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Report on

2016 Inspection of KPMG LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

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THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

PORTIONS OF THE COMPLETE REPORT ARE OMITTED FROM THIS DOCUMENT IN ORDER TO COMPLY WITH SECTIONS 104(g)(2) AND 105(b)(5)(A) OF THE SARBANES-OXLEY ACT OF 2002

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2016 INSPECTION OF KPMG LLP

Preface

The Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KPMG LLP ("KPMG" or "the Firm") for the year 2016 pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.D of this report (which also contains additional information concerning PCAOB inspections generally). The inspection included reviews of portions of selected issuer audits. These reviews were intended to identify whether deficiencies existed in the reviewed work, and whether such deficiencies indicated defects or potential defects in the Firm's system of quality control over audits. In addition, the inspection included a review of policies and procedures related to certain quality control processes of the Firm that could be expected to affect audit quality.

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, portions of Appendix B and Appendix C. Appendix B consists of the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the Firm's system of quality control, those discussions also could eventually be made public, but only to the extent the Firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report. Appendix C presents the text of the paragraphs of the auditing standards that are referenced in Part I.A in relation to the description of auditing deficiencies there.

Note on this report's citations to auditing standards: On March 31, 2015, the PCAOB adopted a reorganization of its auditing standards using a topical structure and a single, integrated numbering system. *See Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015). The reorganization became effective as of December 31, 2016. Citations in this report reference the reorganized PCAOB auditing standards.

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EXECUTIVE SUMMARY

This summary sets out certain key information from the 2016 inspection of KPMG. The inspection procedures included reviews of portions of 50 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. All of the 51 engagements were integrated audits of both internal control and the financial statements. These 51 audits ("51 Audits") consist of 41 non-financial institution issuer audits reviewed pursuant to the inspection team's original inspection plan and 10 additional reviews of financial institution issuer audits that, as described in Part I.A, were selected to replace 11 financial institution issuer audits that had been reviewed as part of the inspection team's original inspection plan for which the Firm obtained improper advance notice. Part I.A of this report provides information about the audit engagements selected for inspection. Part I.C of this report provides certain demographic information about the audits inspected and Part I.D describes the general procedures applied in the PCAOB's 2016 inspections of annually inspected registered firms.

The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. In 22 of the 51 Audits reviewed and in three financial institution issuer audits reviewed as part of the inspection team's original inspection plan, certain of the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in conformity with the applicable financial reporting framework and/or its opinion about whether the issuer had maintained, in all material respects, effective internal control over financial reporting ("ICFR"). The deficiencies in the 22 audits are described in Part I.A of this report under *Audit Deficiencies Related to the 51 Audits*, and the deficiencies in the three financial institution issuer engagements reviewed as part of the inspection team's original inspection plan are described in Part I.A of this report under *Audit Deficiencies Related to the Originally Reviewed Financial Institution Issuer Engagements*.

Effects of Audit Deficiencies on Audit Opinions

Of the 22 issuer audits that appear in Part I.A under *Audit Deficiencies Related to the 51 Audits*, deficiencies in 19 audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in 20 audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below. Of the 20 audits in which substantive testing deficiencies were identified, eight audits included deficiencies in substantive testing that the inspection team determined were caused by a reliance on controls that was excessive in light of deficiencies in the testing of controls.

	Number of Audits
Audits for which deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	17 Audits: Issuers A, B, C, D, E, F, G, H, I, J, K, L, M, N,O, Q, and U
Deficiencies included in Part I.A related to the ICFR audit only	2 Audits: Issuers S and T
Audits for which deficiencies included in Part I.A related to the financial statement audit only	3 Audits: Issuers P, R, and V
Total	22

Of the three financial institution issuer audits reviewed as part of the inspection team's original inspection plan that appear in Part I.A under *Audit Deficiencies Related to the Originally Reviewed Financial Institution Issuer Engagements*, deficiencies in two audits related to either testing controls for purposes of the ICFR opinion only or substantive testing performed for purposes of the opinion on the financial statements only, and one audit related to testing both opinions as noted in the table below.

