

Report on
2013 Inspection of Grant Thornton LLP
(Headquartered in Chicago, Illinois)

Issued by the
Public Company Accounting Oversight Board
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SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002

2013 INSPECTION OF GRANT THORNTON LLP

Preface

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Grant Thornton 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 August 2013 through April 2014. The inspection team performed field work at the Firm's National Office and at 17 of its approximately 54 U.S. practice offices.

A. Review of Audit Engagements

The 2013 inspection of the Firm included reviews of portions of 36 audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. One of the deficiencies relates to auditing aspects of an issuer's financial statements that the issuer restated after the primary inspection procedures.^{2/}

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

^{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.

^{2/} The Board's inspection process did not include review of any additional audit work related to the restatement.

auditing standards in this sub-Part, unless the lack of compliance with these standards 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.^{3/}

^{3/} 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

In this audit, the Firm failed to identify a departure from generally accepted accounting principles ("GAAP") that it should have identified and addressed before issuing its audit opinion. Specifically, the issuer held an investment in a variable interest entity ("VIE") that was not consolidated. The issuer met the criteria under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 810, Consolidation, to be the primary beneficiary of the VIE and was required to consolidate this investment. (AS No.14, paragraph 30)

A.2. Issuer B

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

- The Firm's audit approach involved testing information technology general controls ("ITGCs") over the issuer's general ledger application, which included the module used for property and equipment, and over certain applications used for revenue, accounts receivable, and inventory. The Firm's procedures to test ITGCs over these applications, however, were not sufficient, as it failed to sufficiently evaluate the effects of deficiencies that were identified in user-access and change-management controls. As a result of these deficiencies in the Firm's testing, which are described further below, the Firm failed to establish a basis for reliance on controls over the accuracy and completeness of data and reports obtained from these applications and used (a) in the operation of certain of the issuer's controls that the Firm tested over revenue, accounts receivable, inventory, and property and equipment, and/or (b) in the Firm's substantive or control testing of these areas. (AS No. 5, paragraphs 42 and 47; AS No. 15, paragraph 10)

The deficiencies in testing ITGCs are as follows –

- The Firm failed to perform any procedures to evaluate the effects of the deficiencies in user-access controls for the applications noted above. (AS No. 5, paragraphs 47 and 48)

- The Firm failed to perform any procedures to evaluate the effects of deficiencies in change-management controls for one of the applications noted above related to revenue and accounts receivable. (AS No. 5, paragraphs 47 and 48)
- The Firm identified a monitoring control as an important compensating control for the deficiencies in change-management controls for certain inventory, revenue, and accounts receivable applications and the property and equipment module. The Firm's testing of this control, however, was not sufficient. Specifically –
 - The sample size of two that the Firm used to test the control for certain of the inventory, revenue, and accounts receivable applications was too small to provide sufficient evidence. (AU 350, paragraphs .37 and .38)
 - The Firm tested the monitoring control for certain revenue, accounts receivable, and inventory applications, and the property and equipment module, seven months prior to year end, but the Firm's procedures to update the results of this interim testing to year end were limited to inquiry. (AS No. 5, paragraphs 55 and 56)
- The issuer used data and reports obtained from other applications in the operation of certain controls over revenue, accounts receivable, and inventory, and the Firm used certain of the data and reports in its testing of these controls. The Firm chose not to test ITGCs over these applications and failed otherwise to establish a basis for reliance on the data and reports from these applications. (AS No. 5, paragraph 39; AS No. 15, paragraph 10)
- The Firm's procedures related to inventory were insufficient. Specifically –
 - The Firm's procedures to test controls over the valuation of inventory were insufficient. Specifically, the Firm failed to perform sufficient procedures to test the one control it had identified over the valuation of inventory that the issuer accounted for using the retail method, which represented a significant portion of total inventory, as its procedures were limited to performing a

walkthrough of the process, 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 substantive procedures to test the valuation of the inventory that was calculated using the retail method of accounting. Specifically, the Firm's procedures were limited to testing only one input used in that calculation, without testing other important inputs or the accuracy of the calculation. (AS No. 13, paragraph 8)
- The Firm's procedures to test the existence of, and controls over the existence of, the issuer's inventory were insufficient. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested whether the issuer's cycle-count procedures addressed that inventory items were counted in accordance with the frequency schedule established by management. (AS No. 5, paragraphs 42 and 44; AU 331, paragraph .11)
- The Firm's procedures related to vendor incentives, which reduced cost of sales, were insufficient. Specifically –
 - The Firm's procedures to test controls over vendor incentives were insufficient. The Firm tested two controls, which consisted of (a) verifying whether vendor incentive agreements existed, determining whether approvals existed for certain amounts, and comparing calculated vendor incentives to the amounts recorded in the general ledger, and (b) approving inventory price changes. The Firm, however, failed to identify and test any controls over the calculation of the amount of vendor incentives recorded. (AS No. 5, paragraph 39)
 - The Firm's substantive procedures to test vendor incentives, which consisted of analytical procedures, were insufficient, as follows.
 - The Firm performed analytical procedures in which it compared current-period gross profit by location to the prior-period corresponding amounts. These procedures, however, provided little to no substantive assurance. Specifically –

- The Firm established a threshold for investigating unexpected differences that was high enough to allow for the possibility that a combination of uninvestigated misstatements could aggregate to an unacceptable amount. (AU 329, paragraph .20)
 - The Firm failed to perform procedures to obtain corroboration of management's explanations for differences in excess of its established thresholds. (AU 329, paragraph .21)
- The Firm also performed other analytical procedures regarding vendor incentives; however, these procedures provided little to no substantive assurance, as they consisted of simply comparing the current-year annual amounts by general ledger account to the corresponding amounts in the prior year and investigating certain changes between the amounts. (AU 329, paragraphs .13, .17, and .20)
- The Firm designed its substantive procedures – including sample sizes – to test revenue and certain 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. As a result, the sample sizes the Firm used to test revenue and certain accounts receivable 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 related to property and equipment were insufficient. Specifically –
 - The Firm selected for testing a control over the possible impairment of property and equipment, which involved management's reviews of an impairment analysis; however, the Firm's procedures to test this control were insufficient. Specifically, the Firm's procedures were limited to observing signatures as evidence that a review had occurred and inquiring of management, 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 any procedures to evaluate the reasonableness of the criteria the issuer used to determine which locations required evaluation for possible impairment. (AS No. 13, paragraph 8)

