchase reserve and the related litigation reserve. (AU 342, paragraph .11)
 - The Firm failed to test the accuracy and completeness of the information the issuer used to calculate one significant component of the mortgage-related litigation reserve. (AU 342, paragraph .11)
 - The Firm failed to perform sufficient tests of controls with respect to the valuation of certain trading securities without readily determinable fair values ("hard-to-value securities"). Specifically –
 - The Firm identified the issuer's independent price verification ("IPV") activities, which are executed by an internal independent pricing group ("IPG"), as an important valuation control that had a higher risk of failure, and that the Firm considered to be responsive to a fraud risk it identified. The Firm failed to sufficiently test the IPV control. Specifically –
 - The Firm failed to test any controls over the reasonableness of significant assumptions, the relevance and reliability of prices obtained from external sources, and the accuracy and completeness of certain data, including data in models and manual calculations, that were used in the operation of the IPV control. (AS No. 5, paragraph 39)
 - The Firm failed to determine how IPG's prices were finalized for certain items that the Firm selected for control testing where the IPV procedures were incomplete at the time the Firm performed its testing. (AS No. 5, paragraph 44)
 - The Firm's procedures to test certain items selected for control testing were limited to inquiry, or to substantively re-

pricing the security using its own methods and assumptions, without obtaining evidence of how the control operated. (AS No. 5, paragraph 44)

- The Firm failed to evaluate whether the lack of evidence supporting certain re-pricing assumptions made by IPG that the Firm identified in its testing were the result of deficiencies in the IPV control. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to sufficiently test the issuer's controls over the valuation of these trading securities in other respects, including by taking into account the relevant requirements of generally accepted accounting principles ("GAAP") when assessing design effectiveness. Specifically –
 - The IPV control was designed to adjust the recorded prices in response to only certain of the pricing differences it identified, and when the control produced a range of prices, it was designed to record a price from a pre-determined position within that range; this position varied based upon the reliability of the inputs and the valuation technique that was used to value the securities. In evaluating the design of the IPV control, the Firm failed to evaluate whether this approach was consistent with the fair value measurement concepts within Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurement*, ("Topic 820") which indicates that the fair value measurement should be the point within the related range that is most representative of fair value. (AS No. 5, paragraph 42)
 - The Firm failed to sufficiently test the controls that monitor the results of the IPV activities, as its procedures were limited to noting meeting attendance and to reading meeting minutes and handouts. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to sufficiently test controls over the disclosure of these trading securities at appropriate levels within the fair value hierarchy set forth in FASB ASC Topic 820. Specifically –
 - In evaluating the design effectiveness of the controls, the Firm failed to take into account the relevant GAAP provisions that the level be determined based on facts in existence at the date of the financial statements and may be required to be determined at the individual security level. (AS No. 5, paragraph 42)
 - The Firm failed to test controls over a significant database the issuer used to track the levels assigned to the trading securities. In addition, the Firm failed to sufficiently test controls that addressed the accuracy and completeness of the transfer of this information into other systems, which were used to provide the information for the disclosure regarding the securities' levels, as the Firm's procedure was limited to a test of one security from only one of multiple types of securities. (AS No. 5, paragraphs 39, 42, and 44)
 - The Firm's testing of a control consisting of the subsequent verification of the assigned levels for certain securities was insufficient, as it failed to evaluate whether the control addressed whether changes had occurred that would require a security to be reclassified from level 2 to level 3. (AS No. 5, paragraph 42)
- The Firm failed to perform sufficient tests with respect to the allowance for loan losses ("ALL") and the unfunded commitments reserve. Specifically –
 - The Firm failed to sufficiently test an important control over the loan grading process that it selected, as the sample size the Firm used in its testing was too small to obtain the necessary level of assurance that the control was operating effectively to prevent or detect material misstatements. Specifically, the Firm reduced the number of items it tested from its calculated sample size because it

allocated a portion of the sample to other components of the issuer. This allocation was not appropriate, however, since the Firm's allocation failed to take into account the different risk characteristics and different processes that existed at the components. In addition, the Firm's procedures were designed as a dual-purpose test, and this sample was also too small to provide the Firm with the necessary level of assurance regarding the accuracy of the assigned loan grades the issuer used in the ALL and the unfunded commitments reserve calculation. (AS No. 5, paragraph 44; AU 350, paragraphs .23, .23A, and .44)

- The Firm's approach for substantively testing the ALL was to review and test management's process, but the Firm failed to test the development of the loss rate assumptions used in the calculation of the ALL and the unfunded commitments reserve. While the Firm deemed the assumptions to be reasonable based on its understanding of the methodology and comparisons to peer and market information, it did not establish whether the external information was relevant and comparable to the issuer's information. In addition, the Firm failed to perform tests of details that were specifically responsive to the related fraud risk it identified. (AS No. 13, paragraph 13; AU 342, paragraph .11)
- The Firm failed to perform sufficient substantive procedures to test the calculation of the ALL and the unfunded commitment reserve, including the development of the loss factors used in the calculation. Specifically, the Firm failed to consider the identified risks in determining the sample size, and the resulting sample size was too small to provide the necessary assurance. (AU 342, paragraph .11; AU 350, paragraphs .19, .23, and .23A)
- The Firm failed to sufficiently test controls over the completeness of certain types of derivatives transactions. The issuer received the majority of its confirmations of derivatives from counterparties by facsimile and manually compared the confirmations it received to the derivatives it had recorded in its system. The Firm failed to obtain evidence that the controls it tested addressed the risk of unrecorded derivative activity, as its procedures were limited to testing reconciliations and did not include

testing controls that would address whether all derivative confirmations were received and were matched to recorded derivatives in the system. (AS No. 5, paragraphs 39 and 42)

- The Firm's substantive procedures to test the completeness of those derivatives transactions were insufficient. Specifically, as described above, the Firm failed to sufficiently test controls over the completeness of those derivatives transactions, and it did not, in the alternative, substantively test the completeness of the system-generated report of unmatched confirmations that the Firm used in its substantive testing. (AS No. 15, paragraph 10)

A.2. Issuer B

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. Specifically, with respect to one of the issuer's two components –

- The Firm identified a fraud risk related to revenue. The Firm's testing of controls over revenue and accounts receivable, however, was insufficient. Specifically –
 - The Firm used the work of the issuer's internal auditors ("IA") as evidence of the operating effectiveness of three controls that the Firm considered to be responsive to the fraud risk. The Firm's use of the work of IA was not appropriate given the risk associated with the controls, due to the identified fraud risk, and the level of the Firm's testing of that work. This testing was limited to reperforming only a small portion of IA's testing of two of the controls, and for the third control the Firm used the work of IA without reperforming any of the testing or otherwise performing independent testing of the control. (AS No. 5, paragraph 19; AU 322, paragraphs .20 and .21)
 - For two of the controls mentioned above, which consisted of the review of sales invoices for accuracy and the review and approval of credit memos, the Firm's testing procedures were limited to determining that the reviews and approvals had occurred. For the

third of the controls mentioned above, consisting of the monitoring of the accounts receivable aging and collections, the Firm's procedures to test design effectiveness were limited to inquiring of the control owner and determining that the monitoring had occurred. The Firm, however, failed to evaluate whether the three controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of a report used in the performance of one of these controls. (AS No. 5, paragraphs 39, 42, and 44)

- For another control, consisting of the review and approval of balance sheet account reconciliations, the Firm's procedures were limited to inquiring of the control owner, determining that the reconciliations had been reviewed and approved, and tracing certain amounts in the reconciliations to the general ledger. The Firm, however, failed to evaluate whether this control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The Firm's testing of an information technology-dependent manual control over the posting of sales invoices to the general ledger was insufficient, as it limited its procedures to testing the application of the control to only one transaction. (AS No. 5, paragraph 44)
- The Firm designed its substantive procedures – including its sample sizes – to test revenue and accounts receivable based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. In addition, the Firm used a level of materiality to determine its sample sizes that was too high because it used the materiality level established for the issuer as a whole rather than that established for the component. As a result, the sample sizes the Firm used in its testing were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .18A, .19, .23, and .23A)