	Number of Audits
Audits for which deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	1 Audit: Issuer AAA
Deficiencies included in Part I.A related to the ICFR audit only	1 Audit: Issuer CCC
Audits for which deficiencies included in Part I.A related to the financial statement audit only	1 Audit: Issuer BBB
Total	3

Most Frequently Identified Audit Deficiencies

The following table lists, in summary form, the types of deficiencies that are included most frequently in Part I.A of this report. A general description of each type is provided in the table; the description of each deficiency in Part I.A contains more specific information about the individual deficiency. The table includes only the three most frequently identified deficiencies that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Issue	Part I.A Audits
Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing	18 Audits: Issuers A, B, C, D, E, F, G, I, J, K, N, O, Q, S, T, U, AAA, and CCC
Failure to identify and test any controls that addressed the risks related to a particular account or assertion	11 Audits: Issuers A, E, F, H, K, L, M, N, O, T, and AAA
Failure to sufficiently test significant assumptions or data that the issuer used in developing an estimate	11 Audits: Issuers A, B, C, D, F, I, J, K, O, U, and AAA

Areas in which Audit Deficiencies Were Most Frequently Identified

The following table lists, in summary form, the financial statement accounts or auditing areas in which the deficiencies that are included in Part I.A of this report most frequently occurred. The table includes only the three most frequently identified areas that are in Part I.A of this report and is not a summary of all deficiencies in Part I.A.

Area	Part I.A Audits
Loans, including the allowance for loan losses	8 Audits: Issuers A, B, D, E, J, K, L, and AAA
Revenue, including allowances	7 Audits: Issuers F, G, H, M, N, Q, and R
Business Combinations	6 Audits: Issuers C, F, O, S, U, and AAA

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from November 2015 to April 2018. The inspection team performed field work at the Firm's National Office. In addition, the inspection of the 51 Audits related to audits that were performed by 29 of the Firm's approximately 80 U.S. practice offices.

A. Review of Audit Engagements

Audit Engagements Selected for Inspection

The inspection procedures included reviews of portions of 50 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 51 Audits consist of 41 audits of non-financial institution issuer engagements that the inspection team selected during its planning procedures in late 2015 and early 2016 and 10 additional audits of financial institution issuer engagements that were selected later, for the reasons described below.

In February 2017, the Firm notified the PCAOB that certain members of Firm leadership obtained improper advance notice of engagements to be inspected by the PCAOB during the 2017 inspection. Shortly thereafter, the Firm notified the PCAOB that certain members of Firm leadership had also obtained improper advance notice of financial institution issuer engagements inspected by the PCAOB during the 2016 inspection of the Firm. For the 2016 inspection, in November 2015 through October 2016 and prior to being informed about the Firm's inappropriate access to the list of planned inspections for financial institution engagements, the inspection team conducted 52 reviews of issuer audits, including 11 audits of financial institutions. Fifty-

[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.

one of these audits had 2015 or early 2016 year ends and one had a 2014 year end. The Firm publicly announced in April 2017 that certain members of Firm leadership, in collusion with an individual who was then employed by the PCAOB, obtained improper advance notice of engagements to be inspected by the PCAOB. After the Firm's April 2017 announcement, the inspection team conducted reviews of the audits of 10 additional financial institution issuers[2] with 2015 year ends to replace its reviews of all 11 financial institution audits that had been conducted as part of the inspection team's original inspection plan for which the Firm obtained improper advance notice. The inspections of these 10 additional financial institution audits occurred during the period from May 2017 to October 2017.

Inspection Results

	Reviews
Number of audits reviewed for which the Firm did not obtain improper advance notice	51
Of the 51 Audits reviewed, audits with deficiencies included in Part I.A	22
Percentage of the 51 Audits reviewed with deficiencies included in Part I.A	43%

Comparison of Inspection Results for Audits of Financial Institution Issuers

	Initial Reviews of Financial Institution Audits	Additional Reviews of Financial Institution Audits
Number of audits of financial institution issuers reviewed	11	10
Number of financial institution audits reviewed with deficiencies included in Part I.A	3[3]	9[4]

[2] Issuers A, B, D, E, J, K, L, P, T, and Z

[3] Part I.A deficiencies for all of these audits represented either (1) deficiencies in testing the ALL that were not recurring in nature or (2) deficiencies in areas other than the ALL.

[4] Part I.A deficiencies for three of these audits represented either (1) deficiencies in testing the ALL that were not recurring in nature or (2) deficiencies in areas other than the ALL.