A.3. Issuer C

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 issuer had operating facilities in multiple locations in both U.S and non-U.S. locations. For a significant number of the issuer's locations that, in the aggregate, presented a reasonable possibility of material misstatement, the Firm failed to perform sufficient procedures to test controls over revenue, accounts receivable, and inventory. The Firm selected for testing three controls over these accounts at these locations, but the Firm's testing of those controls was insufficient in the following respects —
 - For one control, which involved the comparison of recorded financial statement amounts and related metrics to budgeted and historical amounts and the discussion of significant differences, the Firm's testing was insufficient, as its procedures were limited to (a) inquiring of management, (b) observing evidence that personnel involved in the operation of the control attended the meetings where the review was performed, (c) observing signatures as evidence that a review had occurred for certain of the issuer's locations, and (d) noting, for one location, that explanations for certain variances were provided. The Firm, however, failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements. Further, the Firm failed to identify and test any controls over the accuracy and completeness of certain data used in the operation of this control. (AS No. 5, paragraphs 39, 42, 44, and B10)
 - The Firm failed to evaluate whether the other two controls, which involved a review of the financial statements and related disclosures by management, and a reconciliation of subsidiary general ledgers to the consolidated general ledger, could effectively

prevent or detect material misstatements to revenue, accounts receivable, and inventory. (AS No. 5, paragraphs 42, 44, and B10)

- For the locations discussed above, the Firm failed to perform any substantive procedures to test revenue, accounts receivable, and inventory. (AS No. 9, paragraphs 11 and 12)

A.4. Issuer D

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

- For the two controls over certain deposit liability accounts that the Firm selected for testing, the Firm used the results of its substantive procedures as evidence of operating effectiveness without performing any direct testing of the controls. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of reports used in the performance of the controls. (AS No. 5, paragraphs 39, 44, and B9)
- The Firm's procedures to test controls over investments in available-for-sale ("AFS") securities were insufficient. Specifically –
 - The Firm failed to identify and test any controls over the existence of investments in AFS securities. (AS No. 5, paragraph 39)
 - The Firm selected for testing one control over the valuation of AFS securities, which consisted of the issuer's comparison of the recorded fair value estimates, which it obtained from an external pricing service, to fair value estimates that it obtained from another external pricing service; the issuer performed this comparison for a small number of securities. The Firm's procedures to test this control were limited to inquiring of management, reperforming the comparisons, tracing the fair value estimates to source documents, and noting that significant variances were investigated. These procedures did not include evaluating whether this control's operation could effectively prevent or detect material misstatements, including whether the control encompassed a sufficient number of AFS securities. Further, the Firm failed to

identify and test any controls over the completeness of a report that the issuer used in the performance of this control. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm's substantive procedures to test the valuation of one category of AFS securities consisted of obtaining values from a pricing service and comparing those values to the issuer's recorded values. The Firm's procedures to test this category of securities were not sufficient because it failed to obtain an understanding of the specific assumptions underlying the fair value measurements that it obtained from the pricing service. (AU 328, paragraph .40)
- The Firm failed to perform sufficient procedures to test the disclosure of the AFS securities described above 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 securities were observable or unobservable. (AU 328, paragraph .43)
- The Firm failed to perform sufficient testing related to a significant component of revenue. Specifically –
 - The Firm failed to identify and test any controls over the completeness, occurrence, and valuation of this component of revenue. (AS No. 5, paragraph 39)
 - The Firm failed to perform sufficient substantive testing of this component of revenue, as follows –
 - The Firm selected a sample of contracts for testing, but limited its procedures on the selected contracts to two out of the 12 months of activity related to each contract. (AU 350, paragraph .24)
 - The Firm failed to test, or to test controls over, the completeness and accuracy of certain important transaction data, obtained from third-party processors, that the issuer imported into its general ledger and used in its calculation of this component of revenue. (AS No. 15, paragraph 10)

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 –

- For one of the issuer's two divisions, the Firm tested ITGCs to support its conclusions regarding the effectiveness of certain application controls over revenue and inventory. The Firm identified several deficiencies in ITGCs over user access and program change management for the important applications supporting revenue and inventory. The Firm's evaluation of the deficiencies was not sufficient. Specifically –
 - Although the Firm noted that the users with inappropriate access did not have financial reporting responsibilities, it failed to evaluate whether these individuals performed inappropriate activities related to the financial accounts. (AS No. 5, paragraphs 47 and 48)
 - Although the Firm tested controls over change management that it considered to compensate for the deficiencies, the Firm selected its sample of program changes for testing from a system-generated report that included only the most recent program change for each application. The Firm failed to determine whether there were additional program changes during the year. (AS No. 5, paragraph 68; AU 350, paragraph .39)
- For the issuer's other division, the Firm tested a control over revenue that consisted of a review of all revenue transactions to assess the appropriateness of revenue recognition. The Firm identified four instances where the control failed to identify errors in revenue recognition, two of which involved the inappropriate deferral of revenue, and determined that the control was not operating effectively. To assess the severity of the deficiency, the Firm identified all of the revenue transactions containing terms that were the same as those where the exceptions were identified, and concluded that the potential magnitude of the errors was not material. The Firm, however, failed to perform any procedures to determine whether the potential problems were isolated to transactions containing terms that were the same as those where the exceptions were identified. (AS No. 5, paragraphs 47 and 48)