- The Firm selected for testing certain controls over income tax-related accounts and inventory; however, the Firm's testing of these controls was not sufficient. Specifically, the Firm's procedures were limited to observing signatures or email correspondence as evidence that the reviews that constituted these controls had occurred, without evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to perform sufficient substantive procedures to test the valuation of inventory. Specifically, the Firm failed to perform any substantive procedures to test the cost of inventory. In addition, the Firm failed to sufficiently test the accuracy and completeness of the listing of excess and dormant inventory that management used in estimating the reserve for excess and obsolete inventory. Specifically, the Firm's procedures were limited to testing controls over certain reports underlying the listing, without performing procedures to determine whether the information from those reports was accurately and completely reflected in the listing and to test the accuracy and completeness, or controls over the accuracy and completeness, of the other information in the listing. (AS No. 13, paragraph 36; AU 342, paragraph .11)
- The Firm's testing of certain controls over property and equipment, and the related depreciation expense, was not sufficient. Specifically, the Firm's procedures were limited to obtaining evidence that reviews and approvals and that certain calculations had occurred, without evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to identify and test any controls over the accounting for sale-leaseback transactions related to certain property and equipment. (AS No. 5, paragraphs 39, 42, and 44)
- The Firm failed to perform sufficient procedures to test the issuer's analysis of the possible impairment of certain property and equipment. To test the recoverability of these assets, the issuer estimated future cash flows. The Firm's testing of these estimated future cash flows, however, was not sufficient. Specifically, the Firm (a) failed to evaluate the reasonableness of the significant assumption related to projected

operating costs; and (b) limited its evaluation of the forecasted revenue and the remaining useful lives of these assets to inquiring of management, testing the mathematical accuracy of selected items, and testing revenue projections for only three specific items, which represented only four percent of the items in this population. (AU 342, paragraph .11)

- The Firm determined that the issuer had recorded certain journal entries incorrectly, and it identified fraud risks related to revenue and management override of controls. The Firm's procedures related to the testing of journal entries for evidence of possible material misstatement due to fraud, however, were insufficient. Specifically—
 - When selecting journal entries for testing, the Firm failed to sufficiently consider unique identifying characteristics of potentially inappropriate journal entries. Specifically, the Firm limited its selection criteria to journal entries related to revenue and expense accounts that were recorded on three specific dates, exceeded the Firm's established materiality level, or contained certain descriptive terms, without considering how the selection criteria would address the identified fraud risk. In addition, the Firm failed to test the completeness of the population of manual journal entries that it obtained from the issuer and used as its source from which it selected journal entries for testing. (AS No. 15, paragraph 10; AU 316, paragraph .61)
 - The Firm tested only a portion of the journal entries that met its selection criteria and arbitrarily excluded the remaining entries. (AU 316, paragraph .61)
 - The Firm selected for testing an important control over manual journal entries that it considered to be responsive to a fraud risk that it had identified. The Firm used the work of IA as its evidence of the operating effectiveness of this control. The Firm's use of this work was inappropriate, given the risks involved and the fact that it limited its own testing of the operating effectiveness of this control to reperforming only a small portion of IA's testing. In addition, the Firm failed to evaluate whether its conclusion that this control was operating effectively was appropriate given the errors in recording

manual journal entries that it identified during its substantive procedures. (AS No. 5, paragraphs 19, 46, and B8; AU 322, paragraphs .20 and .21)

A.3. Issuer C

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

- The Firm failed to perform sufficient tests of controls with respect to the ALL. Specifically –
 - The issuer used a system that was provided and maintained by an external service organization to process loans and record loan-related activity. The Firm failed to obtain a service auditor's report, or perform other procedures, to determine whether the information technology general controls ("ITGCs") over this system were designed and operating effectively. As a consequence of this failure, the Firm's reliance on its interim testing of an automated application control, which calculated the loan-delinquency information used to determine one component of the ALL, was inappropriate. (AS No. 5, paragraph 56)
 - The Firm failed to sufficiently test controls over the spreadsheets that the issuer used to calculate the ALL, as its testing of the controls it selected focused on obtaining evidence that management reviews of the spreadsheets had occurred and comparing the data in the spreadsheets to supporting documentation, without evaluating whether the controls operated at a level of precision that would detect errors in the formulas and data in the spreadsheets that could result in material misstatements. (AS No. 5, paragraphs 42 and 44)
 - The Firm failed to identify and test sufficient controls over loan grading because the single control over loan grading that the Firm tested did not cover a significant portion of the loan portfolio in the current year. (AS No. 5, paragraph 39)

- The Firm failed to sufficiently test a control over the completeness of the loan charge-off report that the issuer used in determining one component of the ALL. Specifically, in testing the control, the Firm selected items only from the report, rather than from the underlying source population of charge-offs. (AS No. 5, paragraph 44)
- The Firm failed to sufficiently test a control over the identification of troubled debt restructurings ("TDRs"), which were a part of the ALL calculation. The control consisted of the review of modified loans to determine whether they were TDRs. The Firm's procedures were limited to obtaining evidence that reviews had occurred and been approved, but did not include evaluating whether the control operated at a level of precision that would prevent or detect material misstatements, including by testing the specific steps used by the control owner to identify TDRs. (AS No. 5, paragraphs 42 and 44)
- The Firm failed in the following respects to perform sufficient substantive procedures to test the ALL –
 - The issuer assigned risk ratings to its loans using an eight-point scale. In calculating one component of the ALL, the issuer combined all the loans from four of the categories within the scale into one category and applied a single loss factor to this category. The Firm failed to assess the appropriateness of this approach. (AU 342, paragraph .11)
 - The Firm failed to perform sufficient substantive procedures to test the completeness of the loan charge-off report that the issuer used as an input in determining the historical loss rates that were a significant assumption in the calculation of one component of the ALL. Specifically, in testing the report, the Firm failed to select for testing loan charge-offs from the source population of charge-offs. (AU 342 paragraph .11)
- The Firm failed to perform sufficient procedures related to available-for-sale ("AFS") debt securities. Specifically –

- The Firm failed to test the control it identified over the disclosure of AFS debt securities within the hierarchy set forth in FASB ASC Topic 820. (AS No. 5, paragraph 39)
- The Firm failed to perform sufficient substantive procedures to test the disclosure of the AFS debt securities as level 2 or level 3 within the hierarchy set forth in FASB ASC Topic 820, because it failed to obtain an understanding of whether the significant inputs used to establish the fair value of the individual securities were observable or unobservable. (AU 328, paragraph .43)
- The Firm failed to perform sufficient procedures related to the provision for income taxes and the related balance sheet accounts. Specifically –
 - The Firm's testing of certain controls related to income taxes was insufficient. The controls included the reconciliation of certain projected and actual tax credits, the review of reconciliations of certain timing differences, and the monitoring of the effective tax rate. The Firm's procedures were limited to inquiring of the control owners and noting signatures as evidence of the performance of the controls, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to identify and test any controls over the accuracy of certain data used in the performance of those controls. (AS No. 5, paragraphs 39, 42, and 44)
 - The Firm failed to test any controls that addressed the accuracy of certain system-generated data that the issuer used in the income tax calculation. (AS No. 5, paragraph 39)
 - The Firm's substantive procedures to test the accuracy of income tax accounts were insufficient, as its procedures were limited to inquiry and a comparison of certain items on the issuer's reconciliation schedule to other issuer-prepared schedules that had not been tested. (AS No. 13, paragraph 8)

A.4. Issuer D

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

- The Firm failed to perform sufficient substantive procedures to test the general component of the ALL for corporate loans, which accounted for a significant portion of that ALL, and the related unfunded commitments reserve. The issuer used three assumptions to calculate this component of the ALL and the unfunded commitments reserve, two of which were derived from internal data, and one of which was derived from external data. With respect to the assumptions derived from internal data, the Firm failed to (a) test whether the information the issuer used was accurate and complete and (b) evaluate the appropriateness or effect of including in the development of the assumptions certain data that related to an alternative method of measuring incurred losses. The Firm evaluated the assumption derived from external data by calculating an estimate of the assumption using certain issuer historical data; the Firm, however, failed to test the accuracy and completeness of the data it used. (AS No. 15, paragraph 10; AU 342, paragraph .11)
- The Firm's testing of controls over the completeness of derivatives transactions was insufficient. The issuer used external organizations to provide certain services related to derivatives transactions, including matching the issuer's confirmations with those of the counterparties. The Firm failed to obtain an understanding of, and test, controls, either at the issuer or at the external organizations, over the matching of confirmations that would provide assurance that transactions without matching confirmations are identified. The Firm also failed to test controls over the monitoring and resolution of unmatched derivative confirmations. (AS No. 5, paragraphs 39 and B19)
- The Firm failed to perform sufficient substantive procedures to test the completeness of derivatives transactions. Specifically –

- The Firm designed its substantive procedures – including its sample sizes – to test the completeness of derivatives transactions based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the sample sizes the Firm used to test derivatives transactions were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)
- The Firm's procedures to evaluate derivatives transactions for which there were unmatched confirmations as of year end were not sufficient. Specifically, the Firm failed to examine documentation related to the subsequent resolution of these items that it had selected for testing. (AS No. 13, paragraph 8)

