

Report on
2017 Inspection of KPMG LLP
(Headquartered in New York, New York)

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

2017 INSPECTION OF KPMG LLP

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EXECUTIVE SUMMARY

In 2017, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KPMG LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act"). The inspection procedures included reviews of portions of the Firm's work on 52 issuer audits, which generally related to issuer year ends in 2016.

The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In 26 audits, certain of these deficiencies 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. These deficiencies are described in Part I.A of the report.

The Board cautions against using the number of audits with deficiencies in the public portion of a report to draw conclusions about the frequency of deficiencies throughout the firm's practice. The audits to be reviewed are most often selected based on perceived risk and not through a practice designed to identify a representative sample that could be extrapolated to the firm's entire practice. The portions of these audits that are reviewed often involve the most risky areas of the financial statements. Thus, much of the audit work that is inspected presents, in the inspection team's view, a heightened possibility of auditing deficiencies.

In the 2017 inspection, the inspection team also assessed the Firm's system of quality control related to issuer audits. Pursuant to the Act, any criticisms or discussions of defects or potential defects in that system will remain nonpublic unless the Firm fails to address those criticisms or defects to the Board's satisfaction, within 12 months of the issuance of this report.

Audit Opinions Affected by the Identified Deficiencies

Fifty of the 52 engagements inspected were integrated audits of both internal control and the financial statements. As depicted in the table below, the inspection team identified deficiencies in both financial statement audits and audits of ICFR.

	Number of Audits
Audits for which deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	<u>18 Audits</u> : Issuers A, B, C, D, E, F, G, H, I, J, K, L, M, O, R, T, U, and W

	Number of Audits
Audits for which deficiencies included in Part I.A related to the ICFR audit only	<u>6 Audits</u> : Issuers N, Q, S, V, X, and Z
Audits for which deficiencies included in Part I.A related to the financial statement audit only	<u>2 Audits</u> : Issuers P and Y
Total	26

Most Frequently Identified Audit Deficiencies

The following table lists, in summary form, the types of deficiencies that appear most frequently in Part I.A of this report and shows which issuer audits included these deficiencies.

Issue	Part I.A Audits
Failure to sufficiently test the design and/or operating effectiveness of controls that included a review element and that the Firm selected for testing	<u>17 Audits</u> : Issuers A, B, C, D, G, H, I, J, K, L, R, S, T, U, V, W, and Z
Failure to identify and test any controls that addressed the risks related to a particular account or assertion	<u>13 Audits</u> : Issuers A, B, F, G, H, K, M, N, O, Q, R, S, and T
Failure to perform substantive procedures to obtain sufficient evidence as a result of relying too heavily on controls (due to deficiencies in testing controls)	<u>13 Audits</u> : Issuers A, B, C, F, H, I, J, L, M, O, T, U, and W
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate	<u>10 Audits</u> : Issuers A, B, C, D, F, G, I, K, P, and T

Areas in which Audit Deficiencies Were Most Frequently Identified

The following table lists, in summary form, the three financial statement accounts or auditing areas in which the deficiencies that are included in Part I.A of this report most frequently occurred.

Area	Part I.A Audits
Revenue, including allowances	<u>11 Audits</u> : Issuers E, F, G, K, L, M, N, T, U, X, and Y
Loans, including the allowance for loan losses	<u>6 Audits</u> : Issuers A, B, C, H, I, and O
Inventory, including related reserves	<u>5 Audits</u> : Issuers E, N, S, T, and W

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Inspections are designed and performed to assess compliance with applicable standards and requirements. The inspection team reviews both (1) selected audits and (2) policies and procedures related to quality control processes. The primary procedures¹ for the inspection were performed from November 2016 to April 2018. Inspectors conducted field work at the Firm's National Office and inspected issuer audits performed by 28 of the Firm's approximately 80 U.S. practice offices.

Part I.A includes a description of all audit deficiencies that reach a defined level of significance, which is described below. These deficiencies are categorized in various ways in both Part I.B and the Executive Summary. Part I.C of this report provides certain demographic information about all of the audits inspected. Part I.D provides a general description of the procedures performed in an annual inspection.

Inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control. This focus on deficiencies and defects necessarily carries through to inspection reports and, therefore, the reports are not intended as balanced report cards or overall rating tools. Further, the lack of discussion within a report of an aspect of the inspected firm's quality control system should not be interpreted to imply that the Board has reached a conclusion about that aspect. Similarly, an inspection of an annually inspected firm does not involve the review of all of the firm's audits, nor is it designed to identify every deficiency in the reviewed audits. Accordingly, an 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 described in that report.

The inspection team's evaluation of the Firm's quality control system included both (1) a review of certain aspects of the Firm's quality control system and (2) an

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 (1) inspection planning, which may commence months before the primary procedures, and (2) inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.

assessment whether the deficiencies identified in individual audits indicate defects or potential defects in the Firm's quality control system.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 51 issuer audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team selected these issuer audits for review after it learned that the Firm obtained improper advance notice of the initial engagements selected.

Certain of the deficiencies identified in the inspection were of such significance that the inspection team determined that the Firm issued an opinion without obtaining sufficient appropriate audit evidence that the financial statements were free of material misstatement and/or the issuer maintained effective ICFR. These deficiencies are described in Part I.A. The descriptions in Part I.A include references to the auditing standards that most directly relate to those deficiencies. (See Appendix C for the text of these standards.) References to provisions of the auditing standards that generally address all aspects of the audit are provided only when lack of compliance with these standards is the primary reason for the deficiency.²

Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. In many cases, the Firm has since performed remedial actions intended to address the deficiencies.³ That an audit deficiency reached the level of significance to be included in Part I.A of an inspection report does not mean that the financial statements are misstated or that there are undisclosed material weaknesses in ICFR. It is often not possible for the inspection

² These broadly applicable provisions are described in Part I.B of this report.

³ 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. An inspection normally includes a review, on a sample basis, 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 could be a basis for criticisms of the firm's quality control system or Board disciplinary sanctions.

team to reach a conclusion on those points because the inspection team usually has only the information the auditor retained and the issuer's public disclosures. Even when not associated with a disclosed misstatement or previously unidentified material weakness, an auditor's failure to obtain sufficient appropriate audit evidence is a serious matter.

The audit deficiencies that were so significant that it appeared that the audit opinion was unsupported are described in Parts I.A.1 through I.A.26, below. Issuer audits are generally presented in the order of significance of the deficiencies identified in the inspections of those audits; severity is assessed based on extent of the deficiencies identified in the audit, financial statement accounts affected, and/or potential consequences of the audit deficiency.⁴

Audit Deficiencies

A.1. Issuer A

In this audit of an issuer in the financials industry sector, 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 engaged in various activities that evidenced the presence of fraud risk factors that were indicative of risks of material misstatement due to fraud with respect to loans, the allowance for loan losses ("ALL"), available-for-sale ("AFS") securities, certain derivatives, and deposit liabilities (the "accounts"). The Firm failed to perform sufficient procedures related to these accounts, as follows –
 - The Firm failed to consider the implications of certain of these fraud risk factors in determining whether there were risks of material misstatement due to fraud in the accounts. (AS 2110.65)
 - To address certain other fraud risk factors it had identified, the Firm selected for testing four entity-level controls. Three of these controls consisted of reviews related to certain aspects of the issuer's control environment, and the fourth control consisted of the

⁴ The 2015 and 2016 audits of Issuers A, B, C, H, I, J, O, and Q were inspected during both the 2016 and 2017 PCAOB inspections; these inspections occurred during calendar year 2017, after the conclusion of the audits of both years.

internal audit function's monitoring of other controls. The Firm's procedures to test these controls were insufficient, as the Firm failed to test, other than for one control for one line of business, whether the control owners' evaluations and/or conclusions regarding the operation of these controls were reasonable and appropriately supported. (AS 2201.42 and .44)

- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on levels of control reliance and assessments of the risks of material misstatement due to fraud that were not supported due to the deficiencies in the Firm's testing of controls and in its risk assessment procedures that are discussed above. As a result, certain of the sample sizes that the Firm used to test the existence of loans and deposit liabilities and the valuation of the ALL, AFS securities, and certain derivatives were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm failed to perform sufficient procedures related to the issuer's ALL, mortgage servicing rights ("MSRs"), and derivatives. Specifically –
 - The issuer used various models in the valuation of (1) the ALL for loans collectively assessed for impairment, (2) MSRs, and (3) a significant portion of derivatives ("certain derivatives"). The Firm selected for testing one control over the validation of these models; this control included the review of significant assumptions used in the models. The Firm limited its procedures to test this control to (1) inquiring of the control owners; (2) evaluating the competence and objectivity of the control owners; and (3) reading the issuer's model risk management policy, issuer-prepared reports, and supporting analyses. For certain of the significant assumptions selected for testing included within certain models, the Firm failed to evaluate the nature of the procedures the control owners performed to review the assumptions, including the specific expectations the control owners applied and the criteria the control owners used to identify items for follow up. In addition, the Firm selected for testing a control over the review of the implementation of and changes to the program the issuer used to transfer information from the data warehouse into a model used to determine a portion of the ALL for loans collectively assessed for impairment. This model and the

related control were implemented during the year under audit. The Firm failed to sufficiently test the aspect of the control related to the review of the baseline code at the time of implementation, as its procedures were limited to inquiry of the control owner. (AS 2201.42 and .44)

- The Firm selected for testing two controls over a significant portion of the issuer's loan portfolio. The first control consisted of management's quarterly reviews of loan valuation calculations, the majority of which were prepared using a discounted cash flow approach, and the second control consisted of management's monthly reviews of loan charge-off determinations. The Firm limited its procedures to test these controls for those loans valued using a discounted cash flow approach to (1) inquiring of the control owners and (2) inspecting a sample of discounted cash flow worksheets or loan status reports and related documents for signatures as evidence of review. The Firm failed to evaluate the nature of the review procedures the control owners performed, including the criteria the control owners used to identify items for follow up and the resolution of such matters. (AS 2201.42 and .44)
- The Firm designed certain of its substantive procedures for the valuation of the ALL and certain derivatives – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of the model validation control that is discussed above. As a result, certain of the sample sizes that the Firm used to test the valuation of the ALL and certain derivatives were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm's approach for testing the ALL was to review and test management's process. The Firm, however, failed to perform sufficient substantive procedures to evaluate the reasonableness of certain significant assumptions that the issuer used as inputs to the models to estimate the value of the ALL associated with loans collectively assessed for impairment. Specifically, the Firm's only procedures to test these assumptions were inquiring of management and reading issuer-prepared reports and supporting analyses, without performing any testing of these analyses. (AS 2501.11)