- The Firm's procedures to test controls over the completeness of revenue were insufficient in the following respects –
 - For one division, the Firm tested a control that involved the issuer's review of a report listing uninvoiced shipments. The Firm's procedures to test this control were insufficient, as the Firm failed to identify and test any controls over the accuracy and completeness of that report. (AS No. 5, paragraph 39)
 - For the other division, the Firm tested a control over revenue recognition that involved the issuer's monthly review of a listing of all sales orders to evaluate the appropriateness of revenue recognition. The Firm's procedures to test this control were insufficient, as its procedures were limited to inquiring of management, attending one meeting that constituted part of the operation of the control, observing evidence that the review had occurred, and comparing certain data used in the performance of the control to supporting documentation. The Firm failed to evaluate whether the control operated at a level of precision that would prevent or detect material misstatements, in that it failed to evaluate the nature of the review procedures performed, the criteria used by the control owner to identify items for investigation, and whether specific items that were investigated were appropriately resolved. (AS No. 5, paragraphs 42 and 44)
- The Firm's substantive procedures to test revenue for one of the divisions were insufficient. Specifically –
 - The Firm used an attribute sampling approach and determined its sample size based on an expectation that there would be no testing exceptions. The Firm, however, identified the four errors in its sample that are described above; it then identified all transactions that it believed were susceptible to the identified errors and performed additional procedures with respect to those transactions. The Firm failed to perform any procedures to determine whether errors were isolated to transactions containing terms that were the same as those where the errors were identified. (AU 350, paragraph .28)

- The Firm failed to perform sufficient procedures to test the completeness of revenue. Specifically, the Firm selected its sample for testing from the population of revenue transactions recorded during the year; however, that population was not appropriate to address the completeness of revenue. (AU 350, paragraph .17)

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 sufficiently test controls that it had selected over the possible impairment of goodwill and other intangible assets, which consisted of management's review of various aspects of the impairment analyses. Specifically, the Firm's procedures to test these controls were limited to inquiring of management; reading emails; attending certain conference calls, between management and an external valuation specialist, that were part of the controls' operation; and performing procedures to test the issuer's impairment analyses. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements, because it failed to obtain an understanding of the review procedures performed and assess their effectiveness. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to sufficiently test certain controls over revenue that it had selected, which consisted of the review and/or approval of various activities or assumptions related to the calculation of revenue. Specifically, the Firm's procedures were limited to tracing certain data used in the performance of the controls to source documents, obtaining evidence that certain approvals that constituted part of the controls had occurred, and, for one control, noting that the contract type and approved revenue recognition method for a sample of contracts were entered accurately into the issuer's system. The Firm, however, failed to test, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements, because it failed to obtain an understanding of the review procedures performed and assess their effectiveness. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to perform sufficient substantive testing of revenue, as follows –
 - The Firm designed its substantive procedures – including its sample size – to test revenue based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls over revenue that are discussed above. As a result, the sample size used to test revenue was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)
 - The substantive procedures the Firm used to test the sample of revenue contracts were not sufficient. Specifically, the Firm failed to evaluate (a) the appropriateness of the revenue recognition method the issuer used and (b) whether deliverables in contracts that contained multiple deliverables represented separate units of accounting. (AS No. 14, paragraph 30)

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 Firm identified a deficiency in the issuer's controls related to the valuation of investment securities and determined that this deficiency was a significant deficiency. In evaluating the severity of this deficiency, the Firm identified and tested two controls that it considered to be compensating controls, consisting of management's reviews of certain data and reports and its recalculation of the yields for certain of the investments. The Firm, however, failed to evaluate whether the controls addressed the risks intended to be addressed by the deficient controls. (AS No. 5, paragraphs 42, 44, and 68)
- The Firm selected for testing one control over the allowance for loan losses ("ALL"), consisting of management's review of the ALL methodology and the loss factors used to calculate the ALL; however, the Firm failed to sufficiently test this control. Specifically, the Firm's procedures were limited to obtaining and reading documents, which were

used as part of the operation of the control, in order to determine whether certain aspects of the review had occurred, 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 substantive procedures to test the general reserve component of the ALL. Specifically –
 - The Firm failed to perform sufficient procedures to test the reasonableness of the loan grades that the issuer assigned to individual loans and used when calculating the general reserve component. Specifically, the issuer used externally prepared appraisals to determine the fair value of the underlying collateral for certain loans; these fair values were an important factor in determining loan grade assignments. The Firm's testing of the appraisals was not sufficient, as it failed to (a) obtain an understanding of the assumptions the appraisers used to value the collateral, (b) test the accuracy and completeness of the data the appraisers used to value the collateral, and (c) evaluate the qualifications of the appraisers. In addition, the appraisals had valuation dates ranging from three months to more than five years before the balance sheet date, and the Firm failed to evaluate the effect of the ages of the appraisals on its conclusion regarding the fair value estimate of the collateral at the balance sheet date. (AU 336, paragraphs .08 and .12)
 - The Firm failed to perform sufficient procedures to evaluate the reasonableness of important assumptions that the issuer used to calculate the general reserve component for each loan grade. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the reasonableness of the qualitative adjustments the issuer made to the historical data to derive the loss factors applied to each loan grade, beyond (a) reading issuer-prepared documentation, which contained only general descriptions of the reasons for the adjustments, and (b) considering the trends in the components of the ALL, without identifying and evaluating any support for the amount of the adjustments. (AU 342, paragraph .11)

A.8. Issuer H

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

- With respect to one of the issuer's locations, the Firm's testing of certain controls over revenue, which involved (a) the review and approval of invoices; (b) the preparation of reconciliations between the location's revenue application and the general ledger, and the review of these reconciliations; and (c) periodic meetings to discuss and review revenue recognition, was insufficient. Specifically, the Firm's procedures were limited to observing evidence that the reviews, reconciliations, and meetings had occurred; there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)
- The Firm's substantive procedures to test revenue from contracts accounted for using the percentage-of-completion method of accounting were insufficient. Specifically, the Firm's procedures to evaluate the reasonableness of the estimated costs to complete performance under the contracts, which the issuer used when calculating the amount of revenue to be recognized, were limited to inquiring of management and observing evidence of management's review and approval of the estimated costs to complete. (AU 342, paragraph .11)
- The Firm failed to identify and test any controls over the monitoring of indicators of the possible impairment of finite-lived intangible assets. (AS No. 5, paragraph 39)