A.5. Issuer E

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 identified deficiencies in ITGCs that affected user access to important applications supporting the recognition of certain revenue and related rebates. In evaluating the severity of the deficiencies in ITGCs, the Firm identified a control, consisting of management's review of financial results, as an important compensating control. The Firm, however, failed to sufficiently test this compensating control. Specifically, the Firm failed to determine whether the compensating control operated at a level of precision that would prevent or detect material misstatements, as it failed to assess the nature of management's review and the appropriateness of the thresholds management used to identify variances for investigation. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the reports used in the performance of the compensating control. (AS No. 5, paragraphs 39, 42, 44, and 68)

- The Firm's procedures to test the valuation of certain intangible assets acquired during the year in business combinations were insufficient. Specifically –
 - The Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions used to determine the fair value of these intangible assets, as its procedures were limited to (a) comparing one of the significant assumptions to historical results, without evaluating the differences noted; (b) verifying the mathematical accuracy of certain underlying calculations; and (c) making reference to its knowledge of the business. (AU 328, paragraphs .26, .28, and .36)
 - The Firm failed to test the accuracy and completeness of the data used to develop certain significant assumptions underlying the valuation of these intangible assets. (AU 328, paragraph .39)
 - The Firm failed to evaluate the reasonableness of the assumptions the issuer used to establish the amortization periods for these intangible assets. (AU 342, paragraph .11)

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 substantive procedures to test the general and unallocated components of the ALL, which accounted for a significant portion of the ALL. Specifically –
 - The issuer used external data to develop the loss-rate assumptions for certain loan segments, which it adjusted using qualitative economic factors in order to estimate the majority of the general component of the ALL. The Firm's testing of this component was not sufficient in that (a) the Firm failed to evaluate whether the external data that the issuer used to develop the loss-rate

assumptions were based upon loans that were comparable to the issuer's loans, and (b) the Firm's evaluation of the appropriateness of the adjustments for the qualitative economic factors was limited to obtaining an issuer-prepared explanation of one such adjustment. (AU 342, paragraph .11)

- The issuer disclosed that during the year, its credit risk profile improved. The Firm's procedures to test the unallocated component of the ALL, which had, despite the improvement in the credit risk profile, increased from the prior year and was over the Firm's established materiality level, were insufficient, as they were limited to a comparison of the ratios of the unallocated component to the total ALL and to the total amount of loans outstanding at year end to those ratios for prior periods. (AU 342, paragraph .04)
- The Firm failed to perform sufficient tests related to the mortgage repurchase reserve. Specifically –
 - The Firm failed to identify and test any controls over (a) the completeness of repurchase demands and (b) the determination of the related mortgage repurchase reserve, including the underlying assumptions. (AS No. 5, paragraph 39)
 - The Firm failed to sufficiently test the assumptions the issuer used to determine the mortgage repurchase reserve, as its procedures were limited to testing the mathematical accuracy of the calculation and comparing certain inputs to supporting documentation, without evaluating the appropriateness of the time periods used in the calculation, the judgments made in determining which data to use in the calculation, or the method used to determine some of the assumptions. The Firm also failed to sufficiently test the completeness of repurchase demands, which the issuer used in the determination of this reserve, as its testing was limited to repurchase demands that resulted in a reserve recorded during the year. (AU 342, paragraph .11)

- The Firm's testing of the one control that it selected over the valuation of mortgage servicing rights, which consisted of the issuer's analysis of the assumptions it made in determining the fair value of the mortgage servicing rights, was insufficient. Specifically, the Firm's testing did not include obtaining an understanding of the procedures the control owner used in performing the analysis. The Firm also failed to identify and test any controls over the accuracy and completeness of the data the control owner used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

A.7. Issuer G

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

- The issuer used a commercial loan file review control to review the grades it had assigned to commercial loans; these grades were an important factor in estimating the ALL. The Firm identified a fraud risk related to the ALL. The Firm, however, failed to sufficiently test the issuer's commercial loan file review control. The Firm's procedures to test this control were intended to be dual-purpose tests, providing assurance both with respect to the effectiveness of ICFR and with respect to the financial statements. The Firm's testing, however, was limited to determining whether each loan in its sample was appropriately included in one of several broad classifications into which the multiple loan grades could be divided, without evaluating whether the specific grades assigned to the loans were appropriate. (AS No. 5, paragraphs 42 and 44; AU 342, paragraph .11)
- The issuer determined the fair values of certain available-for-sale securities without readily determinable fair values ("hard-to-value securities") by obtaining prices from external pricing services. The issuer also used internal models to determine the fair values of these securities, and it used the results of these models to determine which external prices to record in circumstances where the differences between the prices obtained from the external pricing services exceeded a threshold. For the purpose of recording other-than-temporary impairments ("OTTI"), the

issuer used the same cash flow assumptions used in its internal models to determine fair values. The Firm identified a fraud risk related to the valuation of the hard-to-value securities, but failed to perform sufficient procedures to test controls that addressed this risk. Specifically –

- In evaluating the issuer's controls over the valuation of those securities, the Firm failed to test whether the issuer had a sufficient understanding of how those securities were valued (including the specific methods and assumptions the external pricing services used, and the comparability of securities they used as benchmarks) to enable the issuer to determine whether (a) the valuations were reasonable and determined in accordance with GAAP, and (b) the securities were appropriately classified within the fair value hierarchy set forth in FASB ASC Topic 820. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to evaluate whether the issuer's controls were appropriately designed, in that it failed to determine whether they addressed the apparent inconsistencies between the assumptions underlying the recorded fair values provided by an external pricing service and those underlying the recorded OTTI. (AS No. 5, paragraph 42)
- The issuer recorded the fair value of certain other hard-to-value securities based on a weighting of both internal valuations and external trades. The Firm failed to test whether the control it identified and tested, which consisted of the review of the reasonableness of the inputs and assumptions used to value these securities, operated at a level of precision that would prevent or detect material misstatements, as the Firm limited its procedures to inspecting documents reviewed as part of the control and reading certain emails involving the control owners without evaluating whether the control included a sufficient review of all important inputs and assumptions used to value these securities. (AS No. 5, paragraphs 42 and 44)
- The Firm's substantive procedures to test the valuation of certain hard-to-value securities were insufficient. Specifically –

- The Firm failed to address the apparent inconsistencies between the assumptions underlying the prices received from an external pricing service used to determine the recorded fair values of securities and the assumptions underlying internally generated values, including those used to record OTTI. (AU 328, paragraph .47)
- The Firm failed to sufficiently test the issuer's classification of certain securities as level 2 within the hierarchy set forth in FASB ASC Topic 820. Specifically, for level 2 securities for which the recorded value was a price received from an external pricing service, the Firm failed to obtain an understanding of whether the significant inputs used to value those securities were observable or unobservable. (AU 328, paragraph .43)

A.8. Issuer H

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 selected for testing a control over the ALL, for which the Firm had identified a fraud risk, that consisted of management's review of an analysis of the ALL. The Firm failed to sufficiently test this control, as its procedures were limited to inquiring of management and noting a signature as evidence of review, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The issuer calculated the quantitative component of the ALL using a model in which historical loss factors, derived from the issuer's loss experience or that of a peer group, were a significant input. The issuer determined the qualitative component by considering certain environmental factors. The Firm's testing of these two components of the ALL was insufficient, as follows:

- With respect to the quantitative component of the ALL, the Firm failed to test the accuracy of the internal loss-experience data the issuer used to develop the historical loss factor assumptions. The Firm also failed to evaluate whether the issuer's use of the peer group's experience for the prior year was appropriate, including by assessing whether the current and prior years' experience could be expected to be consistent and whether the peer group's loan portfolios were comparable to those of the issuer. (AU 342, paragraph .11)
- The Firm failed to test the amounts the issuer used to develop the qualitative component of the ALL. (AU 342, paragraph .04)
- The Firm failed to perform sufficient procedures to test deposit liabilities. The Firm selected accounts for confirmation that exceeded a monetary threshold. The Firm's procedures related to the remaining population, which represented approximately 86 percent of deposit liabilities and was many times the Firm's established materiality level, were not sufficient, as they were limited to testing the deposit sub-ledger to general ledger reconciliations, cash reconciliations, and suspense account reconciliations. (AS No. 13, paragraph 8; AS No. 15, paragraph 27)

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 –

- The issuer determined the recorded fair value of its hard-to-value securities based on valuations provided by an external investment manager. In evaluating the issuer's controls over the valuation of those securities, the Firm failed to evaluate whether the issuer had obtained a sufficient understanding of how certain classes of these securities were valued to enable the issuer to determine whether (a) the valuations were reasonable and determined in accordance with GAAP and (b) the securities were appropriately classified within the fair value hierarchy set forth in FASB ASC Topic 820. (AS No. 5, paragraphs 42 and 44)