- During the year, the issuer acquired a significant business. The Firm failed to perform sufficient procedures related to the accounting for this business combination, as follows –
 - The Firm selected for testing a control that consisted of the determination, and review of the appropriateness, of the accounting treatment for all significant transactions. This control, however, did not address the risk that the purchase price allocation could be inaccurate, and the Firm failed to identify and test any other controls that addressed this risk. (AS 2201.39)
 - The Firm failed to perform sufficient substantive procedures to test the accuracy of the loan account balances that were used to value the acquired loans. The Firm (1) inspected the purchase agreement and (2) selected a sample of loans from the loan service systems for a portion of the acquired loans and compared certain of the loan information to the acquired company's loan origination documents. The Firm, however, failed to test whether the account balances of these loans were accurate as of the acquisition date. In addition, the Firm excluded a significant portion of the loans from the population from which it selected its sample for testing. (AS 2502.39)

A.2. Issuer B

In this audit of an issuer in the financials industry sector, 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 with respect to the ALL. Specifically –
 - The issuer used models in the determination of the ALL. The Firm selected for testing a control consisting of the validation of these models. The Firm limited its procedures to test this control to (1) inquiring of the control owners, (2) reading the issuer's model governance and validation standards, (3) reading the validation reports and supporting analyses, (4) evaluating the competence and objectivity of the control owners, and (5) reviewing changes to the models since their last validation dates. The Firm failed to evaluate the nature of the review procedures performed by the

control owners, including the specific expectations applied in the reviews, the criteria used to identify items for follow up, and the resolution of such matters. (AS 2201.42 and .44)

- The Firm selected for testing a control consisting of a committee's review and approval of the look-back period, which was an important assumption used in the determination of the ALL. The Firm limited its procedures to test this control to (1) inquiring of certain control owners and (2) reading minutes from the committee meetings, noting that the committee had approved changes to the look-back period in the third and fourth quarters. The Firm failed to evaluate the nature of the specific review procedures that the committee performed to reach its conclusions about the reasonableness of the look-back period. (AS 2201.42 and .44)
- The Firm's approach for testing the ALL was to review and test management's process. The Firm, however, failed to perform sufficient procedures to evaluate the reasonableness of the portfolio segmentation and look-back period assumptions, which were key inputs to the ALL determination. Specifically, the Firm's only procedures to test these assumptions were inquiring of management and reading model validation reports and their supporting analyses, without performing any testing of these analyses. (AS 2501.11)
- The Firm failed to perform sufficient procedures with respect to deposit liabilities. Specifically –
 - The issuer used a service organization to generate retail deposit customer statements using information from the issuer's retail deposit system. The Firm identified and tested a control that consisted of testing the mathematical accuracy of information appearing on a sample of retail deposit statements, including by comparing the information on the statements to the retail deposit system. The Firm, however, failed to identify and test any controls over the completeness of the information transferred from the issuer's retail deposit system to the service organization. (AS 2201.39)
 - The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of

control reliance that was not supported due to the deficiency in the Firm's testing of the control that is discussed above. As a result, the sample sizes that the Firm used in its testing of retail deposits were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- The Firm sent positive confirmation requests to the issuer's customers for certain retail demand deposit accounts. The Firm also selected for testing a sample of retail deposits for which it did not send positive confirmation requests. The Firm failed to sufficiently test those accounts for which the requested confirmations were not returned, as well as the sample of retail deposit accounts that was not included in the confirmation test, as it limited its procedures in both tests to (1) comparing customer names and account numbers from account signature cards to customer statements and (2) comparing account balances on the customer statements to the deposit system from which the statement information was obtained. (AS 2301.08; AS 2310.31)
- The Firm failed to perform sufficient procedures to test loans receivable. Specifically, the Firm sent positive confirmation requests to the issuer's customers for a sample of loan receivable accounts. The Firm failed to sufficiently test those loans receivable in its sample for which the requested confirmations were not returned, as it limited its alternative procedures to (1) recalculating the customer's loan balance using billing statements that were produced by the loan receivable systems that had also been used to generate the confirmation requests and (2) comparing payment information on the billing statements to the loan receivable systems. (AS 2310.31)

A.3. Issuer C

In this audit of an issuer in the financials industry sector, 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 related to the ALL. Specifically –
 - The Firm selected for testing a control that consisted of a committee's review of the risk assessment for graded commercial

loans; this review included evaluating the risk of assigning an inappropriate loan grade for each loan portfolio and determining which loan portfolios would be subject to an independent loan-grade review. The loan grades were an important factor in estimating the general reserve component of the ALL for commercial loans. As part of the control, the committee identified three commercial loan portfolios as having high risk of inappropriate loan grades and determined that these loan portfolios would be subjected to the independent loan-grade review every six to 15 months. The Firm failed to consider that this control was not designed, in the period under audit, to require that significant loan portfolios identified as high risk be subject to an independent loan-grade. (AS 2201.42)

- The issuer subjected all three of the high-risk loan portfolios it identified to its independent loan-grade review control in the period under audit. The Firm, however, in testing the operating effectiveness of this control failed to include one of these portfolios in the population of high-risk loans from which it selected items for testing. This portfolio represented approximately 50 percent of the total high-risk loans. (AS 2201.44)
- The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of the controls that are discussed above. As a result, the sample size the Firm used to test the appropriateness of the assigned loan grades for commercial loans was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm selected for testing a control that consisted of management's review and approval of retail loan charge-offs, which were significant inputs to the calculation of the general reserve component of the ALL for retail loans. The Firm limited its procedures to test this control to inquiring of the control owner and reading the loan charge-off report used to record charge-offs in the loan system. The Firm failed to evaluate the nature of the review procedures the control owner performed, including the criteria the control owner used to determine the appropriateness of the charge-offs. In addition, the Firm failed to identify and test any controls over

the accuracy and completeness of the loan charge-off report that the control owner used in the performance of this control. (AS 2201.39, .42, and .44)

- The Firm failed to perform sufficient substantive procedures to test retail loan charge-offs, as its procedures were limited to comparing a sample of retail loan charge-offs from the loan system to the loan charge-off report, without inspecting any supporting documentation for these charge-offs. (AS 2501.11)
- The Firm failed to perform sufficient procedures to test controls over AFS securities. The issuer recorded the fair values for these securities based on the prices it received from an external pricing service. The Firm selected for testing one control over the valuation of these securities that consisted of the issuer's semi-annual comparison of the recorded fair values for a sample of its largest securities to prices it received from another external pricing service and investigation of any pricing differences that exceeded a threshold. The issuer established a single threshold for investigation, regardless of the types of securities within the issuer's portfolio. The remaining securities for which the issuer did not perform this comparison were, in the aggregate, multiple times the Firm's established level of materiality and presented a reasonable possibility of material misstatement. The Firm failed to sufficiently test whether this control was designed appropriately to detect misstatements that could be material, as it did not evaluate (1) whether the issuer's sampling strategy was appropriate given that a significant portion of the recorded balance was not subject to the price comparison and (2) whether the single threshold that the control owner used, regardless of the type of security, was sufficiently precise. (AS 2201.42)

A.4. Issuer D

The Firm was engaged by the principal auditor of an issuer in the materials industry sector to audit the financial statements and perform certain procedures on ICFR of a significant subsidiary of the issuer to support the principal auditor's opinions on the consolidated financial statements and on the effectiveness of ICFR of the issuer. The Firm failed to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in the audit, as its procedures related to the valuation of property, plant, and equipment ("PPE") were insufficient. Specifically –

- The Firm, as instructed by the principal auditor, selected for testing a control that consisted of management's review of the subsidiary's impairment memorandum and supporting documentation, including the underlying fair value models. The Firm's testing of this control was not sufficient, as the Firm limited its procedures to (1) inquiring of the control owner; (2) reading the impairment memorandum; (3) comparing certain inputs to the fair value models to supporting documentation, the fair values to the fair value models, and the carrying values to the general ledger; and (4) comparing the impairment charges to the amounts the issuer recorded. The Firm failed to evaluate the nature of the review procedures the control owner performed, including the criteria used to identify matters for follow up and the resolution of such matters. In addition, the Firm concluded, and communicated to the principal auditor, that the control was designed and operating effectively despite the fact that this control did not address (1) the reasonableness of certain significant inputs to the fair value models and (2) the determination of the data that should be included in the calculation of the carrying values of the asset groups. (AS 2201.42, and .44)
- The Firm's approach for testing the valuation of PPE, including the impairment charges the issuer recorded, was to review and test management's process. The Firm, however, failed to perform sufficient procedures to test the impairment of PPE. Specifically, the Firm failed to test the reasonableness of certain significant inputs to the fair value models and the appropriateness of the data that were used in the calculation of the carrying values of the asset groups. (AS 1105.10; AS 2502.26, .28, and .39)

A.5. Issuer E

In this audit of an issuer in the industrials industry sector, 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 initiated and processed transactions related to sales and inventory at numerous locations that the issuer aggregated into various business units. In determining the locations at which to perform audit procedures, the Firm excluded a large number of locations from the scope of its audits, which represented a significant amount of the issuer's consolidated revenue, accounts receivable, and inventory. The Firm, however, failed to perform sufficient procedures to support its conclusion that no testing was necessary with respect to the out-of-scope locations. Specifically, the Firm failed to (1) consider the nature and amount of assets, liabilities, and transactions executed at the specific locations; (2)

evaluate whether specific risks of material misstatement existed at these locations; and (3) evaluate whether the risks of material misstatement the Firm identified for the in-scope locations also applied to the out-of-scope locations such that, in combination, they presented a reasonable possibility of material misstatement. In addition, the Firm incorrectly relied on certain entity-level controls that it tested, which it concluded did not operate at a level of precision that would prevent or detect material misstatements, to reach its conclusion that no testing was necessary at the out-of-scope locations. (AS 2101.11-.12; AS 2201.B11; AS 2301.08)