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 Firm selected for testing one control over the issuer's accounting for income taxes, which consisted of a review by an external party of the tax calculations, tax filings, tax positions, and the tax provision. The Firm's procedures to test that control, however, were insufficient. Specifically, the Firm's procedures were limited to obtaining evidence that the review had occurred, including by observing meetings between the issuer and the external party and reading documents prepared or reviewed by the external party, and inquiring of management and the external party. The Firm also referenced certain of its substantive testing when addressing its evaluation of the effectiveness of this control. The Firm, however, failed to test, through any of its procedures, whether the control operated at a level of precision that would prevent or detect material misstatements, because it failed to obtain an understanding of the review procedures performed and assess their effectiveness. (AS No. 5, paragraphs 42, 44, and B9)
- During the year, customers exchanged certain previously purchased products, including some that had been purchased in prior years, for new products. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had obtained evidence regarding the nature of the exchanges and evaluated whether the issuer's practice of allowing exchanges should have affected its policy for revenue recognition. (AS No. 14, paragraph 30)
- The Firm failed to perform sufficient substantive procedures to test one type of revenue for one component, which totaled an amount that was approximately seven times the Firm's established materiality level, as its procedures were limited to confirming only two accounts receivable at year end, scanning the sales journal for one month for significant or unusual transactions, and performing certain analytical procedures that were not designed to provide substantive assurance. (AS No. 13, paragraph 8)

A.10. Issuer J

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 majority of its revenue using an application that electronically captured cost data from external sources and calculated the amount of revenue to be recognized based upon (a) the terms of each underlying agreement and (b) the timing of the costs related to the revenue for each agreement. The Firm decided not to test the issuer's automated controls for this application. Instead, the Firm identified and tested (a) controls over the setup of accounts and contracts and over cash receipts and revenue-related journal entries and (b) a control over revenue activities reported by this application. This latter control consisted of management's review of a daily trend analysis of revenue aggregated into the two product lines that constituted this type of revenue. The Firm failed to evaluate whether this control was designed so that it could effectively prevent or detect material misstatements. In addition, this control, and certain of the other controls that the Firm tested, relied on the accuracy and completeness of data and/or reports generated from the application. The Firm, however, failed to identify and test any controls over the accuracy and completeness of those data and reports. (AS No. 5, paragraphs 39 and 42)
- The Firm failed to perform sufficient substantive procedures to test this type of revenue. Specifically, as noted above, the Firm failed to identify and test any controls over the application-generated data and reports, and the Firm's substantive procedures to test the accuracy and completeness of certain reports it used in its testing of revenue were limited to comparing summarized cost data included in those reports to invoices. The Firm, however, failed to test whether each agreement for which costs were incurred was included in the reports and whether the costs were appropriately allocated among the agreements. In addition, the Firm failed to test the accuracy and completeness of certain other data included in those reports that were important to the calculation of revenue. (AS No. 15, paragraph 10)
- The Firm failed to sufficiently test the one control that it selected over the calculation of share-based compensation expense, consisting of the issuer's review and approval of the share-based compensation calculations and the assumptions used in those calculations. Specifically, the Firm's procedures were limited to comparing the assumptions used in the calculation to supporting documentation and obtaining evidence that a review and approval of the calculation had occurred, 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 certain data that the issuer used in the operation of this control. (AS No. 5, paragraphs 39, 42, and 44)

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 failed to perform sufficient procedures to test a control it selected over the category of revenue that represented the majority of the issuer's revenue. The control consisted of the compilation and resolution of exceptions identified through an automated reconciliation of daily sales to bank deposits. Exceptions that reached certain thresholds, and that had not been resolved within a certain timeframe, were recorded on a manually prepared spreadsheet and distributed to issuer personnel for resolution. The Firm failed to —
 - Identify and test any controls over the accuracy and completeness of the underlying sales data used to perform the automated reconciliation; (AS No. 5, paragraph 39)
 - Identify and test any controls over the accuracy and completeness of the manually prepared spreadsheets, including whether the automated application correctly determined variances between sales and bank deposit data; and (AS No. 5, paragraph 39)
 - Test whether the necessary adjustments to revenue identified through the operation of the control were appropriately recorded. (AS No. 5, paragraphs 42 and 44)
- The Firm failed to perform sufficient substantive procedures to test this category of revenue, as the Firm's procedures were limited to obtaining a sample of the issuer's manually prepared spreadsheets described above and noting that the variances identified in those spreadsheets were documented as resolved. The Firm, however, as noted above, failed to

test whether any required adjustments to revenue were appropriately recorded. In addition, as noted above, the Firm failed to identify and test any controls over the accuracy and completeness of the spreadsheets, and it did not, in the alternative, substantively test the accuracy and completeness of the data included in the spreadsheets. (AS No. 13, paragraphs 8 and 13; AS No. 15, paragraph 10)

A.12. Issuer L

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 issuer licensed the use of its technologies to be included in products manufactured by its customers. The majority of these license agreements required the customer to pay the issuer a per-unit fee based on the number of units the customer produced. The issuer calculated the revenue under these license agreements based upon production data provided by its customers. The Firm, however, failed to identify and test any controls over the accuracy and completeness of the production data, and failed to test the accuracy and completeness of the production data that it used in its substantive testing procedures to test this revenue. (AS No. 5, paragraph 39; AS No. 15, paragraph 10)