	Initial Reviews of Financial Institution Audits	Additional Reviews of Financial Institution Audits
Percentage of audits reviewed with deficiencies included in Part I.A	27%	90%

The inspection results for the originally planned inspections, conducted during the 2016 calendar year, indicated an apparent improvement in some respects over the prior year's results, specifically in certain areas of financial institution audits. In the 11 financial institution audits it reviewed during calendar-year 2016,[5] the inspection team did not identify any deficiencies related to the Firm's testing of the assumptions and inputs underlying the portion of the allowance for loan losses ("ALL") for loans that are collectively evaluated for impairment, and there were no identified deficiencies in the testing of controls over the ALL. When the results of the additional reviews that were performed in 2017 as part of the 2016 inspection were factored in, however, the overall incidence of identified deficiencies increased. The major contributing factor to this increase is the identification of deficiencies related to testing controls over the ALL, which occurred in six of the 10 additional audits inspected in 2017.[6]

Deficiencies Included in Part I.A

In one of the audits described below, after the primary inspection procedures, the Firm revised its opinion on the effectiveness of the issuer's internal control over financial reporting ("ICFR") to express an adverse opinion.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix C to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional

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5 Issuers AA, BB, CC, DD, EE, FF, GG, AAA, BBB, CCC, and DDD

6 Issuers A, B, D, E, J, and K

skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in the references to the auditing standards in this sub-Part, unless the lack of compliance with these standards is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

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

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

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.[7]

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[7] Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and an inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. Failure by a firm to take appropriate actions, or a firm's misrepresentations in responding to an inspection report about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

The audit deficiencies that reached this level of significance are described in Parts I.A.1 through I.A.25, below.

Audit Deficiencies Related to the 51 Audits

A.1. Issuer A

In this audit of an issuer in the financial services industry, 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'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 included testing the mathematical accuracy of information appearing on a sample of retail deposit statements, recalculating interest and fees, and 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 identified and tested a control consisting of the monitoring of customer complaints related to retail deposit accounts. The Firm failed to determine whether all relevant customer complaints were covered by this control. In addition, to test this control, the Firm selected a sample of complaints from a population that excluded a category of complaints that constituted the majority of complaints, without having a basis to do so. (AS 2201.42 and .44)

  - The Firm failed to identify and test any controls over a significant portion of non-retail deposit liabilities. (AS 2201.39)

  - 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 certain of the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample size the Firm used to confirm retail deposits was too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

  - The Firm failed to sufficiently test those retail deposits in its sample for which the requested positive confirmations were not returned, as it limited its alternative procedures to comparing customer names, addresses, and account numbers to signed account signature cards without performing procedures to test the recorded amounts of the deposits. (AS 2310.31)

- The Firm failed to perform sufficient procedures related to loans receivable. Specifically –

- o 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)

- o The Firm failed to perform any substantive procedures to test interest and fees on loans receivable. (AS 2301.36)

A.2. Issuer B

In this audit of an issuer in the financial services industry, 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 –

  - o 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 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. During the period under audit, the issuer did not perform the independent loan-grade review for one of these high-risk loan portfolios; this portfolio represented approximately 45 percent of the total high-risk loans. 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. While the Firm identified and tested another control in this area to address the risk of the issuer assigning inappropriate loan grades to the loans within the high-risk commercial portfolio that was excluded from the independent loan-grade review, the Firm's testing was not sufficient. This control consisted of an annual review of commercial loan grades by the regional managers responsible for the lending relationships for certain loans, including some of the loans within this high-risk commercial loan portfolio. The Firm's testing of this control was not sufficient, because it failed to address the risk that the control might not be effective due to the lack of objectivity of the control owner. (AS 2201.42)

- o 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)

- o 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)

- o 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 an issuer-prepared analysis to amounts recorded in the loan system, without inspecting any supporting documentation for these charge-offs. (AS 2501.11)

- The Firm failed to perform sufficient procedures to test controls over available-for-sale debt 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)

- The Firm failed to perform sufficient procedures with respect to deposit liabilities. Specifically –

    - The issuer placed items in a deposit suspense account when the items needed further evaluation or processing. The Firm identified and tested a control that included a review of the issuer's deposit suspense account reconciliations. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its procedures to (1) inquiring of the control owner, (2) comparing the ending balance from the reconciliations to the general ledger, (3) evaluating the appropriateness of items included in the suspense accounts, (4) determining that certain items had been cleared on a timely basis, and (5) observing signatures as evidence of review. The Firm's testing did not include evaluating the nature of the review procedures performed, including the assessment of whether items that had been cleared from the suspense accounts had been appropriately resolved. (AS 2201.42 and .44)

    - The Firm identified and tested a control over the logging, monitoring, and resolution of customer complaints. The Firm's procedures to test this control were limited to (1) inquiring of the control owner about the customer complaint process and the status of a sample of outstanding complaints, (2) observing a call center employee receiving one customer complaint call and documenting the details of the call in the issuer's customer complaint system, and (3) inspecting the customer complaint log report generated from this system and noting that the outstanding items were related to non-financial matters. The Firm's testing did not include evaluating the nature of the review procedures performed, including testing whether the control owner had cleared any customer complaints during the period under audit and, if so, whether those complaints were appropriately resolved. In addition, the Firm failed to identify and test any controls over (1) the accuracy and completeness of the customer complaint log report and (2) user access to the customer complaint system. (AS 2201.39, .42, and .44)