A.6. Issuer F

In this audit of an issuer that provided insurance services and is in the financials industry sector, 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 related to the majority of the issuer's total revenue. Specifically –
 - The issuer processed a significant portion of this revenue through production systems that were reconciled monthly to the general ledger. While the Firm tested controls over these reconciliations, it failed to identify and test any controls over the accuracy and completeness of the revenue data entered into the production systems. In addition, the Firm selected for testing three controls that consisted of reviews of certain revenue and accounts receivable information. As a result of the deficiency discussed above, the Firm's testing of these controls was also insufficient because the controls relied on the effectiveness of the monthly reconciliation controls with respect to the accuracy and completeness of the revenue and accounts receivable information. (AS 2201.39)
 - The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of the controls that are discussed above. As a result, certain of the sample sizes the Firm used in its testing of this significant portion of revenue, which was performed as of an interim date, were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- The Firm performed analytical procedures to test this revenue for the four months between the interim date and year end. To test the first of these four months, the Firm compared the actual revenue to the revenue for the previous two months. To test the last three months of the year, the Firm developed an expectation using revenue for the previous three years and the first nine months of the current year. These analytical procedures provided little to no substantive assurance, as the Firm failed to (1) establish a threshold for investigation of differences for the test of the first month and (2) evaluate whether the historical information could be expected to be predictive of the current-year amounts for the test of the last three months. (AS 2305.05, .13-.14, and .20)
- The Firm's procedures related to the valuation of insurance reserves were insufficient. Specifically –
 - The issuer determined the valuation of its insurance reserves using historical data for claims paid. The Firm failed to identify and test any controls to address whether the current and historical claims settlements provided an appropriate basis to estimate future losses on existing and future claims. (AS 2201.39)
 - The Firm's approach for testing the valuation of the insurance reserves was to review and test management's process. The Firm, however, failed to perform sufficient procedures to test the historical data for claims paid. Specifically, the Firm limited its procedures to comparing recorded payment amounts for a sample of paid claims to claim transmittal reports and issued checks, without evaluating whether the current and historical claims settlements provided an appropriate basis to estimate future losses on existing and future claims. (AS 2501.11)

A.7. Issuer G

In this audit of an issuer in the consumer discretionary industry sector, 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 amortized certain definite-lived intangible assets using accelerated methods. The Firm's procedures related to these intangible assets were insufficient. Specifically –

- The Firm selected for testing a control that consisted of the review of the issuer's quarterly analysis of the appropriateness of the amortization methods used and whether these intangible assets were potentially impaired. The Firm failed to sufficiently test the aspect of this control that addressed the accuracy and completeness of an important system-generated report used in the operation of this control. Specifically, the Firm limited its testing of this aspect to observing the control owner generate the report from the system and comparing this report to the report that was used in the operation of the control. The Firm, however, failed to obtain an understanding of the parameters the system used to generate the report. (AS 2201.42 and .44)
- The Firm failed to perform sufficient substantive procedures to test the valuation of these intangible assets and the related amortization expense. Specifically, the Firm failed to evaluate the reasonableness of the issuer's amortization methods and the useful lives assigned to these intangible assets. (AS 2501.11)
- The issuer recorded customer discounts, which were approximately three times the Firm's established level of materiality, as reductions to revenue. The Firm, however, failed to identify and test any controls over, and to perform any substantive procedures to test, these discounts. (AS 2201.39; AS 2301.08)

A.8. Issuer H

In this audit of an issuer in the financials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as the Firm failed to perform sufficient procedures with respect to the ALL. Specifically –

- The issuer used models in the valuation of the ALL. The Firm selected for testing a control that consisted of a committee's monitoring of the validation of the ALL models by other issuer personnel. The Firm failed to identify and test controls that sufficiently addressed the risks that the (1) ALL models were not appropriately developed, (2) inputs and assumptions into the models were no longer appropriate based on the current environment, and (3) models were not working as designed, as the single control in this area that the Firm identified and tested was not designed to operate at a level of precision that would prevent or detect material

misstatements in the valuation of the ALL, and the Firm failed to identify and test any other control that did so. (AS 2201.39)

- The Firm selected for testing a control that consisted of management's review of the risk assessment for graded commercial loans; this review included determining which loans would be subject to an independent loan-grade review. The loan grades were an important factor in estimating the ALL for loans that were collectively evaluated for impairment. As part of its evaluation of the effectiveness of this control, the Firm assessed the control's scope by calculating the amount of loans that were subject to an independent loan grade review. In performing this calculation, the Firm aggregated the value of the portfolios selected for review pursuant to this control's operation with loans that were selected for review based on other criteria. This calculation resulted in the Firm including a large amount of loans twice, and the Firm therefore failed to evaluate appropriately the scope of the loan grade reviews and, specifically, whether a significant portion of the commercial loan portfolio that the issuer considered to be of a "risk priority of 'high'" was excluded from the independent loan-grade review. (AS 2201.42 and .44)
- The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of the control related to the assigned loan grades for commercial loans that is discussed above. As a result, the sample size the Firm used to test these loan grades was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.9. Issuer I

In this audit of an issuer in the financials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as its procedures related to the ALL were not sufficient. Specifically –

- The Firm selected for testing a control that consisted of the preparation and review of a risk assessment for graded commercial loans, including the determination of which loans would be subject to an independent loan-grade review during the year. The loan grades were an important factor in estimating the ALL. The Firm's testing of this control was not sufficient.

Specifically, the Firm failed to test whether all graded commercial loans were included in the risk assessment, which was an objective of this control, and, as a result, it failed to evaluate whether the control identified all high-risk commercial loan portfolios for consideration for the independent loan-grade review. (AS 2201.42 and .44)

- The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of the control that is discussed above. As a result, the sample size the Firm used to test the appropriateness of the assigned loan grades for commercial loans was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The issuer used externally prepared appraisals to determine the fair value of the underlying collateral for collateral-dependent loans that it had determined to be individually impaired. For the impaired loans that the Firm selected for testing, the Firm failed to evaluate the reasonableness of certain of the significant assumptions underlying certain appraisals. (AS 2502.26 and .28)

A.10. Issuer J

In this audit of an issuer in the financials industry sector, 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 with respect to AFS securities. Specifically –
 - The Firm selected for testing controls related to AFS securities that consisted of (1) the quarterly review of the initial quarter-end determination of fair values of these securities based on the prices received from external parties, including the testing of the accuracy and completeness of the file that contained these prices ("pricing file"); (2) the quarterly review of the fair value of securities for which the information in the pricing file met certain criteria; (3) the quarterly review of the categorization of the securities within the fair value hierarchy as set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic

820, *Fair Value Measurement*, (4) the review of investment disclosures in the financial statements; and (5) various reconciliations between the securities sub-ledger and supporting documents or the general ledger. The Firm failed to perform sufficient procedures to test the operating effectiveness of each of these controls. Specifically, (1) for two of these controls, including the control that included the quarterly testing of the pricing file, the Firm tested only one instance of the operation of the controls, which was insufficient given the manual nature of the controls and the frequency with which the controls operated, and (2) for three of these controls that were tested as of an interim date three or more months before year end, the Firm failed to perform procedures to update that testing to the year end. In addition, certain information from the pricing file was used in the performance of four of these controls. The Firm's testing of these four controls was also insufficient because these controls relied on the effectiveness of the control that included the testing of the pricing file, which the Firm had insufficiently tested, as described above. (AS 2201.44 and .55)

- The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of the controls that are discussed above. As a result, the sample size the Firm used to test the valuation of certain AFS securities was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm failed to perform sufficient procedures with respect to the provision for income taxes and the related balance sheet accounts. Specifically –
 - The Firm selected for testing controls related to income taxes that included the review of (1) the effective tax rate reconciliation, (2) a schedule that summarized tax payments, (3) an analysis of the issuer's uncertain tax positions, (4) the deferred tax assets and liabilities roll-forward schedule, (5) a memorandum documenting the issuer's conclusions regarding the need to record a deferred tax asset valuation allowance, and (6) the overall income tax calculation. The Firm's procedures to test these controls were limited to (1) inquiring of the control owners; (2) obtaining the schedules and memorandum that were reviewed as part of the

controls, including certain supporting schedules, and noting signatures as evidence of review for certain of these documents; (3) comparing certain balances included in the schedules to supporting documentation and/or the general ledger; (4) reading the issuer's memorandum to verify that it contained the conclusions regarding the need to record a deferred tax asset valuation allowance; and (5) verifying the mathematical accuracy of certain calculations. These procedures were insufficient, as the Firm failed to evaluate the nature of the review procedures that the control owners performed, including the specific criteria used to identify matters for follow up or review and whether those matters were appropriately resolved. In addition, the Firm failed to (1) test the aspect of two of these controls that addressed the completeness of data used in the operation of the controls and (2) identify and test any controls over the completeness of the data used in the operation of one of the six controls and over the accuracy of certain significant inputs used in the operation of another of the controls. (AS 2201.39, .42, and .44)

- The Firm selected for testing a control that consisted of the quarterly review of a schedule that summarized projected tax credits and tax losses related to the issuer's investments, which were significant inputs to the income tax provision. This control did not include an evaluation of the eligibility of the investments included in the schedule to generate tax credits, and the Firm failed to identify and test any other controls that did so. In addition, the Firm failed to test the aspect of the control that addressed the completeness of the data used in the operation of the control. (AS 2201.39, .42, and .44)
- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of two of the controls that are discussed above. As a result, the sample sizes that the Firm used to test deferred tax assets, deferred tax liabilities, tax credits, and tax losses were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
- The Firm failed to perform sufficient procedures with respect to certain derivative assets and liabilities. Specifically –

- The issuer determined the recorded fair value of these derivatives based on valuations provided by an external organization. The Firm selected for testing two controls over these derivative assets and liabilities that consisted of (1) the reconciliation of the amounts recorded in the general ledger to the amounts in the statements that the external organization provided to the issuer, with investigation of variances over a threshold, and (2) the comparison of the recorded fair values to fair value estimates obtained from the counterparties, with investigation of variances over a threshold. The Firm failed to sufficiently test the operating effectiveness of these controls for one of the two months that it selected to test each control. Specifically, for the testing of the first control for that month, the Firm failed to evaluate whether the control owner identified all variances that exceeded the established threshold. For the testing of both controls for that month, the Firm failed to evaluate whether the identified variances were appropriately investigated and resolved. (AS 2201.44)
- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – 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 the valuation of these derivative assets and liabilities were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.11. Issuer K