A.13. Issuer M

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 selected for testing one control over the accounting for business combinations, which consisted of management's review of the purchase accounting worksheet and the related external valuation reports; however, the Firm failed to sufficiently test this control. Specifically, the Firm's procedures were limited to obtaining evidence that the reviews had occurred and comparing amounts in the issuer's purchase accounting worksheet to the valuation report, 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 selected for testing two controls over the evaluation of the possible impairment of property and equipment, consisting of (a) the review of impairment analyses and (b) the review and approval of the

journal entries to record impairments. The Firm's procedures to test these controls were insufficient. For the first control, the procedures were limited to comparing data used in the operation of the control to supporting documentation, comparing the calculated impairment amounts to the general ledger, and testing the mathematical accuracy of the issuer's analysis. For the second control, the Firm's procedures were limited to obtaining evidence that the reviews and approvals had occurred and comparing the calculated impairment to the journal entry. In addition, the Firm stated that certain of its substantive tests were dual-purpose in nature and that these tests provided evidence of the effectiveness of these controls. The Firm, however, failed to test, through any of its procedures, whether these controls operated at a level of precision that would prevent or detect material misstatements, because it failed to obtain an understanding of the review procedures performed and assess their effectiveness. (AS No. 5, paragraphs 42, 44, and B9)

- The Firm's procedures to test controls over the issuer's accounting for inventory were insufficient. Specifically –
 - The controls over the valuation of inventory that the Firm selected for testing consisted of (a) the review and approval of price changes entered into the system that was used to generate purchase orders and (b) the comparison of the total purchase order amounts to the payments made and the investigation of any differences. The Firm failed to test any control that would address whether the cost of inventory items recorded in the issuer's system agreed to the amounts paid. (AS No. 5, paragraph 39)
 - The Firm failed to evaluate the effects of the differences it identified in its substantive testing of the issuer's physical inventory count on its conclusions about the effectiveness of the issuer's controls over inventory. (AS No. 5, paragraph B8)

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 certain application controls over revenue and the valuation of inventory that it selected. Specifically, the scope of the Firm's testing of these application controls was based in part on the Firm's conclusion that ITGCs were effective, and it consisted of testing only one instance of the operation of each control. The Firm's testing of ITGCs, however, was not sufficient to support the Firm's conclusion that they were effective. Specifically –
 - The Firm's testing of controls over program change management was insufficient. Specifically, the Firm limited its procedures to testing one of the various processes that could have been used to make program changes, without determining that this process was the only process by which changes had been made. (AS No. 5, paragraphs 42 and 44)
 - The Firm tested a control that consisted of a periodic review and approval of access rights granted to system users. The Firm's testing of this control was insufficient, however, as the Firm failed to test whether the access that was provided was consistent with the access approved by management. (AS No. 5, paragraph 44)
- The Firm selected for testing a control over the allowance for doubtful accounts that consisted of a review of the aged accounts receivable. The Firm, however, failed to sufficiently test this control, as its procedures were limited to obtaining evidence that the review of the aged accounts receivable had occurred and noting that the resulting journal entry was recorded correctly, 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 accounts receivable aging report that the issuer used in the performance of the control. (AS No. 5, paragraphs 39, 42, and 44)
- The Firm's procedures to test the valuation of certain past-due accounts receivable that it selected for substantive testing were insufficient. Specifically, the Firm's testing of the accounts it selected was limited to inquiring of management, without obtaining corroboration of the explanations it received. (AS No. 13, paragraph 8)

A.15. Issuer O

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer made two significant acquisitions. The Firm selected for testing certain controls that consisted of the review and approval of the accounting for the acquisitions and the preparation of support for the related disclosures in the financial statements; however, it failed to sufficiently test these controls. Specifically, the Firm's procedures were limited to comparing certain data used in the performance of the controls to source documents and observing evidence that certain reviews that constituted part of the controls had occurred. The Firm also referenced certain of its substantive testing when addressing its evaluation of the effectiveness of these controls. The Firm failed to test, however, through any of its procedures, whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42, 44, and B9)

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, as its procedures to test controls over the existence of inventory were insufficient. Specifically –

- The Firm selected for testing a periodic physical inventory count control that operated during the first and third quarters. The Firm's procedures to test this control were insufficient, as they did not include observing the issuer's inventory count procedures and were limited to (a) inquiring of management as to how the inventory count process was performed, (b) reading the issuer's physical inventory count policies, (c) obtaining evidence that the inventory counts had occurred and that unresolved differences were reviewed and recorded, and (d) inspecting a listing of the inventory locations to be counted, including the date and assigned counter. (AS No. 5, paragraphs 42 and 44)
- The Firm's procedures to test controls over changes in inventory between the third quarter, when the issuer's periodic physical inventory count control last operated, and the balance sheet date were insufficient. Specifically, the Firm tested two application controls, which prevented (a) inventory from being recorded without a receiving document and (b) manual adjustments of inventory shipping and receiving dates within the system. The Firm, however, failed to identify and test any controls over

whether the quantities and costs of inventory that was purchased or sold during the period were accurately recorded. (AS No. 5, paragraph 39)

A.17. Issuer Q

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. During the year, the issuer acquired a significant business, and it accounted for the acquisition as a business combination. The issuer engaged an external specialist to determine the fair value of the net assets of the acquired business. The specialist's initial valuation resulted in a net asset value that was significantly higher than the consideration paid. Upon reassessment, the specialist determined that an adjustment to the valuation of the fixed assets was necessary to account for certain economic obsolescence of those assets. As a result, the value of the fixed assets was adjusted by an amount such that the net asset value of the acquired business approximated the consideration paid. The Firm's procedures to evaluate this adjustment were limited to (a) reading the valuation analysis prepared by the issuer's specialist, (b) inquiring of the specialist, and (c) performing a sensitivity analysis that was limited to evaluating the effect on net depreciation and amortization expense if the adjustment had been larger and if the resulting additional decrease in the value of fixed assets had been reallocated to identifiable intangible assets. The Firm's procedures did not include evaluating the reasonableness of the assumptions underlying the amount of adjustment. (AU 328, paragraphs .26, .28, and .39)

A.18. Issuer R

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as the Firm failed to perform sufficient procedures to test the underlying quantities and prices used in the valuation of revenue. Specifically, the Firm's procedures were limited to (a) performing analytical procedures that provided little to no substantive assurance and (b) comparing invoices to other issuer-prepared documents that did not show quantities or prices. The Firm also confirmed the amounts for a sample of accounts receivable outstanding at year end and tested the timing of revenue recognition, but these procedures provided little assurance regarding the valuation of total revenue. (AS No. 13, paragraph 8)