- The Firm's substantive procedures to test the valuation of certain classes of the hard-to-value securities were insufficient. Specifically, the Firm failed to obtain an understanding of the specific methods and assumptions underlying the fair value measurements that it obtained from an external pricing service. In addition, the Firm failed to compare the fair value measurements it obtained to the issuer's prices. (AU 328, paragraph .40)
- The Firm's testing of a control that it selected over the valuation of an insurance-related liability, and a related asset account, was insufficient. The control consisted of the review of the trends in the balances of the liability and related asset. The Firm limited its testing of this control to obtaining evidence that the review had occurred, without evaluating whether this control operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to perform sufficient tests of controls over the accuracy and completeness of certain data used in the operation of the control. The Firm had tested a relevant automated application control when the control was implemented four years earlier, and the Firm determined that the issuer had maintained effective ITGCs since that testing. The Firm's procedures, however, were not sufficient, because it did not evaluate (a) whether there had been any changes to the application that contained the control since its previous tests, and (b) whether the application control needed to be retested given the passage of time since those tests. (AS No. 5, paragraphs 42, 44, B29, B31, and B33)
- The Firm's substantive procedures to test the insurance-related liability and the related asset noted above were insufficient. Specifically, the Firm failed to sufficiently test controls over the accuracy and completeness of data related to this liability and asset, as described above, and it did not otherwise test the accuracy and completeness of the data that it used in its substantive procedures. (AS No. 15, paragraph 10)

A.10. Issuer J

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the valuation of goodwill, for which the Firm identified a fraud risk, were not sufficient.

Specifically, the Firm failed to sufficiently evaluate the reasonableness of certain significant assumptions that the issuer used in its annual analysis of the possible impairment of goodwill for one of its reporting units. With respect to one of these assumptions, the future prices of the issuer's product, the Firm noted that external analysts had projected price decreases during time periods in which the issuer had projected price increases. The Firm, however, failed to perform procedures to evaluate the reasons for the difference, other than obtaining the analysts' projections described above and information regarding projected demand for the product. In addition, the issuer's cash flow projections contemplated that it would sell its product increasingly, and ultimately exclusively, in a market with higher margins than the markets in which it was then selling the majority of its product. The Firm failed to evaluate the issuer's ability to carry out that course of action. (AS No. 14, paragraph 3; AU 328, paragraphs .17, .26, .28, and .36)

A.11. Issuer K

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 identified and tested one management review control over the revenue, accounts receivable, and inventory related to a majority of the issuer's subsidiaries, which, in combination represented a significant portion of total revenue, accounts receivable, and inventory. The Firm's testing of this control, however, was insufficient, as its procedures were limited to inquiring of management and obtaining evidence of review, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data and reports management used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)
- The Firm failed to perform sufficient substantive procedures to test certain revenue, accounts receivable, and inventory. The Firm designed its procedures – including its sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes

used to test certain revenue, accounts receivable, and inventory were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)

- The Firm's planned approach for testing revenue included the performance of substantive analytical procedures; however, the analytical procedures the Firm performed provided little to no substantive assurance. Specifically –
 - Certain of the thresholds the Firm established for investigation of unexpected differences were too high to identify misstatements that could be material. (AU 329, paragraph .20)
 - For certain differences that were in excess of the thresholds for investigation, the Firm limited its procedures to inquiring of management, without obtaining corroboration of the explanations. (AU 329, paragraph .21)
 - The Firm failed to sufficiently test certain data it used in the analytical procedures, as it failed to ascertain that the market data it used to assess the reliability of the issuer's data related to a similar mix of products. (AU 329, paragraph .16)

A.12. Issuer L

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the issuer's ALL were insufficient. The issuer had a practice of refinancing loans, including loans that were delinquent, and, when estimating the ALL, it treated the refinanced loans as if they were newly originated loans with no history of delinquencies. The Firm used a combination of reviewing and testing management's process and developing an independent estimate to test the ALL. In neither of these approaches, however, did the Firm consider the appropriateness of the issuer's treatment of the refinanced loans in its determination of the ALL. (AU 342, paragraphs .11 and .12)

A.13. Issuer M

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 records its most significant category of revenue on a net basis by estimating allowances for contractual discounts and other amounts that are expected to be uncollectible. The Firm identified and tested two controls over these estimated allowances, which involved the preparation of analyses of historical billing and collection activity and the review of these analyses, but its testing of these controls was insufficient. Specifically, the Firm's testing was limited to obtaining evidence that the analyses had been prepared and reviewed, and comparing the analyses to the general ledger, without evaluating whether these controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to perform sufficient substantive procedures to test the allowances described above. Specifically, while the Firm tested the mathematical accuracy of a report the issuer used to estimate the allowances, and it compared certain data within the report to source documentation, it failed to evaluate whether the assumptions used to develop the allowances were consistent with the data within the report. In addition, the Firm's planned approach for testing the allowances included the performance of substantive analytical procedures; however, the Firm's analytical procedures provided little to no substantive assurance. Specifically, the Firm established thresholds for investigation of unexpected differences that were too high to provide the necessary level of assurance that differences that may be potential material misstatements would be identified for investigation. (AU 329, paragraph .20; AU 342, paragraph .11)
- For another category of revenue, which was based on a combination of contractual base rates plus amounts determined by usage and was recorded in the general ledger through manual journal entries, the Firm identified certain fraud risks. The Firm, however, failed to perform sufficient procedures to test controls over this revenue. Specifically, the

Firm did not identify and test any controls over (a) the accuracy and completeness of the hours billed and (b) the completeness of the recorded revenue. (AS No. 5, paragraph 39)

- The Firm designed its substantive procedures – including sample sizes – to test the revenue discussed immediately above based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes the Firm used to test this category of revenue were too small to provide sufficient evidence. Further, the Firm failed to perform procedures to test the completeness of the recorded revenue. (AS No. 13, paragraphs 16, 18, 36, and 37; AU 350, paragraphs .19, .23, and .23A)

A.14. Issuer N

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

- The Firm failed to sufficiently test two controls that it selected over the issuer's determination of the ALL; the controls consisted of management's review of the qualitative component of the ALL and management's review of loan charge-offs, including related appraisals. The Firm failed to evaluate whether the first control, and the appraisal-review aspect of the second control, operated at a level of precision that would prevent or detect material misstatements, as it did not determine the nature of the reviews performed, including the metrics or criteria applied and the process for resolving identified exceptions. (AS No. 5, paragraphs 42 and 44)
- To test the qualitative component of the ALL, the Firm developed an independent estimate. This estimate, however, did not provide sufficient assurance as to the qualitative component of the ALL, as it was based on the Firm's general knowledge of the issuer and experience in the industry, and the Firm did not perform procedures to obtain evidence to support the various factors it used to develop its estimate. (AU 342, paragraph .12)

A.15. Issuer O

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

- The Firm's tests of controls over the general component of the ALL related to commercial loans, as well as qualitative adjustments management made to the ALL, were insufficient. Specifically, the Firm failed to test any aspect of controls that addressed the assumptions and data underlying the loss-emergence factor, which was the issuer's estimate of the time that would pass between a loss event and the related charge-off, and which was a significant factor in the calculation of the general component of the ALL related to commercial loans. In addition, the Firm failed to identify and test any controls over the assumptions and data that management used in determining the qualitative adjustments. (AS No. 5, paragraph 39)
- There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed procedures to evaluate the reasonableness of the important assumptions, and test certain of the data, underlying the loss-emergence factor for commercial loans and the qualitative adjustments to the ALL. (AU 342, paragraph .11)

A.16. Issuer P

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The issuer determined the recorded fair value of certain of its hard-to-value securities based on valuations provided by an external investment manager. In evaluating the issuer's controls over the valuation of those securities, the Firm failed to test whether the issuer had obtained a sufficient understanding of how these securities were valued to enable the issuer to determine whether the valuations were reasonable and determined in accordance with GAAP. (AS No. 5, paragraphs 42 and 44)