- o The Firm limited its substantive procedures to test the deposit and cash suspense account reconciliations to (1) comparing the ending balance from the reconciliations to the general ledger, (2) testing the mathematical accuracy of the calculations within the reconciliations, and (3) inspecting whether certain items included in the suspense accounts had been cleared on a timely basis. The Firm, however, failed to test whether suspense items that had been cleared were appropriately resolved. (AS 2301.08)

A.3. Issuer C

In this audit of an issuer in the oil and gas industry, 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 experienced certain adverse market conditions and deteriorating financial results during the year. The issuer developed forecasted financial results to prepare projections of cash flows and earnings before interest, taxes, depreciation, and amortization ("EBITDA"). The issuer used both of these projections in its annual assessment of the possible impairment of goodwill, and also used the EBITDA projections in its evaluation of the ability to continue as a going concern. The Firm failed to perform sufficient procedures related to its evaluation of the issuer's valuation of goodwill and the issuer's ability to continue as a going concern. Specifically –

- o The Firm selected for testing a control that consisted of reviews of the issuer's forecasted financial results by senior management. The Firm failed to sufficiently test this control, as its procedures were limited to (1) inquiring of the control owners, (2) testing the mathematical accuracy of the forecasts, and (3) inspecting documentation used in the operation of this control. The Firm failed to evaluate the nature of the review procedures performed by the control owners, including the criteria used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

- o The Firm failed to sufficiently evaluate the reasonableness of significant assumptions that the issuer used to develop the forecasted financial results used to project EBITDA and cash flows. Specifically, with respect to the revenue, gross margin, and operating expense assumptions underlying the forecasted financial results, the Firm's procedures were limited to (1) inquiring of management, (2) reading publicly available information regarding expected trends in the issuer's industry to understand when market conditions were generally expected to improve, and (3) obtaining and reading the issuer's cost-reduction plans. (AS 2415.03; AS 2502.26 and .28)

- o To estimate the fair value of its reporting units in order to perform the goodwill impairment analysis, the issuer used a discounted cash-flow approach and a market approach based on applying valuation multiples to EBITDA. In addition to the deficiency described above in testing the forecasted financial results, the Firm failed to perform any procedures to evaluate the reasonableness of the valuation multiples that the issuer used at year end in the market approach to the valuation of the reporting units. (AS 2502.26 and .28)

- The Firm's procedures related to the valuation of assets acquired during the year in a significant business combination were insufficient. Specifically –

- o The Firm selected for testing three controls that included management's review of (1) the opening balance sheet, fair values assigned to the acquired assets, and adjustments made during the measurement period; (2) the external valuation report that the issuer used to determine the fair value of acquired long-lived assets; and (3) the external valuation report that the issuer used to determine the fair value of acquired intangible assets. The Firm's testing of these three controls was not sufficient. Specifically, the Firm limited its procedures to inquiring of management and inspecting documentation used in the operation of these controls. The Firm failed to evaluate the nature of the review procedures performed by the control owners, including the expectations they applied in their reviews, the criteria they used to identify matters for follow up, and the resolution of such matters. In addition, the Firm failed to test, other than through inquiry, the aspect of the third control that addressed the accuracy and completeness of certain data that the issuer provided to the specialist for use in the valuation of the acquired intangible assets. (AS 2201.42 and .44).

- o The Firm failed to sufficiently evaluate the reasonableness of certain data and significant assumptions that the issuer used to determine the fair value of certain acquired assets. Specifically –

  - ▪ The Firm failed to test the accuracy of the historical-cost and asset-condition data used to value the acquired property and equipment. (AS 2502.39)

  - ▪ The Firm's procedures to evaluate the projected revenue and margins that the issuer used to value certain acquired intangible assets were insufficient, as they were limited to comparing the projected results of the acquired company for the year to the actual results for the same period. In addition, the Firm failed to test the accuracy and completeness of the data used to calculate the attrition rate, which was a significant assumption underlying the valuation of one of the acquired intangible assets. (AS 2502.26, .28, and .39)

A.4. Issuer D

In this audit of an issuer in the financial services industry, 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 issuer's ALL, mortgage servicing rights ("MSRs"), and derivatives. Specifically –