A.19. Issuer S

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements because its procedures to test inventory were insufficient. Specifically –

- The Firm failed to perform sufficient procedures to test the valuation of finished goods inventory, as its procedures were limited to (a) performing an analysis of trends in inventory balances and related ratios that provided little to no substantive assurance and (b) obtaining information about variances between standard and actual costs and inquiring of management regarding these variances. (AS No. 13, paragraph 8)
- The Firm failed to perform sufficient procedures to test the valuation of raw materials inventory. Specifically, the Firm's procedures consisted of selecting a sample of items to test. For the majority of the items selected, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had compared the recorded amounts to any support other than issuer-generated purchase orders, which did not constitute evidence of the actual price paid for these items. (AS No. 13, paragraph 8)

A.20. Issuer T

In this audit, the Firm failed to perform sufficient procedures to test the possible impairment of intangible assets other than goodwill. The Firm failed to evaluate the reasonableness of the financial projections that the issuer used in its impairment analysis related to a reporting unit, to which a significant portion of the issuer's intangible assets other than goodwill was assigned, beyond (a) noting that the projections appeared reasonable based on historical and forecasted results and (b) comparing the projections to those made in the prior year. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered that (a) the issuer included a significant growth in revenue in its financial projections used in the analysis despite a significant decline in revenue for the most recent year and (b) in evaluating goodwill, the issuer's external specialist determined that the fair value of these intangible assets was below their carrying value. (AS No. 14, paragraph 3; AU 342, paragraph .11)

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which the Firm failed to comply with the requirement to obtain sufficient appropriate 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. 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
AS No. 5, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>	Issuers B, C, D, E, F, G, H, I, J, K, L, M, N, O, and P
AS No. 9, <i>Audit Planning</i>	Issuer C
AS No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i>	Issuers B, F, I, K, N, R, and S
AS No. 14, <i>Evaluating Audit Results</i>	Issuers A, F, I, and T
AS No. 15, <i>Audit Evidence</i>	Issuers B, D, J, L, and K
AU Section 328, <i>Auditing Fair Value Measurements and Disclosures</i>	Issuers D and Q
AU Section 329, <i>Substantive Analytical Procedures</i>	Issuer B
AU Section 331, <i>Inventories</i>	Issuer B
AU Section 336, <i>Using the Work of a Specialist</i>	Issuer G
AU Section 342, <i>Auditing Accounting Estimates</i>	Issuers G, H, and T
AU Section 350, <i>Audit Sampling</i>	Issuers B, D, E, and F

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,^{4/} 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 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

^{4/} When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with 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.

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.^{5/}

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 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

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

need for changes to its financial statements or reporting on ICFR, or to take steps to prevent reliance on previously expressed audit opinions.^{6/}

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 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.^{7/} 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

^{6/} 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.

^{7/} 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.

nature, significance, and frequency of deficiencies;^{8/} 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 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

^{8/} 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.

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.^{9/}

^{9/} 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.



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December 4, 2014

Re: Response to Part I of the Draft Report on the 2013 Inspection of Grant Thornton LLP

Dear Ms. Munter:

We appreciate the opportunity to respond to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2013 Inspection of Grant Thornton LLP (the "Report"). We support the PCAOB's mission to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports. We share these goals and recognize the important role the PCAOB's inspection process plays in improving audit quality, serving investors and safeguarding the public interest. The PCAOB inspection report and dialogue with the inspections staff is an integral component in focusing our efforts.

The Firm notes that approximately 75% of the engagements included in Part I of the Report relate to the audit of internal control over financial reporting. Since the completion of these audits, which were principally related to calendar year-end 2012 engagements, the Firm has implemented a number of significant actions related to auditing internal control as well as other areas and continue to invest resources focused on improving audit quality.

We carefully considered each of the report findings for the Issuer audits described in Part I of the Report. Accordingly, we took all steps necessary to fulfil our responsibilities under AU 390, *Consideration of Omitted Procedures after the Report Date* and AU 561 *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*.

We look forward to the continuing dialogue as we pursue our shared goals of improving audit quality across the profession and protecting the investing public.

Respectfully submitted,

By:

Stephen M. Chipman

Stephen M. Chipman
CEO

Jeffrey L. Burgess

Jeffrey L. Burgess
National Managing Partner of Audit Services

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 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		
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 B, C, D, E, H, J, K, L, M, N, and P
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 B, C, D, E, F, G, H, I, J, K, M, N, O, and P
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	Issuers B, C, D, E, F, G, H, I, J, K, M, N, O, and P

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
	<p>necessary authority and competence to perform the control effectively.</p> <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. 5.47	<p>Factors that affect the risk associated with a control include -</p> <ul style="list-style-type: none"> • The nature and materiality of misstatements that the control is intended to prevent or detect; • The inherent risk associated with the related account(s) and assertion(s); • Whether there have been changes in the volume or nature of transactions that might adversely affect control design or operating effectiveness; • Whether the account has a history of errors; • The effectiveness of entity-level controls, especially controls that monitor other controls; • The nature of the control and the frequency with which it operates; • The degree to which the control relies on the effectiveness of other controls (<u>e.g.</u>, the control 	Issuers B and E