A.17. Issuer Q

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 used an IT application to manage and track transactions with its customers, and another IT application to calculate revenue and refunds due to customers. The Firm's testing of controls over revenue, deferred revenue, and accounts receivable was insufficient. Specifically, the Firm failed to identify and test any controls over the accuracy and completeness of the data in the first application or the transfer of relevant data to the second application. In addition, the Firm failed to identify and test any controls over the refund calculations performed in the second application, including controls over the entry of information that prompted the calculation to occur. (AS No. 5, paragraph 39)
- The Firm's substantive procedures to test revenue, deferred revenue, and accounts receivable were insufficient. Specifically –
 - The Firm designed its substantive procedures – including its sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes the Firm used in its tests of details of revenue, deferred revenue, and accounts receivable were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)
 - When performing its tests of the sampled revenue transactions and accounts receivable, the Firm compared the selected items to certain system-generated data; the Firm, however, failed to test the accuracy and completeness of the data it used. (AS No. 15, paragraph 10)
 - The Firm's planned approach for testing revenue included the performance of substantive analytical procedures. Due to deficiencies in these procedures, however, the analytical procedures the Firm performed provided little to no substantive assurance. Specifically –

- The Firm developed certain of its expectations using data that it had not tested for accuracy and completeness. (AU 329, paragraph .16)
- The Firm used certain ratios derived from prior-year data to develop its expectation for one of the analytical procedures, but it failed to evaluate whether the ratios could be expected to be predictive of current-year results given significant changes in the issuer's business in the current year. (AU 329, paragraph .17)
- For one of its analytical procedures, the Firm established a threshold for investigation of unexpected differences that was at a level that would have allowed the Firm not to identify differences that may be potential material misstatements. (AU 329, paragraph .20)

A.18. Issuer R

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to perform sufficient procedures to test controls over the sales rebate accrual for two of the issuer's components. Specifically –

- For one component, the controls that the Firm selected over the sales rebate accrual consisted of (1) discussions among component personnel about the component's significant estimates, the periodic documentation of these estimates, and the review of such documentation by the division controller; and (2) the reconciliation of sub-ledgers to the general ledger accounts and the review of those reconciliations. The Firm's testing of the first control was limited to obtaining the estimates-methodology memorandum and confirming that the methodology was consistent with its understanding, and noting evidence of review of the periodic documentation of those estimates. The Firm tested the second control by determining that the reconciliations were supported by appropriate data and agreed to the general ledger, and observing signatures as evidence of review.

- For the second component, the controls that the Firm selected over the sales rebate accrual consisted of the reconciliation of sales reports and sub-ledgers to the general ledger accounts and the review of those reconciliations. The Firm's testing of these controls was limited to obtaining evidence that the reconciliations were prepared and observing signatures as evidence of review, and noting that no differences over the specified threshold were identified.

The Firm's procedures to test these controls did not include evaluating whether they operated at a level of precision that would prevent or detect material misstatements related to the sales rebate accrual. (AS No. 5, paragraphs 42 and 44)

A.19. Issuer S

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 used external service organizations to process certain revenue transactions. The Firm's procedures to test controls over this revenue were insufficient. The Firm considered the service auditors' reports for these service organizations in order to determine whether any issues raised in the reports should affect its planned audit procedures; the Firm failed, however, to evaluate whether the controls tested by the service auditors sufficiently addressed the relevant assertions related to revenue processed by the service organizations and identify and test the user controls described in the service auditors' reports, or to identify and test other controls over this revenue. (AS No. 5, paragraphs 39 and B19)
- The Firm used certain data provided by one of the service organizations in the substantive analytical procedures it used to test some of the revenue types discussed above. The Firm, however, failed to obtain evidence about the effectiveness of controls over the data, or, in the alternative, substantively test the accuracy and completeness of the data. (AU 329, paragraph .16)
- The Firm tested a control that it asserted addressed the risks of material misstatement regarding the classification of derivative gains and losses as

either revenue or operating expenses. This control consisted of the review and approval of the accuracy of details of derivatives transactions recorded in the issuer's system. The Firm's testing of this control was insufficient, as its procedures were limited to observing the entry of details of derivatives transactions into the system and noting evidence of approval of the terms of the transactions, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements related to the classification of derivative gains and losses. (AS No. 5, paragraphs 42 and 44)

A.20. Issuer T

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm tested certain controls over the issuer's accounting for business combinations that consisted of (a) management's review of the underlying agreements, (b) management's review of the allocation of goodwill to reporting units, and (c) the use of qualified external valuation specialists to perform valuations of assets acquired in business combinations. The Firm's testing of these controls was insufficient, as it failed to evaluate whether these controls operated at a level of precision that would prevent or detect material misstatements. Specifically, the Firm failed to evaluate the extent of the control owners' reviews of the underlying agreements and the allocation of goodwill to reporting units, including the steps involved to identify, investigate, and resolve any concerns or differences. The Firm also failed to identify and test any controls over the inputs and assumptions that the external valuation specialists used to perform the valuations; the issuer also used certain of these assumptions to evaluate certain intangible assets for impairment and to determine whether a valuation allowance was needed for certain deferred tax assets. (AS No. 5, paragraphs 39, 42, and 44)

A.21. Issuer U

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. Regarding the issuer's accounting for business combinations, the Firm selected a control that consisted of management's review of the valuation report prepared by an external specialist. The Firm's testing of this control was insufficient, as the Firm's procedures were limited to inquiring of management and obtaining evidence of review, without evaluating whether

the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

A.22. Issuer V

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. To test the valuation of a significant portion of the issuer's hard-to-value investment securities, the Firm obtained values from a pricing service and compared those values to the issuer's recorded values for the securities. These procedures, however, were not sufficient because, for the securities tested through this approach, the Firm failed to obtain an understanding of the specific methods and assumptions underlying the fair value measurements that it obtained from the pricing service. (AU 328, paragraphs .26 and .40)

A.23. Issuer W

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

- The Firm's testing of a control that consisted of management's review of the determination of the reserve for product liability claims, including the data the issuer used in that determination, was insufficient. Specifically, the Firm's procedures were limited to inquiring of issuer personnel, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to perform sufficient procedures to test the completeness of the issuer's data that the Firm used in its substantive tests of the reserve for product liability claims. Specifically, the Firm failed to sufficiently test controls over the data, as described above, and there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated whether the data included all of the matters included in the confirmations it received from the issuer's external legal counsel. (AU 342, paragraph .11)

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which either (a) the Firm failed to comply with the requirement to obtain sufficient appropriate audit 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 ICFR, or (b) the Firm failed to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in an audit in which it played a role but was not the principal auditor. Each deficiency could relate to several applicable provisions of the standards that govern the conduct of audits, including both the paragraphs of the standards that are cited at the end of each description of the deficiency included in Part I.A of this report and one or more of the specific paragraphs discussed below.

Many audit deficiencies involve a lack of due professional care. AU 230, *Due Professional Care in the Performance of Work* ("AU 230"), paragraphs .02, .05, and .06, requires the independent auditor to plan and perform his or her work with due professional care and sets forth aspects of that requirement. AU 230, paragraphs .07 through .09, and Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), paragraph 7, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement. AS No. 15, *Audit Evidence* ("AS No. 15"), paragraph 4, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of ICFR) and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

The table below lists the specific auditing standards that are referenced for each deficiency included in Part I.A of this report. See the descriptions of the deficiencies in

Part I.A for identification of the specific paragraphs, in addition to those noted above, that relate to the individual deficiencies.

PCAOB Auditing Standards	Issuers
<i>AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>	A, B, C, D, E, F, G, H, I, K, M, N, O, P, Q, R, S, T, U, and W
<i>AS No. 13, The Auditor's Responses to the Risks of Material Misstatement</i>	A, B, C, D, H, K, M, and Q
<i>AS No. 14, Evaluating Audit Results</i>	J
<i>AS No. 15, Audit Evidence</i>	A, B, D, H, I, and Q
<i>AU Section 316, Consideration of Fraud in a Financial Statement Audit</i>	B
<i>AU Section 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i>	B
<i>AU Section 328, Auditing Fair Value Measurements and Disclosures</i>	C, E, G, I, J, and V
<i>AU Section 329, Substantive Analytical Procedures</i>	K, M, Q, and S
<i>AU Section 342, Auditing Accounting Estimates</i>	A, B, C, D, E, F, G, H, L, M, N, O, and W
<i>AU Section 350, Audit Sampling</i>	A, B, D, K, M, and Q

C. Information Concerning PCAOB Inspections Generally Applicable to Annually Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audits and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion

in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

C.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. For these audits, the inspection team selects certain portions of the audits for inspection, and it reviews the engagement team's work papers and interviews engagement personnel regarding those portions. If the inspection team identifies a potential issue that it is unable to resolve through discussion with the firm and any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report.

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,^{3/} as well as a firm's failures to perform, or to perform sufficiently, certain necessary audit procedures. The inspection does not involve the review of all of a firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, a Board inspection report

^{3/} 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.

should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS 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. In reaching its conclusions, the inspection team considers whether audit documentation or any persuasive other evidence that a firm might provide to the inspection team supports a firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.^{4/}

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among

^{4/} 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.

selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

Inclusion of an audit 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 the issuer of the need for changes to its financial statements or reporting on ICFR, or to take steps to prevent reliance on previously expressed audit opinions.^{5/}

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

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 issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when

^{5/} An inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system.^{6/} If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the Firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies;^{7/} related firm methodology, guidance, and practices; and possible root causes.