In this audit of an issuer that provided electric services and is in the utilities industry sector, 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 related to commodity derivatives. Specifically –
 - The Firm selected for testing three controls over the existence and/or completeness of these derivatives. The Firm failed to sufficiently test these controls, as follows –

- The issuer used an external organization to match the majority of these derivative trades to counterparty confirmations. One of the controls the Firm selected for testing consisted of (1) the issuer's derivatives system's electronic receipt of records of matched and unmatched trades from the external organization and (2) the investigation of any unmatched trades. The Firm failed to test the aspect of this control that consisted of the investigation of unmatched trades. (AS 2201.42 and .44)
- For the derivatives not subject to the control above, the Firm selected for testing a control that consisted of the issuer (1) comparing the terms of derivative trades to confirmations received from counterparties, (2) investigating any discrepancies, and (3) reviewing a report to identify any remaining unmatched trades. The Firm's procedures to test this control were limited to selecting a sample of trades from the total population of derivative positions and, for each selection, (1) comparing the trade terms to confirmations the issuer received from the counterparties and (2) verifying the derivative was appropriately designated as confirmed and matched within the system. These procedures were insufficient, as the Firm failed to determine whether its selections represented derivative trades that were subject to this control. (AS 2201.42 and .44)
- The third control that the Firm selected consisted of the review of errors related to the entry of trades into the derivatives system and the determination of remedial actions. The Firm's testing of this control was insufficient, as the Firm failed to identify and test any controls over the completeness of the population of errors that was reviewed. (AS 2201.39)
- The Firm failed to sufficiently test controls over the valuation and presentation and disclosure of a significant portion of these derivatives. The Firm selected for testing a control over commodity derivatives that consisted of (1) a comparison of prices that the issuer determined to the average of prices that the issuer obtained from external pricing services and, in the event of a difference, the adjustment of the recorded price to the externally obtained price

and (2) the assessment of the fair value leveling within the fair value hierarchy as set forth in FASB ASC Topic 820. In testing this control, the Firm limited its procedures to (1) inquiring of the control owner; (2) inspecting documentation used in the operation of the control; and (3) comparing, for a sample of derivatives, the price determined by the issuer to the average of the prices from the external pricing services. These procedures were insufficient, as the Firm failed to test how the control owner evaluated (1) the reliability of the prices obtained from the external pricing services and used in the operation of the control and (2) the reasonableness of the fair value leveling, including the criteria used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

- For a significant category of these derivatives, the Firm failed to perform sufficient substantive procedures to evaluate the valuation and the leveling within the fair value hierarchy set forth in FASB ASC Topic 820. The Firm independently determined the fair value for a sample of these derivatives and compared those values to the amounts recorded by the issuer. The Firm, however, failed to obtain a sufficient understanding of the methods and assumptions used by the external pricing services to develop the prices used by the issuer to value the derivatives. Specifically, the Firm limited its procedures to obtaining confirmations of the general methods used by the external pricing services that did not provide information about the specific methods and assumptions used to develop the individual prices, including whether the significant inputs used to value these derivatives were observable or unobservable. (AS 2502.26, .28, .40, and .43)
- The Firm failed to perform sufficient procedures related to certain revenue, which was multiple times the Firm's established level of materiality. Specifically –
 - For this revenue, the issuer provided certain of its customers a document outlining the contract terms and billing rates. The Firm selected for testing an automated control that generated this document upon a customer's enrollment. The Firm's procedures to test this control were limited to (1) inquiring of management, (2) inspecting the configuration of the relevant system after year end, and (3) selecting one customer enrollment after year end and

noting that the document was automatically generated and sent to the customer. These procedures were insufficient because the Firm failed to test the configuration of the system and any instances of the control that occurred during the year. (AS 2201.42 and .44)

- A significant portion of this revenue involved variable billing rates. The Firm failed to identify and test any controls over the accuracy of the variable billing rates used in billing cycles after the first billing of a new customer. (AS 2201.39)
- The Firm's substantive procedures to test this revenue consisted of tests of details for a sample of transactions. This testing was insufficient, as it was limited to comparing the recorded revenue to invoices and cash receipts, without performing any procedures to test that the billing rates used were consistent with customer contracts or the issuer's price list. (AS 2301.08)

A.12. Issuer L

In this audit of an issuer in the industrials industry sector, 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 related to certain revenue from three of the issuer's business units, which represented a significant portion of the issuer's total revenue. Specifically –

- The controls that the Firm identified and tested over the occurrence of this revenue included (1) a control that consisted of the review and approval of customer contracts or purchase orders that, depending on the business unit, either exceeded a monetary threshold or contained non-standard terms and (2) a control that consisted of the quarterly review of revenue transactions that exceeded a monetary threshold and occurred during a specified period of days before and after quarter end. The Firm failed to evaluate whether the parameters the control owners used for the selection of transactions were appropriate to address the risk related to this revenue. (AS 2201.42)
- The controls that the Firm identified and tested to address the pricing of certain of this revenue included controls for two business units that consisted of the monthly review of the comparison of the current-month gross margins by product line to, depending on the business unit, either

(1) budgeted gross margins or (2) current year-to-date and/or prior-year gross margins, with investigation of variances over established thresholds. The Firm's procedures to test these controls were insufficient, as they were limited to, for a sample of comparisons, testing the mathematical accuracy of the gross margin calculations and tracing the totals to the trial balance, determining whether explanations were provided for all variances over the controls' investigation thresholds, and inspecting signatures as evidence that a review had occurred. The Firm failed to evaluate (1) whether the budgeted, current year-to-date, and prior-year gross margins were appropriate bases for establishing expectations to identify matters for investigation and (2) the nature of the procedures performed by the control owners, including whether items identified for investigation were appropriately resolved. (AS 2201.42 and .44)

- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the sample sizes the Firm used to test this revenue were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.13. Issuer M

In this audit of an issuer in the materials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as its procedures related to revenue from the issuer's domestic operations were insufficient. Specifically –

- The issuer priced its products using (1) for the majority of its customers, price lists that could be overridden by customer service representatives and (2) for most of the customers for one of its business segments, non-standard pricing. The Firm, however, failed to identify and test any controls over the pricing of revenue transactions. (AS 2201.39)
- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of controls that is discussed above. As a result, certain of the sample sizes that the Firm used to test this revenue were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.14. Issuer N

In this audit of an issuer in the consumer staples industry sector, 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 failed to perform sufficient procedures to test controls over revenue at two of the issuer's business units, which represented over 75 percent of total revenue. The Firm identified a risk related to the pricing of revenue transactions. With respect to the accuracy of revenue, the Firm selected for testing three automated controls over system access, the transfer of data to the general ledger, and the integrity of certain data related to orders. These controls, however, did not address the risk of incorrect pricing of revenue transactions, and the Firm failed to identify and test any other controls that addressed that risk. (AS 2201.39)
- With respect to inventory at these two business units, which represented the majority of inventory, the Firm selected for testing controls that included management's review of a report to ensure that all inventory was counted in accordance with the issuer's cycle-count policy. The Firm's testing of these controls was not sufficient because (1) for inventory at the first business unit and certain inventory at the second business unit, the Firm failed to identify and test any controls over the accuracy and completeness of the reports used in the performance of the controls and (2) for the remaining inventory at the second business unit, to test controls over the accuracy and completeness of the report, the Firm selected only one instance of the report, which was insufficient because the Firm did not test the information technology general controls over the system that produced this report. (AS 2201.39, .46, and .47)

A.15. Issuer O

In this audit of an issuer in the financials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. Specifically, the Firm failed in the following respects to perform sufficient procedures related to two segments of the issuer's loan portfolio, which in the aggregate represented over 90 percent of total loans –

- The issuer placed items in a loan suspense account when the items needed further evaluation; certain types of transactions were initially placed in these accounts, as were items for which the issuer was unable to identify the appropriate accounts for posting. The Firm identified and tested a control that included a review of the issuer's loan suspense account reconciliations. This control, however, did not address the risk that items that had been cleared from the suspense accounts had not been appropriately resolved, and the Firm failed to identify and test any other controls that addressed that risk. (AS 2201.39)
- The Firm failed to perform sufficient substantive procedures to test these two segments of the loan portfolio. Specifically –
 - The Firm limited its procedures to test the suspense accounts for these two segments of the loan portfolio to (1) comparing the ending balance from the reconciliations of these accounts to the general ledger, (2) testing the mathematical accuracy of the reconciliations, (3) evaluating the appropriateness of certain items included in the suspense accounts, and (4) observing signatures as evidence of review of the reconciliations. The Firm failed to test whether suspense items that had been cleared were appropriately resolved. (AS 2301.08)
 - The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of controls that is discussed above. As a result, the sample size that the Firm used to test the existence of one of the two segments of the loan portfolio, which represented approximately 18 percent of total loans, was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.16. Issuer P

In this audit of an issuer in the financials industry sector, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The issuer recorded MSR's at the lower of amortized cost or fair value. The Firm failed to perform sufficient procedures to test certain types of MSR's. Specifically –
 - The issuer determined the fair value of these MSR's by selecting the mid-point of a range that it developed using certain significant assumptions. The Firm evaluated the reasonableness of these assumptions by comparing them to those of peers that it selected; these comparisons indicated ranges of acceptable values for the assumptions. The Firm's procedures were insufficient, as follows –
 - The Firm obtained wide ranges of values for the selected peers. The Firm failed to evaluate whether the peers were sufficiently comparable to the issuer to provide a relevant indicator of the fair value of the issuer's MSR's. (AS 2502.26 and .28)
 - The issuer's amount for one of the assumptions fell outside the Firm's range. To evaluate this outlier, the Firm calculated a revised fair value of these MSR's using the mid-point of its range for this assumption and determined that the resulting fair value was within the issuer's fair value range. The Firm, however, failed to perform any procedures to evaluate whether the issuer's range was an appropriate expectation to evaluate this assumption. (AS 2502.26 and .28)
 - The Firm failed to test the amortized cost of these MSR's. (AS 2501.07)
- The Firm failed to perform sufficient procedures to test deposit liabilities. Specifically, the Firm sent positive confirmation requests to the issuer's customers for a sample of deposit accounts. The Firm failed to perform sufficient alternative procedures for the confirmations that were not returned, as these procedures were limited to comparing certain information from the confirmation requests to customer statements that were generated from the system that had also been used to generate the confirmation requests. (AS 2310.31)