- The Firm selected for testing two controls: one over the ALL, MSRs, and derivatives; and another over the ALL. The Firm's testing of these controls was not sufficient. 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. (AS 2201.42 and .44)

  - The Firm selected for testing a control over a significant portion of the issuer's loan portfolio that consisted of management's quarterly reviews of loan valuation calculations, the majority of which were prepared using a discounted cash flow approach. The Firm limited its procedures to test this control for those loans valued using a discounted cash flow approach to (1) inquiring of the control owners, (2) reading a sample of discounted cash flow worksheets and related documents, and (3) inspecting the 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 – including the sample sizes used in those procedures – to test the valuation of the ALL and certain derivatives 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 that the Firm used in its testing 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)

A.5. <u>Issuer E</u>

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

- The Firm failed to perform sufficient procedures to test controls over the ALL. Specifically –

  - The Firm selected for testing a control that consisted of (1) a committee's review of the risk assessment for loans subject to grading by the issuer, including the determination of which loans would be subject to an independent loan-grade review, and (2) the independent review by the issuer's loan review group of the assigned loan grades for a sample of loans on an annual basis, including the identification of impaired loans as of the review date. The loan grades were an important factor in estimating the ALL. The Firm's testing of this control was not sufficient. Specifically –

    - The Firm limited its procedures to test the aspect of the control consisting of the review of the risk assessment to (1) inquiring of the preparer of the risk assessment and of one of the control owners, (2) reading certain documentation used in the operation of the control, and (3) reading the committee's meeting minutes that indicated approval of the risk assessment. The Firm's testing did not include evaluating the nature of the review procedures performed by the control owners, including the criteria used to identify items for follow up and the resolution of such matters. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data used in the operation of this control. (AS 2201.39, .42, and .44)

        - The Firm failed to sufficiently test the aspect of the control consisting of the independent review of a sample of loans, including the identification of impaired loans, by the issuer's loan review group, as the Firm's procedures were limited to evaluating the appropriateness of the loan grades. The Firm's testing did not include evaluating the nature of the specific steps that the loan review group performed to identify impaired loans. (AS 2201.42 and .44)

        - The Firm failed to identify and test any controls over the ongoing evaluation of loans for potential impairment to address the risk of not identifying impaired loans in a timely manner. (AS 2201.39)

    - The Firm selected for testing a control that included management's review of the qualitative component of the ALL. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its procedures to inquiring of the control owner and reading certain documentation used in the operation of the control. The Firm failed to evaluate the nature of the review procedures performed by the control owner, including the criteria used to identify items for follow up and the resolution of such matters. (AS 2201.42 and .44)

- The Firm failed to perform sufficient procedures with respect to loans receivable. Specifically –

    - The issuer placed items in loan suspense accounts when the items needed further evaluation or processing. The Firm identified and tested a control that consisted of 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)

- In determining its sample sizes used to confirm loans, the Firm failed to take into account tolerable misstatement. As a result, the samples that the Firm used to test the loans' existence were too small to provide sufficient evidence. (AS 2315.16, .23, and .23A)

- The Firm failed to perform sufficient procedures with respect to deposits. Specifically –

  - The data reflecting the issuer's deposit account transaction activity were 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)

  - The issuer placed items in a deposit clearing or suspense account when the items needed further evaluation or processing. The Firm selected for testing two controls that consisted of reviews of the issuer's deposit clearing and suspense account reconciliations, including an assessment of the appropriateness of the resolution of items that had been cleared from these accounts. The Firm's testing of these controls was not sufficient. Specifically, the Firm limited its procedures to (1) inquiring of the control owner, (2) comparing the ending balance from the reconciliations to the general ledger, (3) evaluating the appropriateness of the items in the clearing and suspense accounts, (4) determining that certain items had cleared on a timely basis, and (5) observing signatures as evidence of review. The Firm's testing did not include evaluating the nature of the review procedures performed, including the assessment of whether items that had been cleared from the clearing or suspense accounts had been appropriately resolved. (AS 2201.42 and .44)

  - The Firm failed to perform sufficient substantive procedures to test the deposit clearing and suspense accounts. Specifically, the Firm limited its procedures to (1) comparing the ending balance from the reconciliations for these accounts to the general ledger, (2) testing the mathematical accuracy of the reconciliations, and (3) inspecting documentation that noted certain items had been cleared on a timely basis. The Firm, however, failed to test whether items that had been cleared were appropriately resolved. (AS 2301.08)