In addition to evaluating the audit work performed on specific audits, inspections include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining issuer audit engagements, including the application of the firm's risk-rating system; (4) processes related to the firm's use of audit work that the firm's foreign affiliates perform

^{6/} Not every audit deficiency suggests a defect or potential defect in a firm's quality control system, and this report does not discuss every audit deficiency the inspection team identified.

^{7/} An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.

on the foreign operations of the firm's U.S. issuer audits; and (5) the firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

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

Procedures in this area are designed to focus on (a) how 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. To assess this area, the inspection team may interview members of the firm's leadership and review significant management reports and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.

C.2.b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area are designed to focus on (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 distinct from 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 may interview members of the firm's management and review documentation related to certain of these topics. In addition, the inspection team's evaluation may include the results of interviews of audit partners regarding their responsibilities and allocation of time. In addition, the inspection team may review a sample of partners' personnel files.

C.2.c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Issuer Audit Engagements, Including the Application of the Firm's Risk-Rating System

The inspection team may consider the firm's documented policies and procedures in this area. In addition, the inspection team may select certain issuer audits to (a) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the issuer audit engagements and (b) observe whether the audit procedures were responsive to the risks identified during the process.

C.2.d. Review of Processes Related to a Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audits

The inspection team may review the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the firm's U.S. issuer audits, review available information relating to the most recent foreign affiliated firms' internal inspections, interview members of the firm's leadership, and review 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 may also review certain of the audit work performed by the firm's foreign affiliates on the foreign operations of the firm's U.S. issuer audits.

C.2.e. Review of a Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Defects or Potential Defects in Quality Control

C.2.e.i. Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area are designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team may interview members of the firm's management and review documents regarding how the firm identifies, evaluates, and

responds to possible indicators of deficiencies in audit performance. In addition, the inspection team may review documents related to the design, operation, and evaluation of findings of the firm's internal inspection program, and may compare the results of its review of audit work to those from the internal inspection's review of the same audit work.

C.2.e.ii. Review of Response to Defects or Potential Defects in Quality Control

The inspection team may review steps the firm has taken to address possible quality control deficiencies and assess the design and effectiveness of the related processes. In addition, the inspection team may inspect audits of issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies have improved.

C.2.e.iii. Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team may assess policies, procedures, and guidance related to aspects of independence requirements and the firm's consultation processes, as well as the firm's compliance with these requirements and processes. In addition, the inspection team may review documents, including certain newly issued policies and procedures, and interview firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

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

END OF PART I

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

APPENDIX C

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{8/}

^{8/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.



KPMG LLP
345 Park Avenue
New York, NY 10154-0102

Telephone +1 212 758 9700
Fax +1 212 758 9819
Internet www.us.kpmg.com

September 12, 2014

Ms. Helen A. Munter
Director – Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Dear Ms. Munter:

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2013 Inspection of KPMG LLP dated August 12, 2014 ("Draft Report").

KPMG has established a culture built on an absolute commitment to performing consistently high-quality audits. We share the PCAOB's objectives of continually improving audit quality, building confidence in the auditing profession and meeting our responsibilities to investors and other participants in the capital markets system. We believe that the PCAOB's inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of audit quality control. We remain committed to full cooperation with the PCAOB, appreciate the professionalism and commitment of the PCAOB staff and value the important role the PCAOB plays in improving audit quality.

We conducted a thorough evaluation of the matters identified in Part I of the Draft Report and have taken actions to address the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures.

We remain dedicated to evaluating and improving our system of audit quality control, monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We understand our responsibility to the capital markets and are committed to continually improving our firm and working constructively with the PCAOB to improve audit quality.

Very truly yours,

KPMG LLP

John B. Veihmeyer
Chairman and Chief Executive Officer

James P. Liddy
Vice Chair, Audit

cc: Mr. James R. Doty
Mr. Lewis H. Ferguson
Ms. Jeanette M. Franzel
Mr. Jay D. Hanson
Mr. Steven B. Harris

APPENDIX D

AUDITING STANDARDS REFERENCED IN PART I

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

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
PLANNING THE AUDIT		
Using the Work of Others		
AS No. 5.19	The extent to which the auditor may use the work of others in an audit of internal control also depends on the risk associated with the control being tested. As the risk associated with a control increases, the need for the auditor to perform his or her own work on the control increases.	Issuer B
USING A TOP-DOWN APPROACH		
Selecting Controls to Test		
AS No. 5.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, B, C, D, E, F, K, M, O, Q, S, and T
TESTING CONTROLS		
Testing Design Effectiveness		
AS No. 5.42	<p>The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.</p> <p>Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.</p>	Issuers A, B, C, E, F, G, H, I, K, M, N, P, R, S, T, U, and W
Testing Operating Effectiveness		
AS No. 5.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.	Issuers A, B, C, E, F, G, H, I, K, M, N, P, R, S, T, U, and W

	<p>Note: In some situations, particularly in smaller companies, a company might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for a company's financial reporting and associated controls, the auditor may take into account the combined competence of company personnel and other parties that assist with functions related to financial reporting.</p>	
Relationship of Risk to the Evidence to be Obtained		
AS No. 5.46	<p>For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness would result. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases</p> <p>Note: Although the auditor must obtain evidence about the effectiveness of controls for each relevant assertion, the auditor is not responsible for obtaining sufficient evidence to support an opinion about the effectiveness of each individual control. Rather, the auditor's objective is to express an opinion on the company's internal control over financial reporting overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.</p>	Issuer B
AS No. 5.56	<p>The additional evidence that is necessary to update the results of testing from an interim date to the company's year-end depends on the following factors -</p> <ul style="list-style-type: none"> • The specific control tested prior to the as-of date, including the risks associated with the control and the nature of the control, and the results of those tests; • The sufficiency of the evidence of effectiveness obtained at an interim date; • The length of the remaining period; and • The possibility that there have been any significant changes in internal control over financial reporting subsequent to the interim date. 	Issuer C

	Note: In some circumstances, such as when evaluation of the foregoing factors indicates a low risk that the controls are no longer effective during the roll-forward period, inquiry alone might be sufficient as a roll-forward procedure.	
EVALUATING IDENTIFIED DEFICIENCIES		
AS No. 5.68	The auditor should evaluate the effect of compensating controls when determining whether a control deficiency or combination of deficiencies is a material weakness. To have a mitigating effect, the compensating control should operate at a level of precision that would prevent or detect a misstatement that could be material.	Issuer E
APPENDIX B – SPECIAL TOPICS		
Integration of Audits		
AS No. 5.B8	<p><i>Effect of Substantive Procedures on the Auditor's Conclusions About the Operating Effectiveness of Controls.</i> In an audit of internal control over financial reporting, the auditor should evaluate the effect of the findings of the substantive auditing procedures performed in the audit of financial statements on the effectiveness of internal control over financial reporting. This evaluation should include, at a minimum –</p> <ul style="list-style-type: none"> • The auditor's risk assessments in connection with the selection and application of substantive procedures, especially those related to fraud. • Findings with respect to illegal acts and related party transactions. • Indications of management bias in making accounting estimates and in selecting accounting principles. • Misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls. 	Issuer B
Use of Service Organizations		
AS No. 5.B19	AU sec. 324.07 through .16 describe the procedures that the auditor should perform with respect to the activities performed by the service organization. The procedures include -	Issuers D and S

	<p>a. Obtaining an understanding of the controls at the service organization that are relevant to the entity's internal control and the controls at the user organization over the activities of the service organization, and</p> <p>b. Obtaining evidence that the controls that are relevant to the auditor's opinion are operating effectively.</p>	
Benchmarking of Automated Controls		
AS No. 5.B29	<p>If general controls over program changes, access to programs, and computer operations are effective and continue to be tested, and if the auditor verifies that the automated application control has not changed since the auditor established a baseline (i.e., last tested the application control), the auditor may conclude that the automated application control continues to be effective without repeating the prior year's specific tests of the operation of the automated application control. The nature and extent of the evidence that the auditor should obtain to verify that the control has not changed may vary depending on the circumstances, including depending on the strength of the company's program change controls.</p>	Issuer I
AS No. 5.B31	<p>To determine whether to use a benchmarking strategy, the auditor should assess the following risk factors. As these factors indicate lower risk, the control being evaluated might be well-suited for benchmarking. As these factors indicate increased risk, the control being evaluated is less suited for benchmarking. These factors are –</p> <ul style="list-style-type: none"> • The extent to which the application control can be matched to a defined program within an application. • The extent to which the application is stable (i.e., there are few changes from period to period). • The availability and reliability of a report of the compilation dates of the programs placed in production. (This information may be used as evidence that controls within the program have not changed.) 	Issuer I
AS No 5.B33	<p>After a period of time, the length of which depends upon the circumstances, the baseline of the operation of an automated application control should be reestablished. To determine when to reestablish a baseline, the auditor should evaluate the following factors -</p>	Issuer I