A.17. Issuer Q

In this audit of an issuer in the financials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to perform sufficient procedures with respect to deposits. The issuer's deposit accounts reflected transaction data transmitted to the issuer from various external service providers. The Firm failed to identify and test any controls over the completeness and accuracy of these data. (AS 2201.39)

A.18. Issuer R

In this audit of an issuer in the energy industry sector, 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 related to the valuation of property, plant, and equipment. Specifically –
 - The Firm selected for testing a control that consisted of management's quarterly review of a list of asset groups with forecasted negative operating results ("the watch list") to identify indicators of possible impairment. The issuer had lost its sole customer for one of its asset groups in the prior year, which resulted in no revenue and negative operating results for this asset group for the past two years. This asset group was not included on the watch list. The Firm failed to take into consideration, when evaluating the effectiveness of the control, the omission of this asset group from the watch list. (AS 2201.42 and .44)
 - The Firm failed to perform sufficient substantive procedures to test for possible impairment the asset group described above, as it limited its procedures to inquiring of management regarding the issuer's rationale for concluding that an impairment indicator did not exist and reviewing legal letters from internal and external counsel about the status of pending litigation with the sole customer. The Firm, however, failed to perform any procedures to evaluate the reasonableness of management's assertion that the asset group would generate positive cash flow. (AS 2301.08)
- The Firm failed to perform sufficient procedures to test controls over the assessment of the possible impairment of a significant loan receivable.

Specifically, the Firm failed to identify and test any controls that addressed whether any impairment indicators that existed between the dates of the issuer's annual impairment analysis for the loan receivable were identified on a timely basis. (AS 2201.39)

A.19. Issuer S

In this audit of an issuer in the materials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. Specifically, the Firm failed in the following respects to perform sufficient procedures to test controls over the issuer's three types of inventory –

- The Firm selected for testing two controls over the valuation of one type of inventory that consisted of the monthly reviews of (1) the calculation of the cost of goods produced for this inventory and (2) the lower-of-cost-or-market analysis. The Firm's testing of the first control was insufficient, as the Firm failed to test the aspect of this control that addressed the accuracy of certain significant inputs to the calculation. As a result of this deficiency, the Firm's testing of the second control was also insufficient because this control relied on the effectiveness of the first control, as the cost of goods produced was a significant input to the lower-of-cost-or-market analysis. (AS 2201.42 and .44)
- The Firm selected for testing a control over another type of inventory that consisted of the review of the month-end inventory calculation. The Firm failed to test the aspect of this control that addressed the accuracy of certain significant inputs to the calculation of this inventory. (AS 2201.42 and .44)
- The Firm selected for testing an automated control over the cost for all three types of inventory that consisted of a three-way match among the purchase order, receiving document, and vendor invoice or a two-way match between the purchase order and vendor invoice. The system performed the match in accordance with certain preconfigured thresholds before approving payment of the invoice. The Firm failed to sufficiently test this control, as its procedures were limited to (1) inquiring of IT personnel, (2) observing in the system the thresholds used for the match and evaluating them for reasonableness, and (3) verifying for two vendor invoices that the underlying information was within the preconfigured thresholds and that the system performed the match before approving

payment of the invoices. The Firm's procedures, however, did not include testing whether the system prevented the payment of invoices that did not match. In addition, the Firm failed to identify and test any controls that addressed the resolution of items that did not match within the preconfigured thresholds. (AS 2201.39, .42, and .44)

- The Firm selected for testing a control over payroll costs, which were a significant input to the determination of the cost of goods produced for two types of inventory. This control consisted of (1) the review of the service auditor's reports provided by the service organization that the issuer used to perform its payroll function and (2) the documentation of the necessary user controls specified in the service auditor's reports. The Firm, however, did not test the issuer's control over the accuracy and completeness of payroll data transmitted by the issuer to the service organization that was identified as a necessary user control in the service auditor's reports. (AS 2201.B22)

A.20. Issuer T

In this audit of a manufacturer and distributor of consumer products in the consumer staples industry sector, 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 related to the allowances for sales returns and sales markdowns, as follows –
 - The issuer determined its allowance for sales returns based on processed customer returns. For one of the issuer's business units, the Firm selected for testing a control consisting of the review and approval of credit memoranda for processed customer returns. This control included the comparison of inventory returns to customer claims. The Firm failed to test this aspect of the control, and the Firm failed to identify and test any other controls that addressed the risk that the processed customer returns data were not accurate. (AS 2201.39)
 - For another of the issuer's business units, which was acquired during the year, the Firm's testing of the allowances for sales returns and sales markdowns consisted solely of analytical procedures. These analytical procedures, however, provided little to

no substantive assurance. For these procedures, the Firm calculated the average ratio for the prior two years of the allowance amounts to accounts receivable and applied this ratio to the current-year accounts receivable to determine its expectation for the current-year allowance amounts. The Firm, however, failed to establish appropriate expectations, as it failed to obtain evidence that the prior-years' ratios would be predictive of the current-year amounts. (AS 2305.13 and .14)

- The Firm failed to perform sufficient procedures related to inventory, as follows –
 - A significant portion of the issuer's inventory was located in one warehouse. The Firm selected for testing a control over the existence of this inventory. The control required that 80 percent of the inventory storage locations at this warehouse be counted at least once a year. The Firm failed to evaluate whether this control was designed to appropriately address the risk related to the existence of inventory. Specifically, the Firm did not evaluate whether this control, which required that only 80 percent of the inventory storage locations be counted, could effectively prevent or detect material misstatement of the inventory located in this warehouse. (AS 2201.42)
 - The Firm designed certain of its substantive procedures – including the sample size used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of the control that is discussed above. As a result, the sample size the Firm used to test the existence of this inventory was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)
 - To determine the allowance for excess and obsolete inventory for one of its components, the issuer applied a different reserve percentage to each of the categories within its two types of inventory. The Firm failed to perform sufficient testing of this allowance. Specifically –
 - For both types of inventory, the Firm failed to test the completeness of the inventory included in each of the

categories used in the calculation of the allowance. (AS 2501.11)

- For one type of inventory, the Firm failed to evaluate the reasonableness of the reserve percentages that the issuer applied to the categories in determining the allowance. (AS 2501.11)

A.21. Issuer U

In this audit of an issuer in the real estate industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to certain revenue, which was multiple times the Firm's established level of materiality. Specifically –

- The Firm selected for testing a control over this revenue that consisted of (1) the comparison, by contract, of accrued revenue for the current month to both accrued revenue for the prior month and amounts invoiced during the current month and (2) the investigation of variances over an established threshold. The Firm's procedures to test the operating effectiveness of this control consisted of (1) inspecting the comparisons for two months and verifying that explanations were provided for all variances over the established threshold and (2) obtaining corroboration of the control owner's explanations for a small number of the hundreds of variances for each month selected that exceeded the threshold. The Firm's testing of this control, however, was insufficient as the Firm failed to obtain sufficient evidence to conclude that the control operated effectively. Specifically, the Firm's sample to test this control was too small in light of the frequency that the control operated. (AS 2201.46 and .47)
- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of the control that is discussed above. As a result, the sample sizes the Firm used to test this revenue were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.22. Issuer V

In this audit of an issuer in the industrials industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to sufficiently test controls over the valuation of goodwill and intangible assets. The Firm selected for testing a control that consisted of the preparation and review of the issuer's quarterly qualitative analysis of the possible impairment of goodwill and intangible assets. The Firm's procedures to test this control were limited to inquiring of the control owners; reading a narrative describing the issuer's process for assessing impairment; obtaining the issuer's impairment memorandum for two quarters and tracing certain amounts from one of these memoranda to supporting documentation; and, for one quarter, obtaining the control owner's review comments as evidence that the review had occurred. The Firm failed to evaluate the nature of the review procedures performed, including the criteria the control owner used to identify matters for follow up and whether those matters were appropriately resolved. (AS 2201.42 and .44)

A.23. Issuer W

In this audit of an issuer in the information technology industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to the existence of inventories at certain of the issuer's locations. Specifically –

- The Firm identified and tested one control over the existence of these inventories. This cycle-count control was designed to count all raw materials and 40 percent of the value of work-in-process and finished goods inventories at these locations at least once a year. The values of the work-in-process and finished goods inventories not subject to this cycle-count control at these locations were, in the aggregate, multiple times the Firm's established level of materiality. The Firm failed to evaluate whether this control, which required that only 40 percent of the value of work-in-process and finished goods inventories be counted, could effectively prevent or detect material misstatement of this inventory. (AS 2201.42)
- The Firm designed certain of its substantive procedures – including the sample sizes used in those procedures – based on a level of control reliance that was not supported due to the deficiency in the Firm's testing of controls that is discussed above. As a result, certain of the sample sizes

the Firm used to test these inventories were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

A.24. Issuer X

In this audit of an issuer in the health care industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm identified a deficiency in the control that it tested over two types of revenue; this revenue was, in the aggregate, multiple times the Firm's established level of materiality. The Firm identified and tested a compensating control, but it determined that this control was ineffective and that the deficiency in the first control was unremediated as of the year end. The Firm failed to sufficiently evaluate the severity of the deficiency in the first control, as it failed to include the more significant of the two revenue types in its evaluation of the magnitude of the potential misstatement resulting from this deficiency. (AS 2201.62)

A.25. Issuer Y

In this audit of an issuer in the energy industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test revenue were not sufficient. The Firm documented that the issuer had accepted financial instruments from a significant customer in exchange for accounts receivable due from that customer, that it had recorded significant losses on those financial instruments, and that it may accept similar financial instruments in the future. The Firm, however, failed to evaluate, in light of these circumstances, whether the issuer had met the revenue recognition criterion that the price was fixed and determinable for sales to this customer. (AS 2810.03)

A.26. Issuer Z

In this audit of an issuer in the information technology industry sector, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. During the year, the issuer repurchased certain of its convertible notes and recognized a loss on the repurchase. The Firm identified a control over this transaction that consisted of management's review of the accounting for non-routine transactions and, to test the operating effectiveness of this control, it selected the repurchase of the convertible notes. The Firm's testing of the effectiveness of this control was not sufficient, as the Firm did not identify, and take into account, that the control owner had failed to detect that the issuer had not appropriately determined the amount of the loss on the repurchase of the convertible notes in accordance with FASB ASC Subtopic 470-20, *Debt with Conversion and Other Options*. (AS 2201.44)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the auditing standards that govern the conduct of audits. The paragraphs of the standards that are cited in Part I.A for each deficiency are only those that most directly relate to the deficiency. The deficiencies also may relate, however, to other paragraphs of those standards and to other auditing standards, including those concerning due professional care, responses to risk assessments, and audit evidence.