A.6. Issuer F

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

- The Firm's procedures related to the valuation of certain intangible assets acquired and liabilities assumed during the year in a business combination were insufficient. Specifically –
  - The issuer valued these assets and liabilities based on their forecasted cash flows. The Firm failed to identify and test any controls over the accuracy and completeness of the inputs into the contractual cash flows the issuer used to determine the fair value of these assets and liabilities. (AS 2201.39)
  - The Firm failed to test certain significant assumptions underlying the cash-flow forecasts used to value these assets and liabilities. (AS 2502.26 and .28)
- The Firm selected for testing a control over the valuation of goodwill that consisted of management's review of qualitative and quantitative information that was part of the issuer's qualitative assessment of the potential impairment of goodwill. The Firm's procedures to test this control were insufficient. Specifically, to test the design effectiveness of this control, the Firm selected an occurrence of the control from the previous year and failed to test the design of the control for the year under audit. In addition, its test of operating effectiveness was limited to reading the memorandum prepared by the control owner that described the qualitative and quantitative information and the conclusions reached. The Firm did not, however, evaluate the nature of the procedures the control owner performed to review the qualitative information. (AS 2201.42 and .44)

- For two of the issuer's segments, the Firm failed to perform sufficient procedures related to certain revenue; for each segment, that revenue represented a significant portion of the issuer's total revenue. Specifically –

    - For one of these segments, with respect to one type of revenue –

        - The Firm's testing of the two controls it identified over the recognition of this revenue was insufficient in the following respects –

            - One of these controls consisted of (1) the comparison, by issuer personnel at the issuer's numerous locations, of evidence of delivery to sales records and (2) the resolution of identified differences. In determining the scope of its tests of this control, the Firm assumed that the control operated similarly across these locations. Based on this assumption, the Firm reduced the number of locations it selected for testing the design effectiveness of this control to one. The Firm, however, failed to (1) obtain evidence, beyond inquiry, to support its assumption that the control operated similarly at all locations and (2) evaluate the evidence it obtained through inquiry that indicated apparent differences in the design of the control at different locations. In addition, the Firm limited its testing of the operating effectiveness of this control to comparing evidence of delivery to system-generated sales records as part of its substantive testing, without testing whether differences identified by the control owners were resolved timely and appropriately. (AS 2201.42 and .44)

            - The Firm failed to identify and test any controls over the accuracy and completeness of certain data that the control owner used in the operation of the second control. (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 controls that are discussed above. As a result, 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)

- For the second of these two segments, the Firm selected for testing five controls that consisted of the monthly calculation of revenue and reviews of revenue information. The Firm's testing of these controls was not sufficient, as the Firm failed to identify and test any controls over the accuracy and completeness of data and reports that the control owners used in the operation of these controls. (AS 2201.39)

A.7. <u>Issuer G</u>

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

- The Firm's procedures related to revenue at certain of the issuer's locations, which represented a significant amount of the issuer's total revenue and presented a reasonable possibility of material misstatement, were insufficient. Specifically –

  - The Firm selected for testing one control over revenue at these locations, which consisted of a comparison of operating results to the prior-periods' results and to forecasted results and the investigation of variances above established thresholds. The Firm's procedures to test this control were limited to (1) inquiring of the control owner, (2) inspecting documentation as evidence of review, (3) noting that all comparisons as required by the control description were performed, and (4) determining whether explanations were provided for all variances over the investigation thresholds. The Firm's testing was insufficient, as it did not include evaluating the nature of the procedures performed by the control owner, including whether items identified for investigation were appropriately resolved. (AS 2201.42 and .44)

  - o The Firm failed to perform any substantive procedures to test revenue at these locations. (AS 2301.08)

- The Firm selected for testing four controls over income taxes that consisted of (1) the quarterly and annual reviews of certain income tax calculations and analyses, (2) the review of an analysis of the deferred tax asset valuation allowance and of the roll-forward of net operating losses, (3) the quarterly review of the identification and valuation of the issuer's uncertain tax positions, and (4) the monitoring of certain factors that could potentially affect the issuer's assertion regarding permanent reinvestment. The Firm's procedures to test these controls were insufficient, as they were limited to (1) inquiring of the control owner and other issuer personnel, (2) tracing certain income tax account balances included in the analyses to the general ledger, (3) testing the mathematical accuracy of certain calculations, (4) obtaining various reports and schedules used by the issuer to support its ability to assert permanent reinvestment, and (5) noting that the control owner identified an immaterial error in one income tax account. The Firm failed to evaluate the nature of the review procedures performed, including the criteria used by the control owner to identify items for follow up and the resolution of such matters. (AS 2201.42 and .44)

A.8. <u>Issuer H</u>

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The Firm failed to perform sufficient procedures related to the issuer's revenue in the following respects –