	<ul style="list-style-type: none"> • The effectiveness of the IT control environment, including controls over application and system software acquisition and maintenance, access controls and computer operations. • The auditor's understanding of the nature of changes, if any, on the specific programs that contain the controls. • The nature and timing of other related tests. • The consequences of errors associated with the application control that was benchmarked. • Whether the control is sensitive to other business factors that may have changed. For example, an automated control may have been designed with the assumption that only positive amounts will exist in a file. Such a control would no longer be effective if negative amounts (credits) begin to be posted to the account. 	
AS No. 13, The Auditor's Responses to the Risks of Material Misstatement		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS No. 13.8	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuers C, D, and H
Responses to Fraud Risks		
AS No. 13.13	<i>Addressing Fraud Risks in the Audit of Financial Statements.</i> In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in accordance with paragraphs 16-17 of this standard, the auditor should perform tests of those controls.	Issuer A

TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS No. 13.16	<i>Controls to be Tested.</i> If the auditor plans to assess control risk at less than the maximum by relying on controls, ^{12/} and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance . ^{13/} However, the auditor is not required to assess control risk at less than the maximum for <i>all</i> relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	Issuers B, D, K, M, and Q
<p><u>Footnotes to AS No. 13.16</u></p> <p>^{12/} Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures.</p> <p>^{13/} Terms defined in Appendix A, <i>Definitions</i>, are set in boldface type the first time they appear.</p>		
AS No. 13.18	<i>Evidence about the Effectiveness of Controls in the Audit of Financial Statements.</i> In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers B, D, K, M, and Q
SUBSTANTIVE PROCEDURES		
AS No. 13.36	The auditor should perform substantive procedures for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk.	Issuers B and M
AS No. 13.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends	Issuers B, D, K, M, and Q

	upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	
AS No. 14, Evaluating Audit Results		
EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS		
AS No. 14.3	In forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.	Issuer J
AS No. 15, Audit Evidence		
SUFFICIENT APPROPRIATE AUDIT EVIDENCE		
Using Information Produced by the Company		
AS No. 15.10	<p>When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:^{3/}</p> <ul style="list-style-type: none"> • Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and • Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. 	Issuers A, B, D, I, and Q
Footnote to AS No. 15.10		
<p>^{3/}When using the work of a specialist engaged or employed by management, <i>see</i> AU sec. 336, <i>Using the Work of a Specialist</i>. When using information produced by a service organization or a service auditor's report as audit evidence, <i>see</i> AU sec. 324, <i>Service Organizations</i>, and for integrated audits, <i>see</i> Auditing Standard No. 5, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>.</p>		

SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE		
Selecting Specific Items		
AS No. 15.27	The application of audit procedures to items that are selected as described in paragraphs 25-26 of this standard does not constitute audit sampling, and the results of those audit procedures cannot be projected to the entire population. ^{12/}	Issuer H
<p><u>Footnote to AS No. 15.27</u></p> <p>^{12/} If misstatements are identified in the selected items, <u>see</u> paragraphs 12-13 and paragraphs 17-19 of Auditing Standard No. 14.</p>		
AU Section 316, Consideration of Fraud in a Financial Statement Audit		
RESPONDING TO ASSESSED FRAUD RISKS		
Audit Procedures Performed to Specifically Address the Risk of Management Override of Controls		
AU 316.61	<p>The auditor should use professional judgment in determining the nature, timing, and extent of the testing of journal entries and other adjustments. For purposes of identifying and selecting specific entries and other adjustments for testing, and determining the appropriate method of examining the underlying support for the items selected, the auditor should consider:</p> <ul style="list-style-type: none"> • The auditor's assessment of the fraud risk. The presence of fraud risk factors or other conditions may help the auditor to identify specific classes of journal entries for testing and indicate the extent of testing necessary. • The effectiveness of controls that have been implemented over journal entries and other adjustments. Effective controls over the preparation and posting of journal entries and adjustments may affect the extent of substantive testing necessary, provided that the auditor has tested the controls. However, even though controls might be implemented and operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items. 	Issuer B

	<ul style="list-style-type: none">• The entity's financial reporting process and the nature of the evidence that can be examined. The auditor's procedures for testing journal entries and other adjustments will vary based on the nature of the financial reporting process. For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments might involve both manual and automated procedures and controls. Regardless of the method, the auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items. In addition, the auditor should be aware that journal entries and other adjustments might exist in either electronic or paper form. When information technology (IT) is used in the financial reporting process, journal entries and other adjustments might exist only in electronic form. Electronic evidence often requires extraction of the desired data by an auditor with IT knowledge and skills or the use of an IT specialist. In an IT environment, it may be necessary for the auditor to employ computer-assisted audit techniques (for example, report writers, software or data extraction tools, or other systems-based techniques) to identify the journal entries and other adjustments to be tested.• The characteristics of fraudulent entries or adjustments. Inappropriate journal entries and other adjustments often have certain unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual, or seldom-used accounts, (b) made by individuals who typically do not make journal entries, (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (d) made either before or during the preparation of the financial statements that do not have account numbers, or (e) containing round numbers or a consistent ending number.• The nature and complexity of the accounts. Inappropriate journal entries or adjustments may be applied to accounts that (a) contain transactions that are complex or unusual in nature, (b) contain significant estimates and period-end adjustments, (c) have been prone to errors in the past, (d) have not been reconciled on a timely basis or contain unreconciled	
--	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--

	<p>differences, (e) contain intercompany transactions, or (f) are otherwise associated with an identified fraud risk. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations based on factors set forth in paragraphs 11 through 14 of Auditing Standard No. 9, Audit Planning.</p> <ul style="list-style-type: none"> Journal entries or other adjustments processed outside the normal course of business. Standard journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements, or to record recurring periodic accounting estimates generally are subject to the entity's internal controls. Nonstandard entries (for example, entries used to record nonrecurring transactions, such as a business combination, or entries used to record a nonrecurring estimate, such as an asset impairment) might not be subject to the same level of internal control. In addition, other adjustments such as consolidating adjustments, report combinations, and reclassifications generally are not reflected in formal journal entries and might not be subject to the entity's internal controls. Accordingly, the auditor should consider placing additional emphasis on identifying and testing items processed outside of the normal course of business. 	
<p>AU Section 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</p>		
<p>EXTENT OF THE EFFECT OF THE INTERNAL AUDITORS' WORK</p>		
<p>AU 322.20</p>	<p>In making judgments about the extent of the effect of the internal auditors' work on the auditor's procedures, the auditor considers—</p> <ol style="list-style-type: none"> The materiality of financial statement amounts—that is, account balances or classes of transactions. The risk (consisting of inherent risk and control risk) of material misstatement of the assertions related to these financial statement amounts. The degree of subjectivity involved in the evaluation of the audit evidence gathered in support of the assertions.^{fn 7} 	<p>Issuer B</p>

	As the materiality of the financial statement amounts increases and either the risk of material misstatement or the degree of subjectivity increases, the need for the auditor to perform his or her own tests of the assertions increases. As these factors decrease, the need for the auditor to perform his or her own tests of the assertions decreases.	
Footnote to AU 322.20		
<p>^{fn7} For some assertions, such as existence and occurrence, the evaluation of audit evidence is generally objective. More subjective evaluation of the audit evidence is often required for other assertions, such as the valuation and disclosure assertions.</p>		
AU 322.21	For assertions related to material financial statement amounts where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is high, the auditor should perform sufficient procedures to fulfill the responsibilities described in paragraphs .18 and .19. In determining these procedures, the auditor gives consideration to the results of work (either tests of controls or substantive tests) performed by internal auditors on those particular assertions. However, for such assertions, the consideration of internal auditors' work cannot alone reduce audit risk to an acceptable level to eliminate the necessity to perform tests of those assertions directly by the auditor. Assertions about the valuation of assets and liabilities involving significant accounting estimates, and about the existence and disclosure of related-party transactions, contingencies, uncertainties, and subsequent events, are examples of assertions that might have a high risk of material misstatement or involve a high degree of subjectivity in the evaluation of audit evidence.	Issuer B
AU Section 328, Auditing Fair Value Measurements and Disclosures		
EVALUATING CONFORMITY OF FAIR VALUE MEASUREMENTS AND DISCLOSURES WITH GAAP		
AU 328.17	The auditor should evaluate management's intent to carry out specific courses of action where intent is relevant to the use of fair value measurements, the related requirements involving presentation and disclosures, and how changes in fair values are reported in financial statements. The auditor also should evaluate management's ability to carry out those courses of action. Management often documents plans and intentions relevant to specific assets or liabilities and GAAP may	Issuer J