Many audit deficiencies involve a lack of due professional care. Paragraphs .02, .05, and .06 of AS 1015, *Due Professional Care in the Performance of Work*, require the independent auditor to plan and perform his or her work with due professional care and set forth aspects of that requirement. AS 1015.07-.09, and paragraph .07 of AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, 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 2301.03, .05, and .08 require the auditor to design and implement audit responses that address the risks of material misstatement. Paragraph .04 of AS 1105, *Audit Evidence*, 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. Appropriateness is the measure of the quality of audit evidence; to be appropriate, evidence must be both relevant and reliable in providing support for the related conclusions.

B.1. List of Specific Auditing Standards Referenced in Part I.A

The table below lists the specific auditing standards that are referenced in Part I.A of this report, cross-referenced to the issuer audits for which each standard is cited. For each auditing standard, the table also provides the number of distinct deficiencies for which the standard is cited for each of the relevant issuer audits. This information identifies only the number of times that the standard is referenced, regardless of whether the reference includes multiple paragraphs or relates to multiple financial statement accounts.

PCAOB Auditing Standards	Audits	Number of References per Audit
AS 1105, Audit Evidence	Issuer D	1
AS 2101, Audit Planning	Issuer E	1
AS 2110, Identifying and Assessing Risks of Material Misstatement	Issuer A	1
AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements	Issuer A	4
	Issuer B	3
	Issuer C	4
	Issuer D	1
	Issuer E	1
	Issuer F	2
	Issuer G	2
	Issuer H	2
	Issuer I	1
	Issuer J	4
	Issuer K	6
	Issuer L	2
	Issuer M	1
	Issuer N	2
	Issuer O	1
	Issuer Q	1
	Issuer R	2
	Issuer S	4
	Issuer T	2
	Issuer U	1
Issuer V	1	
Issuer W	1	
Issuer X	1	
Issuer Z	1	
AS 2301, The Auditor's Responses to the Risks of Material Misstatement	Issuer A	2
	Issuer B	2
	Issuer C	1
	Issuer E	1
	Issuer F	1

PCAOB Auditing Standards	Audits	Number of References per Audit
	Issuer G	1
	Issuer H	1
	Issuer I	1
	Issuer J	3
	Issuer K	1
	Issuer L	1
	Issuer M	1
	Issuer O	2
	Issuer R	1
	Issuer T	1
	Issuer U	1
	Issuer W	1
AS 2305, Substantive Analytical Procedures	Issuer F	1
	Issuer T	1
AS 2310, The Confirmation Process	Issuer B	2
	Issuer P	1
AS 2315, Audit Sampling	Issuer A	2
	Issuer B	1
	Issuer C	1
	Issuer F	1
	Issuer H	1
	Issuer I	1
	Issuer J	3
	Issuer L	1
	Issuer M	1
	Issuer O	1
	Issuer T	1
	Issuer U	1
	Issuer W	1
AS 2501, Auditing Accounting Estimates	Issuer A	1
	Issuer B	1
	Issuer C	1
	Issuer F	1

PCAOB Auditing Standards	Audits	Number of References per Audit
	Issuer G Issuer P Issuer T	1 1 2
AS 2502, Auditing Fair Value Measurements and Disclosures	Issuer A Issuer D Issuer I Issuer K Issuer P	1 1 1 1 2
AS 2810, Evaluating Audit Results	Issuer Y	1

B.2. Financial Statement Accounts or Auditing Areas Related to Identified Audit Deficiencies

The table below lists the financial statement accounts or auditing areas related to the deficiencies included in Part I.A of this report and identifies the audits described in Part I.A where deficiencies relating to the respective areas were observed.

	AS 1105	AS 2101	AS 2110	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2501	AS 2502	AS 2810
Accounts receivable		E		E	E						
AFS securities			A	A, C, J	A, J			A, J			
Business combinations				A						A	
Convertible notes				Z							
Deposit liabilities			A	A, B, Q	A, B		B, P	A, B			
Derivative assets and liabilities			A	A, J, K	A, J			A, J		K	
Income taxes				J	J			J			

	AS 1105	AS 2101	AS 2110	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2501	AS 2502	AS 2810
Impairment of goodwill and intangible assets				V							
Impairment of PP&E	D			D, R	R					D	
Impairment of loan receivables				R							
Insurance reserves				F					F		
Intangible assets, including amortization				G					G		
Inventory, including related reserves		E		E, N, S, T, W	E, T, W			T, W	T		
Loans, including ALL			A	A, B, C, H, I, O	A, C, H, I, O		B	A, C, H, I, O	A, B, C	I	
MSRs				A					P	P	
Revenue, including allowances		E		E, F, G, K, L, M, N, T, U, X	E, F, G, K, L, M, U	F, T		F, L, M, U			Y

B.3. Audit Deficiencies by Industry

The table below lists the industries⁵ of the issuers for which audit deficiencies were discussed in Part I.A of this report and cross references the issuers to the specific auditing standards related to the deficiencies.

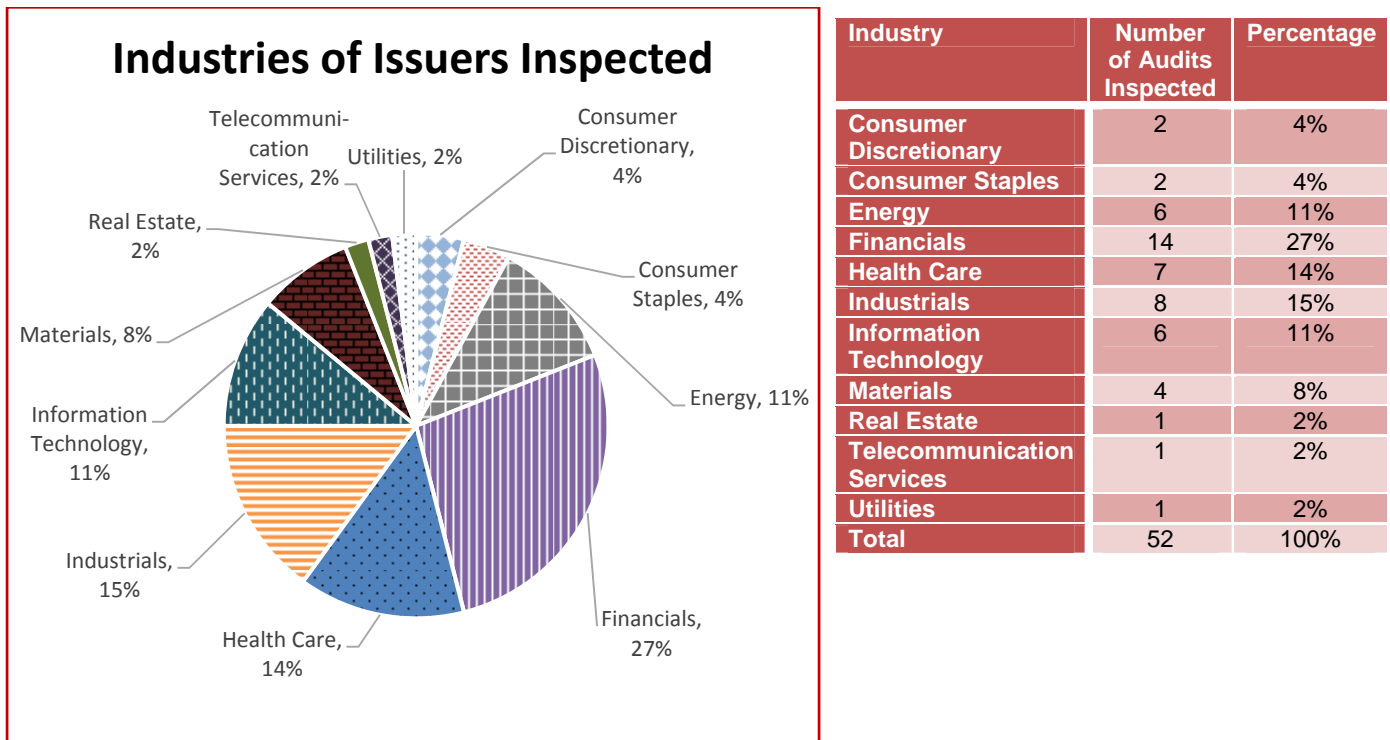
	AS 1105	AS 2101	AS 2110	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2501	AS 2502	AS 2810
Consumer Discretionary				G	G				G		
Consumer Staples				N, T	T	T		T	T		
Energy				R	R						Y
Financials			A	A, B, C, F, H, I, J, O, Q	A, B, C, F, H, I, J, O	F	B, P	A, B, C, F, H, I, J, O	A, B, C, F, P	A, I, P	
Health Care				X							
Industrials		E		E, L, V	E, L			L			
Information Technology				W, Z	W			W			
Materials	D			D, M, S	M			M		D	
Real Estate				U	U			U			
Utilities				K	K					K	

⁵ The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

C. Data Related to the Issuer Audits Selected for Inspection⁶

C.1. Industries of Issuers Inspected

The chart below categorizes the 52 issuers whose audits were inspected in 2017, based on the issuer's industry.⁷