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

	<p>environment or information technology general controls);</p> <ul style="list-style-type: none"> • The competence of the personnel who perform the control or monitor its performance and whether there have been changes in key personnel who perform the control or monitor its performance; • Whether the control relies on performance by an individual or is automated (<i>i.e.</i>, an automated control would generally be expected to be lower risk if relevant information technology general controls are effective); and <p>Note: A less complex company or business unit with simple business processes and centralized accounting operations might have relatively simple information systems that make greater use of off-the-shelf packaged software without modification. In the areas in which off-the-shelf software is used, the auditor's testing of information technology controls might focus on the application controls built into the pre-packaged software that management relies on to achieve its control objectives and the IT general controls that are important to the effective operation of those application controls.</p> <ul style="list-style-type: none"> • The complexity of the control and the significance of the judgments that must be made in connection with its operation. <p>Note: Generally, a conclusion that a control is not operating effectively can</p>	
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AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
	be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.	
AS No. 5.48	<p>When the auditor identifies deviations from the company's controls, he or she should determine the effect of the deviations on his or her assessment of the risk associated with the control being tested and the evidence to be obtained, as well as on the operating effectiveness of the control.</p> <p>Note: Because effective internal control over financial reporting cannot, and does not, provide absolute assurance of achieving the company's control objectives, an individual control does not necessarily have to operate without any deviation to be considered effective.</p>	Issuers B and E
AS No. 5.55	<i>Roll-Forward Procedures.</i> When the auditor reports on the effectiveness of controls as of a specific date and obtains evidence about the operating effectiveness of controls at an interim date, he or she should determine what additional evidence concerning the operation of the controls for the remaining period is necessary.	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 	Issuer B

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
	<p>interim date.</p> <p>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.</p>	
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.	Issuers E and G
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. 	Issuer M

AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
	Misstatements detected by substantive procedures. The extent of such misstatements might alter the auditor's judgment about the effectiveness of controls.	
AS No. 5.B9	To obtain evidence about whether a selected control is effective, the control must be tested directly; the effectiveness of a control cannot be inferred from the absence of misstatements detected by substantive procedures. The absence of misstatements detected by substantive procedures, however, should inform the auditor's risk assessments in determining the testing necessary to conclude on the effectiveness of a control.	Issuers D, I, M, and O
Multiple Locations Scoping Decisions		
AS No. 5.B10	<p>In determining the locations or business units at which to perform tests of controls, the auditor should assess the risk of material misstatement to the financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk.</p> <p>Note: The auditor may eliminate from further consideration locations or business units that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the company's consolidated financial statements</p>	Issuer C

AS No. 9, Audit Planning		
PLANNING AN AUDIT		
Multi-location Engagements		
AS No. 9.11	In an audit of the financial statements of a company with operations in multiple locations or business units, ^{13/} the auditor should determine the extent to which audit procedures should be performed at selected locations or business units to obtain sufficient	Issuer C

AS No. 9, Audit Planning		
	<p>appropriate evidence to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. This includes determining the locations or business units at which to perform audit procedures, as well as the nature, timing, and extent of the procedures to be performed at those individual locations or business units. The auditor should assess the risks of material misstatement to the consolidated financial statements associated with the location or business unit and correlate the amount of audit attention devoted to the location or business unit with the degree of risk of material misstatement associated with that location or business unit</p>	
AS No. 9.12	<p>Factors that are relevant to the assessment of the risks of material misstatement associated with a particular location or business unit and the determination of the necessary audit procedures include:</p> <ul style="list-style-type: none"> a. The nature and amount of assets, liabilities, and transactions executed at the location or business unit, including, e.g., significant transactions executed at the location or business unit that are outside the normal course of business for the company, or that otherwise appear to be unusual given the auditor's understanding of the company and its environment;^{14/} b. The materiality of the location or business unit;^{15/} c. The specific risks associated with the location or business unit that present a reasonable possibility^{16/} of material misstatement to the company's consolidated financial statements; d. Whether the risks of material misstatement associated with 	Issuer C

AS No. 9, Audit Planning

	<p>the location or business unit apply to other locations or business units such that, in combination, they present a reasonable possibility of material misstatement to the company's consolidated financial statements;</p> <p>e. The degree of centralization of records or information processing;</p> <p>f. The effectiveness of the control environment, particularly with respect to management's control over the exercise of authority delegated to others and its ability to effectively supervise activities at the location or business unit; and</p> <p>g. The frequency, timing, and scope of monitoring activities by the company or others at the location or business unit.</p> <p>Note: When performing an audit of internal control over financial reporting, refer to Appendix B, Special Topics, of Auditing Standard No. 5¹⁷⁷ for considerations when a company has multiple locations or business units.</p>	
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Footnotes to AS No. 9

^{14/} Paragraph .66 of AU sec. 316, *Consideration of Fraud in a Financial Statement Audit*.

^{15/} Paragraph 10 of Auditing Standard No. 11 describes the consideration of materiality in planning and performing audit procedures at an individual location or business unit

^{16/} There is a reasonable possibility of an event, as used in this standard, when the likelihood of the event is either "reasonably possible" or "probable," as those terms are used in the FASB Accounting Standards Codification, Contingencies Topic, paragraph 450-20-25-1.

^{17/} Paragraphs B10-B16 of Auditing Standard No. 5.

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 B, I, K, N, R, and S
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 K
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 . 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 and F
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	Issuers B and F

AS No. 13, The Auditor's Responses to the Risks of Material Misstatement		
	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.	
SUBSTANTIVE PROCEDURES		
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 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.	Issuers B and F
Footnote to AS No. 13		
<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>		

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 T

AS No. 14, Evaluating Audit Results		
Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS No. 14.30	<p>The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.</p> <p>Note: AU sec. 411, <i>The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles</i>, establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, <i>Evaluating Consistency of Financial Statements</i>, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.</p> <p>Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.</p>	Issuers A, F, and I

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:</p> <ul style="list-style-type: none"> • Test the accuracy and completeness of the information, or test the controls over the accuracy 	Issuers B, D, J, L, and K

AS No. 15, Audit Evidence		
	<p>and completeness of that information; and</p> <ul style="list-style-type: none"> Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. 	

AU Section 328, Auditing Fair Value Measurements and Disclosures		
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. 	Issuer Q
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 measurements and disclosures in the entity's financial statements.	Issuer Q
AU 328.39	The auditor should test the data	Issuer Q

AU Section 328, Auditing Fair Value Measurements and Disclosures		
	<p>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.</p>	
Developing Independent Fair Value Estimates for Corroborative Purposes		
AU 328.40	<p>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.</p>	Issuer D

AU Section 328, Auditing Fair Value Measurements and Disclosures		
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. 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 statements.	Issuer D
<u>Footnote to AU 328</u>		
^{fn 6} See section 329, <i>Analytical Procedures</i> .		