	<p>require it to do so. While the extent of evidence to be obtained about management's intent and ability is a matter of professional judgment, the auditor's procedures ordinarily include inquiries of management, with appropriate corroboration of responses, for example, by:</p> <ul style="list-style-type: none"> • Considering management's past history of carrying out its stated intentions with respect to assets or liabilities. • Reviewing written plans and other documentation, including, where applicable, budgets, minutes, and other such items. • Considering management's stated reasons for choosing a particular course of action. • Considering management's ability to carry out a particular course of action given the entity's economic circumstances, including the implications of its contractual commitments. 	
TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AU 328.26	<p>The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:</p> <ul style="list-style-type: none"> a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06). b. The fair value measurement was determined using an appropriate model, if applicable. c. Management used relevant information that was reasonably available at the time. 	Issuers E, J, and V
AU 328.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value	Issuers E and J

	<p>measurements and disclosures in the entity's financial statements.</p>	
<p>AU 328.36</p>	<p>To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows),^{fn5} individually and taken as a whole, need to be realistic and consistent with:</p> <ul style="list-style-type: none"> a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances; b. Existing market information; c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies; d. Assumptions made in prior periods, if appropriate; e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable; f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; and g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate. <p>Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience.</p>	<p>Issuers E and J</p>
<p><u>Footnote to AU 328.36</u></p> <p>^{fn5} The auditor also should consider requirements of GAAP that may influence the selection of assumptions (see FASB Concepts Statement No. 7).</p>		

AU 328.39	The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.	Issuer E
Developing Independent Fair Value Estimates for Corroborative Purposes		
AU 328.40	The auditor may make an independent estimate of fair value (for example, by using an auditor-developed model) to corroborate the entity's fair value measurement. ^{fn} ⁶ When developing an independent estimate using management's assumptions, the auditor evaluates those assumptions as discussed in paragraphs .28 to .37. Instead of using management's assumptions, the auditor may develop his or her own assumptions to make a comparison with management's fair value measurements. In that situation, the auditor nevertheless understands management's assumptions. The auditor uses that understanding to ensure that his or her independent estimate takes into consideration all significant variables and to evaluate any significant difference from management's estimate. The auditor also should test the data used to develop the fair value measurements and disclosures as discussed in paragraph .39.	Issuers I and V
<p><u>Footnote to AU 328.40</u></p> <p>^{fn6} See section 329, Analytical Procedures.</p>		
DISCLOSURES ABOUT FAIR VALUES		
AU 328.43	The auditor should evaluate whether the disclosures about fair values made by the entity are in conformity with GAAP. ^{fn8} Disclosure of fair value information is an important aspect of financial statements. Often, fair value disclosure is required because of the relevance to users in the evaluation of an entity's performance and financial position. In addition to the fair value information required under GAAP, some entities disclose voluntary additional fair value information in the notes to the financial	Issuers C and G

	statements.	
Footnote to AU 328.43		
<p>^{fn 8} See also paragraph 31 of Auditing Standard No. 14, Evaluating Audit Results.</p>		
EVALUATING THE RESULTS OF AUDIT PROCEDURES		
AU 328.47	The auditor should evaluate the sufficiency and competence of the audit evidence obtained from auditing fair value measurements and disclosures as well as the consistency of that evidence with other audit evidence obtained and evaluated during the audit. The auditor's evaluation of whether the fair value measurements and disclosures in the financial statements are in conformity with GAAP is performed in the context of the financial statements taken as a whole (see paragraphs 12 through 18 and 24 through 27 of Auditing Standard No. 14, Evaluating Audit Results).	Issuer G
AU Section 329, Substantive Analytical Procedures		
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Availability and Reliability of Data		
AU 329.16	<p>Before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information. The auditor obtains assurance from analytical procedures based upon the consistency of the recorded amounts with expectations developed from data derived from other sources. The reliability of the data used to develop the expectations should be appropriate for the desired level of assurance from the analytical procedure. The auditor should assess the reliability of the data by considering the source of the data and the conditions under which it was gathered, as well as other knowledge the auditor may have about the data. The following factors influence the auditor's consideration of the reliability of data for purposes of achieving audit objectives:</p> <ul style="list-style-type: none"> • Whether the data was obtained from independent sources outside the entity or from sources within the entity • Whether sources within the entity were 	Issuers K, Q, and S

	<p>independent of those who are responsible for the amount being audited</p> <ul style="list-style-type: none"> • Whether the data was developed under a reliable system with adequate controls • Whether the data was subjected to audit testing in the current or prior year • Whether the expectations were developed using data from a variety of sources 	
Precision of the Expectation		
AU 329.17	<p>The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.</p>	Issuer Q
Investigation and Evaluation of Significant Differences		
AU 329.20	<p>In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.</p>	Issuers K, M, and Q
AU 329.21	<p>The auditor should evaluate significant unexpected differences. Reconsidering the methods and factors used in developing the expectation and inquiry of management may assist the auditor in this regard. Management responses, however, should ordinarily be corroborated with other evidential matter. In those cases when an explanation for the difference cannot be obtained, the auditor should obtain sufficient evidence about the assertion by performing other audit procedures to satisfy himself as to whether the difference is a misstatement. In designing such other procedures, the auditor should</p>	Issuer K

	consider that unexplained differences may indicate an increased risk of material misstatement. (See Auditing Standard No. 14, Evaluating Audit Results.)	
AU Section 342, Auditing Accounting Estimates		
AU 342.04	The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole. As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.	Issuers F and H
EVALUATING ACCOUNTING ESTIMATES		
Evaluating Reasonableness		
AU 342.11	<p>Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:</p> <ul style="list-style-type: none"> a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation. b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. 	Issuers A, B, C, D, E, F, G, H, L, M, O, and W

	<p>e. Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose.</p> <p>f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions.</p> <p>g. Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions.</p> <p>h. Consider using the work of a specialist regarding certain assumptions (section 336, Using the Work of a Specialist).</p> <p>i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.</p>	
AU 342.12	Develop an expectation. Based on the auditor's understanding of the facts and circumstances, he may independently develop an expectation as to the estimate by using other key factors or alternative assumptions about those factors.	Issuers L and N
AU Section 350, Audit Sampling		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AU 350.18A	Paragraphs 8 - 9 of Auditing Standard No. 11, Consideration of Materiality in Planning and Performing an Audit, describe the auditor's responsibilities for determining tolerable misstatement at the account or disclosure level. When the population to be sampled constitutes a portion of an account balance or transaction class, the auditor should determine tolerable misstatement for the population to be sampled for purposes of designing the sampling plan. Tolerable misstatement for the population to be sampled ordinarily should be less than tolerable misstatement for the account balance or transaction class to allow for the possibility that misstatement in the portion of the account or transaction class not subject to audit sampling, individually or in combination with other misstatements,	Issuer B

	would cause the financial statements to be materially misstated.	
AU 350.19	The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed." After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details. ^{fn3} Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuers A, B, D, K, M, and Q
<p><u>Footnote to AU 350.19</u></p> <p>^{fn3} Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.</p>		
AU 350.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	Issuers A, B, D, K, M, and Q
AU 350.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting	Issuers A, B, D, K, M, and Q

	from an efficient and effectively designed statistical sample.	
DUAL-PURPOSE SAMPLES		
AU 350.44	<p>In some circumstances, the auditor may design a sample that will be used for dual purposes: as a test of control and as a substantive test. In general, an auditor planning to use a dual-purpose sample would have made a preliminary assessment that there is an acceptably low risk that the rate of deviations from the prescribed control in the population exceeds the tolerable rate. For example, an auditor designing a test of a control over entries in the voucher register may design a related substantive test at a risk level that is based on an expectation of reliance on the control. The size of a sample designed for dual purposes should be the larger of the samples that would otherwise have been designed for the two separate purposes. In evaluating such tests, deviations from the control that was tested and monetary misstatements should be evaluated separately using the risk levels applicable for the respective purposes.</p> <p>Note: Paragraph 47 of Auditing Standard No. 13, The Auditor's Responses to the Risks of Material Misstatement, provides additional discussion of the auditor's responsibilities for performing dual-purpose tests.</p>	Issuer A