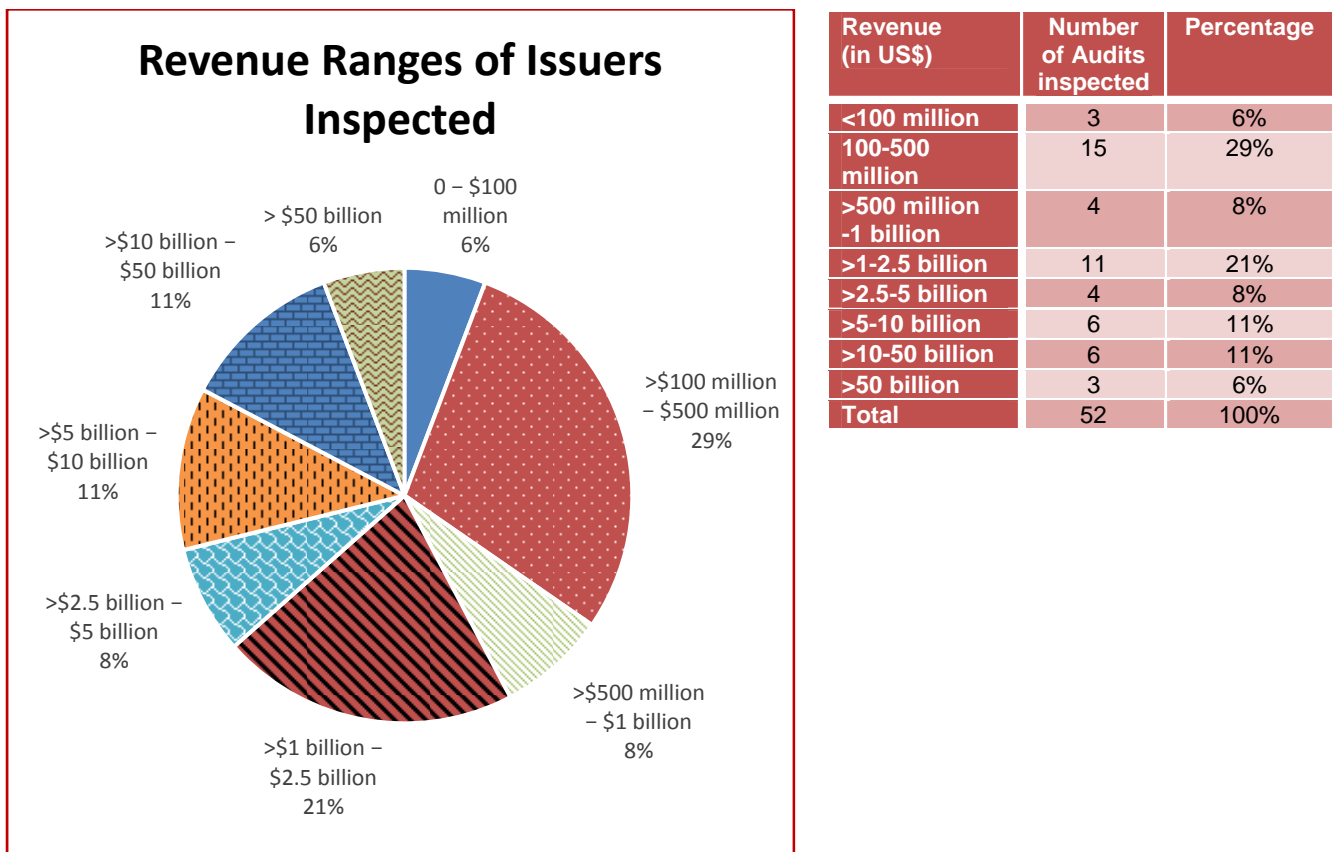


⁶ Where the audit work inspected related to an engagement in which the Firm played a role but was not the principal auditor, the industry and the revenue included in the tables and charts in this section are those of the entity for which an audit report was issued by the primary auditor. As discussed above, the inspection process included reviews of portions of 51 selected issuer audits completed by the Firm and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor.

⁷ See Footnote 5 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 52 issuers whose audits were inspected in 2017.⁸ This presentation of revenue data is intended to provide information related to the size of issuers whose audits were inspected and is not indicative of whether the inspection included a review of the Firm's auditing of revenue in the issuer audits selected for review.



⁸ The revenue amounts reflected in the chart are for the issuer's fiscal year end that corresponds to the audit inspected by the PCAOB. The revenue amounts were obtained from S&P and reflect a standardized approach to presenting revenue amounts.

D. Information Concerning PCAOB Inspections that is Generally Applicable to Annually Inspected Firms

This section provides a brief description of the procedures that are often performed in annual inspections of auditing firms.

D.1. Reviews of Audit Work

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. For each specific portion of the audit that is selected, the inspection team 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 review of any 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. 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.⁹

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,¹⁰ as well as a firm's failure to perform,

⁹ 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 adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

¹⁰ 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 the applicable financial reporting framework, 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

or to perform sufficiently, certain necessary risk assessment procedures, tests of controls, and substantive audit procedures.

In reaching its conclusions about whether a deficiency exists, an inspection team considers whether audit documentation or any other evidence that a firm might provide to the inspection team supports the firm's contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. 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 1215, *Audit Documentation*, provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. 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.

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

QC 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*, 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

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.

assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion or a failure to obtain sufficient appropriate audit evidence to fulfill the objectives of the firm's role in an audit may indicate a defect or potential defect in a firm's quality control system.¹¹ If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of the deficiencies;¹² related firm methodology, guidance, and practices; and possible root causes.

Inspections also 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

¹¹ 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.

¹² 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.

quality control. A description of the procedures generally applied to these areas is below.

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

Procedures in this area are designed to focus on (1) how management is structured and operates the firm's business, and the implications that the management structure and processes have on audit performance and (2) 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 firm personnel, including firm leadership, and review significant management reports, communications, and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.

D.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 (1) 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; (2) the firm's processes for allocating its partner resources; and (3) 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. Further, the inspection team may review a sample of partners' personnel files.

D.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 (1) 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 (2) observe whether the audit procedures were responsive to the risks of material misstatement identified during the firm's process.

D.2.d. Review of Processes Related to a Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on 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 internal inspections of foreign affiliated firms, interview members of the firm's leadership, and review the U.S. engagement teams' supervision concerning, and procedures for control of, the audit work that the firm's foreign affiliates performed on a sample of audits.

D.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

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

D.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 underlying 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.

D.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.

END OF PART I

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

APPENDIX B

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.¹³

¹³ 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 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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January 11, 2019

Mr. George Botic
Director - Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: Response to Part I of Draft Report on the 2017 Inspection of KPMG LLP

Dear Mr. Botic:

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on 2017 Inspection of KPMG LLP dated December 18, 2018 ("Draft Report").

We take the findings from the PCAOB inspection process seriously and believe the inspection process provides valuable insights to improve the quality of our audits. We are committed to full cooperation with the PCAOB, appreciate the professionalism and commitment of the PCAOB staff, and value the important role the PCAOB plays in improving audit quality.

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

Consistently executing quality audits is our top priority. We remain dedicated to continuous improvement in our audit engagement performance and our system of audit quality control. We understand that many of our stakeholders are interested in our overall efforts to improve audit quality, including the specific actions we have taken and continue to take. These actions are included in our 2018 Audit Quality Report. We understand our responsibility to our stakeholders and are committed to working constructively with the PCAOB in the months and years to come.

Sincerely yours,

KPMG LLP

Lynne M. Doughtie
Chairman and Chief Executive Officer

Frank E. Casal
Vice Chair – Audit

APPENDIX C

AUDITING STANDARDS REFERENCED IN PART I

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

AS 1105, Audit Evidence		
SUFFICIENT APPROPRIATE AUDIT EVIDENCE		
Using Information Produced by the Company		
AS 1105.10	<p>When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:³</p> <ul style="list-style-type: none"> ▪ Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and ▪ Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. 	Issuer D
<p><u>Footnote to AS 1105.10</u></p> <p>³ When using the work of a specialist engaged or employed by management, see AS 1210, <i>Using the Work of a Specialist</i>. When using information produced by a service organization or a service auditor's report as audit evidence, see AS 2601, <i>Consideration of an Entity's Use of a Service Organization</i>, and for integrated audits, see AS 2201, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>.</p>		

AS 2101, Audit Planning		
PLANNING AN AUDIT		
Multi-Location Engagements		
AS 2101.11	<p>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</p>	Issuer E

AS 2101, Audit Planning		
	<p>audit procedures should be performed at selected locations or business units to obtain sufficient 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>	
<p><u>Footnote to AS 2101.11</u></p> <p style="text-align: center;">¹³ The term "business units" includes subsidiaries, divisions, branches, components, or investments.</p>		
AS 2101.12	<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 that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") executed at the location or business unit;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 possibility¹⁶ of material misstatement to the company's consolidated financial statements; d. Whether the risks of material misstatement associated with 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; e. The degree of centralization of records or information processing; f. The effectiveness of the control environment, particularly with respect to management's control 	Issuer E

AS 2101, Audit Planning		
	<p>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 AS 2201¹⁷ for considerations when a company has multiple locations or business units.</p>	
<p><u>Footnotes to AS 2101.12</u></p> <p>¹⁴ Paragraph .66 of AS 2401, <i>Consideration of Fraud in a Financial Statement Audit</i>.</p> <p>¹⁵ AS 2105.10 describes the consideration of materiality in planning and performing audit procedures at an individual location or business unit.</p> <p>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.</p> <p>¹⁷ AS 2201.B10-.B16.</p>		

AS 2110, Identifying and Assessing Risks of Material Misstatement		
Factors Relevant to Identifying Fraud Risks		
AS 2110.65	<p>The auditor should evaluate whether the information gathered from the risk assessment procedures indicates that one or more fraud risk factors are present and should be taken into account in identifying and assessing fraud risks. Fraud risk factors are events or conditions that indicate (1) an incentive or pressure to perpetrate fraud, (2) an opportunity to carry out the fraud, or (3) an attitude or rationalization that justifies the fraudulent action. Fraud risk factors do not necessarily indicate the existence of fraud; however, they often are present in circumstances in which fraud exists. Examples of fraud risk factors related to fraudulent financial reporting and misappropriation of assets are listed in AS 2401.85. These illustrative risk factors are classified based on the three conditions discussed in this paragraph, which generally are present when fraud exists.</p>	Issuer A

AS 2110, Identifying and Assessing Risks of Material Misstatement		
	Note: The factors listed in AS 2401.85 cover a broad range of situations and are only examples. Accordingly, the auditor might identify additional or different fraud risk factors.	