AU Section 329, Substantive Analytical Procedures		
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Plausibility and Predictability of the Relationship		
AU 329.13	It is important for the auditor to understand the reasons that make relationships plausible because data sometimes appear to be related when they are not, which could lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship can provide important evidence when appropriately scrutinized.	Issuer B
Precision of the Expectation		
AU 329.17	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	Issuer B

AU Section 329, Substantive Analytical Procedures		
	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.	
Investigation and Evaluation of Significant Differences		
AU 329.20	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.	Issuer B
AU 329.21	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 consider that unexplained differences may indicate an increased risk of material misstatement. (See Auditing Standard No. 14, <i>Evaluating Audit Results</i> .)	Issuer B

AU Section 331, Inventories		
INVENTORIES		
<p>AU 331.11</p>	<p>In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances. [Revised, June 1981, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No.39.]</p>	<p>Issuer B</p>

AU Section 336, Using the Work of a Specialist		
QUALIFICATIONS AND WORK OF A SPECIALIST		
<p>AU 336.08</p>	<p>The auditor should consider the following to evaluate the professional qualifications of the specialist in determining that the specialist possesses the necessary skill or knowledge in the particular field:</p> <ul style="list-style-type: none"> a. The professional certification, license, or other recognition of the competence of the specialist in his or her field, as appropriate b. The reputation and standing of 	<p>Issuer G</p>

AU Section 336, Using the Work of a Specialist		
	<p>the specialist in the views of peers and others familiar with the specialist's capability or performance</p> <p>c. The specialist's experience in the type of work under consideration.</p>	
USING THE FINDINGS OF THE SPECIALIST		
AU 336.12	<p>The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the opinion of another specialist.</p>	Issuer G

AU Section 342, Auditing Accounting Estimates		
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> <p>a. Identify whether there are</p>	Issuers G, H, and T

AU Section 342, Auditing Accounting Estimates

	<p>controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation.</p> <p>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.</p> <p>c. Consider whether there are additional key factors or alternative assumptions about the factors.</p> <p>d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data.</p> <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</p>	
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AU Section 342, Auditing Accounting Estimates		
	<p>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 Section 350, Audit Sampling		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AU 350.17	<p>When planning a particular sample, the auditor should consider the specific audit objective to be achieved and should determine that the audit procedure, or combination of procedures, to be applied will achieve that objective. The auditor should determine that the population from which he draws the sample is appropriate for the specific audit objective. For example, an auditor would not be able to detect understatements of an account due to omitted items by sampling the recorded items. An appropriate sampling plan for detecting such understatements would involve selecting from a source in which the omitted items are included. To illustrate, subsequent cash disbursements might be sampled to test recorded accounts payable for understatement because of omitted purchases, or shipping documents might be sampled for understatement of sales due to shipments made but not recorded as sales.</p>	Issuer E
AU 350.19	<p>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</p>	Issuers B and F

AU Section 350, Audit Sampling		
	<p>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.^{fn 3} Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.</p>	
AU 350.23	<p>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.</p>	Issuers B and F
AU 350.23A	<p>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 from an efficient and effectively designed statistical sample.</p>	Issuers B and F
Performance and Evaluation		
AU 350.24	<p>Sample items should be selected in such a way that the sample can be</p>	Issuer D

AU Section 350, Audit Sampling		
	<p>expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. For example, haphazard and random-based selection of items represents two means of obtaining such samples. ^{fn 4}</p>	
AU 350.28	<p>If the sample results suggest that the auditor's planning assumptions were incorrect, he should take appropriate action. For example, if monetary misstatements are discovered in a substantive test of details in amounts or frequency that is greater than is consistent with the assessed levels of inherent and control risk, the auditor should alter his risk assessments. The auditor should also consider whether to modify the other audit tests that were designed based upon the inherent and control risk assessments. For example, a large number of misstatements discovered in confirmation of receivables may indicate the need to reconsider the control risk assessment related to the assertions that impacted the design of substantive tests of sales or cash receipts.</p>	Issuer E
SAMPLING IN TESTS OF CONTROLS		
Planning Samples		
AU 350.37	<p>Samples taken to test the operating effectiveness of controls are intended to provide a basis for the auditor to conclude whether the controls are being applied as prescribed. When the degree of assurance desired by the evidential matter in the sample is high, the auditor should allow for a low level of sampling risk (that is, the risk of assessing control risk too low). ^{fn 9}</p>	Issuer B
AU 350.38	<p>To determine the number of items to be selected for a particular sample for a test of controls, the auditor should consider the tolerable rate of deviation from the controls being tested, the likely rate of deviations, and the allowable risk of assessing control risk too low. When circumstances are similar, the effect on sample size of those factors should be</p>	Issuer B

AU Section 350, Audit Sampling		
	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 from an efficient and effectively designed statistical sample.	
Sample Selection		
AU 350.39	Sample items should be selected in such a way that the sample can be expected to be representative of the population. Therefore, all items in the population should have an opportunity to be selected. Random-based selection of items represents one means of obtaining such samples. Ideally, the auditor should use a selection method that has the potential for selecting items from the entire period under audit. Paragraphs 44 through 46 of Auditing Standard No. 13, <i>The Auditor's Responses to the Risks of Material Misstatement</i> , describe the auditor's responsibilities for performing procedures between the interim date of testing and period end.	Issuer E
Footnotes to AU 350		
<p>^{fn 3} 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> <p>^{fn 4} Random-based selection includes, for example, random sampling, stratified random sampling, sampling with probability proportional to size, and systematic sampling (for example, every hundredth item) with one or more random starts.</p> <p>^{fn 9} The auditor who prefers to think of risk levels in quantitative terms might consider, for example, a 5 percent to 10 percent risk of assessing control risk too low.</p>		