- The issuer processed a significant portion of its revenue through one revenue system. While the Firm tested controls over the entry of data in the system and the processing of sales transactions, it failed to identify and test any controls over the accuracy and completeness of the data transferred from the revenue system to the general ledger. (AS 2201.39)

- The Firm identified a fraud risk related to an incentive to inappropriately recognize revenue at the end of financial reporting periods in order to meet internal forecasts. The Firm's procedures to address this risk consisted of reviewing transactions that were recorded in the last five days of the year and for which the contract or delivery date reflected in the revenue system was either blank or after year end. This testing was insufficient, as the Firm failed to test any other transactions that were recorded in the last five days of the year without considering whether other transactions during this period presented the same risk. (AS 2301.13)

- The Firm failed to perform sufficient procedures to test a significant portion of revenue. The Firm performed analytical procedures that constituted its primary substantive testing of this revenue. The analytical procedures, however, were insufficient. Specifically, the Firm failed to develop expectations that were sufficiently precise to identify potential material misstatements, as, in performing the procedures, it failed to disaggregate the data to address important factors such as the different products, which the issuer assigned to separate reportable segments, and variations among the issuer's geographical markets, which the issuer disclosed as having an effect on sales. In addition, the Firm failed to sufficiently test the accuracy and completeness of certain data it used in the performance of these analytical procedures, as it limited its procedures to comparing the data to system-generated reports that it had not tested. (AS 2305.16 and .17)

A.9. <u>Issuer I</u>

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The Firm's procedures related to certain types of inventory at two of the issuer's divisions, which represented a significant portion of total inventory, were insufficient in the following respects –

- With respect to the existence of this inventory at both of these divisions –

  - The Firm selected for testing controls over the existence of this inventory that consisted of the performance and review of cycle counts. The Firm's testing of these controls was limited to (1) inquiring of the control owners, (2) observing and performing cycle counts at certain locations of one of these divisions and comparing the quantities from its counts to the issuer's system of record, and (3) inspecting documents for the control owner's sign-off as evidence of review. The Firm failed to determine whether the cycle-count procedures at these divisions were performed in accordance with the issuer's cycle-count policies, including whether (1) all inventory items were identified and counted, (2) the cycle counts occurred as frequently as planned, and (3) the issuer monitored the accuracy of the results of the cycle-count procedures. (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 deficiency in the Firm's testing of controls that is discussed above. As a result, the sample sizes the Firm used to test the existence of this inventory at year end were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- With respect to the valuation of this inventory at one of these two divisions –

  - The Firm selected for testing a control over the reserve for excess or obsolete inventory that consisted of management's review of the calculation of the reserve. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its testing to (1) inquiring of the control owners, (2) testing the mathematical accuracy of the reserve calculation, and (3) comparing the total inventory balance in the reserve calculation to the general ledger. The Firm's testing did not include evaluating the nature of the review procedures performed, including (1) whether the control owners assessed the reasonableness of the reserve percentages the issuer used to calculate the reserve and (2) the criteria the control owners used to identify matters for follow up and the resolution of such matters. In addition, the Firm failed to identify and test any controls over the accuracy of certain data used in the performance of this control. (AS 2201.39, .42, and .44)

  - The Firm failed to perform sufficient substantive procedures to test the reserve for excess or obsolete inventory at this division. Specifically –

    - The Firm failed to sufficiently evaluate the reasonableness of the reserve percentages that the issuer used to calculate the reserve, as the Firm's procedures were limited to (1) inquiring of management, (2) comparing the reserve balance to prior-year amounts, and (3) obtaining the sales data and gross margin for a sample of sales transactions of inventory that had previously been reserved. (AS 2501.11)

- The Firm failed to test the accuracy of certain data that the issuer used to calculate the reserve, beyond comparing those data to a data warehouse system, and the Firm did not, in the alternative, test controls over the accuracy of those data. (AS 2501.11)

A.10. Issuer J

In this audit of an issuer in the financial services industry, 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.11. Issuer K

In this audit of an issuer in the financial services industry, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The Firm's procedures related to the ALL for one type of loan, which represented a significant portion of the issuer's loan portfolio, were not sufficient. Specifically –