AS 2201, 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 2201.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, B, C, F, G, H, J, K, M, N, O, Q, R, S, and T
TESTING CONTROLS		
Testing Design Effectiveness		
AS 2201.42	<p>The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.</p> <p>Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.</p>	Issuers A, B, C, D, G, H, I, J, K, L, R, S, T, V, and W.
Testing Operating Effectiveness		
AS 2201.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.	Issuers A, B, C, D, G, H, I, J, K, L, R, S, V, and Z

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
	<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 2201.46	<p>For each control selected for testing, the evidence necessary to persuade the auditor that the control is effective depends upon the risk associated with the control. The risk associated with a control consists of the risk that the control might not be effective and, if not effective, the risk that a material weakness would result. As the risk associated with the control being tested increases, the evidence that the auditor should obtain also increases</p> <p>Note: Although the auditor must obtain evidence about the effectiveness of controls for each relevant assertion, the auditor is not responsible for obtaining sufficient evidence to support an opinion about the effectiveness of each individual control. Rather, the auditor's objective is to express an opinion on the company's internal control over financial reporting overall. This allows the auditor to vary the evidence obtained regarding the effectiveness of individual controls selected for testing based on the risk associated with the individual control.</p>	Issuers N and U
AS 2201.47	<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 	Issuers N and U

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

	<p>which it operates;</p> <ul style="list-style-type: none"> ▪ The degree to which the control relies on the effectiveness of other controls (e.g., the control environment or information technology general controls); ▪ 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.e., 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 be supported by less evidence than is necessary to support a conclusion that a control is operating effectively.</p>	
AS 2201.55	<p><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.</p>	Issuer J

AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements		
EVALUATING IDENTIFIED DEFICIENCIES		
AS 2201.62	The auditor must evaluate the severity of each control deficiency that comes to his or her attention to determine whether the deficiencies, individually or in combination, are material weaknesses as of the date of management's assessment. In planning and performing the audit, however, the auditor is not required to search for deficiencies that, individually or in combination, are less severe than a material weakness.	Issuer X
APPENDIX B - Special Topics		
MULTIPLE LOCATIONS SCOPING DECISIONS		
AS 2201.B11	In assessing and responding to risk, the auditor should test controls over specific risks that present a reasonable possibility of material misstatement to the company's consolidated financial statements. In lower-risk locations or business units, the auditor first might evaluate whether testing entity-level controls, including controls in place to provide assurance that appropriate controls exist throughout the organization, provides the auditor with sufficient evidence.	Issuer E
USE OF SERVICE ORGANIZATIONS		
AS 2201.B22	If the service auditor's report on controls placed in operation and tests of operating effectiveness contains a qualification that the stated control objectives might be achieved only if the company applies controls contemplated in the design of the system by the service organization, the auditor should evaluate whether the company is applying the necessary procedures.	Issuer S

AS 2301, The Auditor's Responses to the Risks of Material Misstatement		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS 2301.08	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, E, G, K, O, and R

AS 2301, The Auditor's Responses to the Risks of Material Misstatement		
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS 2301.16	<p style="text-align: center;"><i>Controls to be Tested.</i> If the auditor plans to assess control risk at less than the maximum by relying on controls,¹² and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance.¹³ However, the auditor is not required to assess control risk at less than the maximum for <i>all</i> relevant assertions and, for a variety of reasons, the auditor may choose not to do so.</p>	Issuers A, B, C, F, H, I, J, L, M, O, T, U, and W
<p><u>Footnotes to AS 2301.16</u></p> <p>¹² Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures.</p> <p>¹³ Terms defined in Appendix A, <i>Definitions</i>, are set in boldface type the first time they appear.</p>		
AS 2301.18	<p style="text-align: center;"><i>Evidence about the Effectiveness of Controls in the Audit of Financial Statements.</i> In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.</p>	Issuers A, B, C, F, H, I, J, L, M, O, T, U, and W
SUBSTANTIVE PROCEDURES		
AS 2301.37	<p style="text-align: center;">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</p>	Issuers A, B, C, F, H, I, J, L, M, O, T, U, and W

AS 2301, <i>The Auditor's Responses to the Risks of Material Misstatement</i>		
	combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	

AS 2305, <i>Substantive Analytical Procedures</i>		
AS 2305.05	<p>Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations:</p> <ul style="list-style-type: none"> a. Financial information for comparable prior period(s) giving consideration to known changes b. Anticipated results—for example, budgets, or forecasts including extrapolations from interim or annual data c. Relationships among elements of financial information within the period d. Information regarding the industry in which the client operates—for example, gross margin information e. Relationships of financial information with relevant nonfinancial information 	Issuer F
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Plausibility and Predictability of the Relationship		
AS 2305.13	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.	Issuers F and T
AS 2305.14	As higher levels of assurance are desired from analytical procedures, more predictable relationships are required to develop the expectation. Relationships in a	Issuers F and T

AS 2305, Substantive Analytical Procedures		
	<p>stable environment are usually more predictable than relationships in a dynamic or unstable environment. Relationships involving income statement accounts tend to be more predictable than relationships involving only balance sheet accounts since income statement accounts represent transactions over a period of time, whereas balance sheet accounts represent amounts as of a point in time. Relationships involving transactions subject to management discretion are sometimes less predictable. For example, management may elect to incur maintenance expense rather than replace plant and equipment, or they may delay advertising expenditures.</p>	
Investigation and Evaluation of Significant Differences		
AS 2305.20	<p>In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.</p>	Issuer F

AS 2310, The Confirmation Process		
ALTERNATIVE PROCEDURES		
AS 2310.31	<p>When the auditor has not received replies to positive confirmation requests, he or she should apply alternative procedures to the nonresponses to obtain the evidence necessary to reduce audit risk to an acceptably low level. However, the omission of alternative procedures may be acceptable (a) when the auditor has not identified unusual qualitative factors or systematic characteristics related to the nonresponses, such as that all nonresponses pertain to year-end transactions, and (b) when testing for overstatement of amounts, the nonresponses in the aggregate, when projected as 100 percent misstatements to the population and added to the sum of all other unadjusted differences, would not affect the auditor's decision about whether the financial statements are materially misstated.</p>	Issuers B and P

AS 2315, Audit Sampling		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AS 2315.19	<p>After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details.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>	Issuers A, B, C, F, H, I, J, L, M, O, T, U, and W
<p><u>Footnote to AS 2315.19</u></p> <p>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>		
AS 2315.23	<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 A, B, C, F, H, I, J, L, M, O, T, U, and W
AS 2315.23A	<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 A, B, C, F, H, I, J, L, M, O, T, U, and W

AS 2501, Auditing Accounting Estimates		
EVALUATING ACCOUNTING ESTIMATES		
AS 2501.07	<p>The auditor's objective when evaluating accounting estimates is to obtain sufficient appropriate evidential matter to provide reasonable assurance that—</p> <ul style="list-style-type: none"> a. All accounting estimates that could be material to the financial statements have been developed. b. Those accounting estimates are reasonable in the circumstances. c. The accounting estimates are presented in conformity with applicable accounting principles² and are properly disclosed.³ 	Issuer P
<p><u>Footnotes to AS 2501.07</u></p> <p>² AS 2815, <i>The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles,"</i> discusses the auditor's responsibility for evaluating conformity with generally accepted accounting principles.</p> <p>³ See paragraph .31 of AS 2810, <i>Evaluating Audit Results.</i></p>		
Evaluating Reasonableness		
AS 2501.11	<p>Review and test management's process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:</p> <ul style="list-style-type: none"> a. Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation. b. Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests. c. Consider whether there are additional key factors or alternative assumptions about the factors. d. Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data. e. Analyze historical data used in developing the 	Issuers A, B, C, F, G, and T

AS 2501, Auditing Accounting Estimates		
	<p>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> <ul style="list-style-type: none"> f. Consider whether changes in the business or industry may cause other factors to become significant to the assumptions. 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. h. Consider using the work of a specialist regarding certain assumptions (AS 1210, <i>Using the Work of a Specialist</i>). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate. 	

AS 2502, 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		
AS 2502.26	<p>The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:</p> <ul style="list-style-type: none"> a. Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06). b. The fair value measurement was determined using an appropriate model, if applicable. c. Management used relevant information that was reasonably available at the time. 	Issuers D, I, K, and P
AS 2502.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management	Issuers D, I, K, and P

AS 2502, Auditing Fair Value Measurements and Disclosures		
	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.	
AS 2502.39	The auditor should test the data used to develop the fair value measurements and disclosures and evaluate whether the fair value measurements have been properly determined from such data and management's assumptions. Specifically, the auditor evaluates whether the data on which the fair value measurements are based, including the data used in the work of a specialist, is accurate, complete, and relevant; and whether fair value measurements have been properly determined using such data and management's assumptions. The auditor's tests also may include, for example, procedures such as verifying the source of the data, mathematical recomputation of inputs, and reviewing of information for internal consistency, including whether such information is consistent with management's intent and ability to carry out specific courses of action discussed in paragraph .17.	Issuers A and D
Developing Independent Fair Value Estimates for Corroborative Purposes		
AS 2502.40	The auditor may make an independent estimate of fair value (for example, by using an auditor-developed model) to corroborate the entity's fair value measurement. 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.	Issuer K
<p><u>Footnote to AS 2502.40</u></p> <p>⁶ See AS 2305, <i>Substantive Analytical Procedures</i>.</p>		

AS 2502, Auditing Fair Value Measurements and Disclosures		
DISCLOSURES ABOUT FAIR VALUES		
AS 2502.43	The auditor should evaluate whether the disclosures about fair values made by the entity are in conformity with GAAP. ⁸ 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 K
<p><u>Footnote to AS 2502.43</u></p> <p>⁸ See also paragraph .31 of AS 2810, <i>Evaluating Audit Results</i>.</p>		

AS 2810, Evaluating Audit Results		
EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS		
AS 2810.03	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 Y