- With respect to these loans that were collectively evaluated for impairment –

  - The Firm identified and tested one control over the model that the issuer used to determine this portion of the ALL. This control included a review of the appropriateness of the model and its assumptions. The Firm limited its procedures to test this control to (1) inquiring of the control owners, (2) evaluating the competence of the control owners, (3) reading documentation and analyses used in the performance of the control, and (4) documenting that the control owners' conclusions were consistent with the Firm's general expectations. The Firm failed to evaluate the nature of the review procedures performed by the control owners in their reviews, including the criteria used to identify items for follow up and the resolution of such matters. (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 assumptions, which were key inputs to the estimation of this portion of the ALL. Specifically, the Firm's only procedures to test these assumptions were inquiring of management and reading an issuer-prepared report and supporting analyses, without performing any testing of these analyses. (AS 2501.11)

- With respect to the loans of this type that were subject to troubled debt restructuring provisions and individually evaluated for impairment –

- o The Firm failed to identify and test any controls over the default-rate assumption the issuer used in the valuation of these loans. (AS 2201.39)

- o The Firm failed to perform any substantive procedures to evaluate the reasonableness of the default-rate assumption. (AS 2501.11)

A.12. Issuer L

In this audit of an issuer in the financial services industry, 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 loans. Specifically –

    - o The Firm limited its procedures to test these suspense accounts for these two segments of the loan portfolio to comparing the ending balance from the reconciliations to the general ledger and investigating any suspense items that had not been cleared. The Firm failed to test whether suspense items that had been cleared were appropriately resolved. (AS 2301.08)

    - o In determining its sample sizes used to confirm these loans, the Firm failed to take into account tolerable misstatement. As a result, the samples that the Firm used to test the loans' existence were too small to provide sufficient evidence. (AS 2315.16, .23, and .23A).

A.13. Issuer M

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

- The Firm identified a fraud risk related to recording inappropriate revenue using manual journal entries. The Firm's procedures related to the testing of journal entries for evidence of possible material misstatement due to fraud, however, were insufficient. Specifically –

    - As part of its response to the fraud risk, the Firm selected for testing a control over journal entries that was intended to provide for the review and approval of all manual journal entries. The Firm, however, failed to identify and test any controls over the completeness of the population of manual journal entries that was reviewed pursuant to this control. (AS 2201.39)

    - The Firm's substantive testing of manual journal entries was not sufficient because the Firm failed to either test controls over the completeness of the population of manual journal entries from which it made selections for testing or substantively test the completeness of that population. (AS 2401.61)

- The Firm failed to perform sufficient procedures to test the existence of a significant portion of total inventory. Specifically –

    - The Firm selected for testing a control over the existence of this inventory that consisted of the performance of cycle counts on various dates. The Firm, however, failed to identify and test any controls that addressed whether the counting procedures were consistently executed and the accuracy of the counts. (AS 2201.39)

    - 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 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)

A.14. <u>Issuer N</u>

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

- The Firm failed to perform sufficient procedures related to the existence of raw materials and work-in-process inventories, the values of which were each more than double the Firm's established level of materiality. Specifically –

  - The issuer held its raw materials and finished goods inventories at warehouses owned by external parties, which conducted monthly full physical counts of those inventories. The Firm identified and tested a control over the existence of these inventories that consisted of the issuer's representative observing physical counts at least once a year. The Firm's testing of this control included inquiring of management and reading the issuer's physical count policy, which consisted of a series of key count steps. In addition, the Firm observed the year-end full physical count conducted at one warehouse, which held the issuer's finished goods, and obtained, for two other warehouses, documentation of the year-end full physical counts that included signatures to indicate that the issuer's representative had observed the counts. The Firm, however, failed to evaluate whether the count documentation it inspected for the two warehouses in its sample that it did not visit provided sufficient evidence that all important steps related to the counts were performed as designed. (AS 2201.44)

  - The Firm failed to identify and test any controls over the existence of the issuer's work-in-process inventory. (AS 2201.39)

  - The Firm failed to perform any substantive procedures to test the existence of a significant portion of the issuer's work-in-process inventory. (AS 2301.08)

- The Firm failed to perform sufficient procedures to test the issuer's revenue. Specifically, the Firm's procedures to test revenue consisted of (1) performing an analytical procedure that it intended to be its primary substantive test and (2) reviewing contracts and confirming terms for a sample of customers. The analytical procedure, however, provided little to no substantive assurance, as the threshold that the Firm established to investigate differences was too high to identify misstatements that could be material, either individually or in the aggregate. (AS 2305.20)

A.15. Issuer O

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

- During the year, the issuer acquired a significant business. The Firm failed to perform sufficient procedures related to the valuation of certain assets acquired, including intangible assets, and liabilities assumed, as described below.

  - Two of the controls that the Firm selected for testing over the valuation of these assets and liabilities consisted of comparisons of the assumptions included in an external valuation report that the issuer used to determine the fair value of these assets and liabilities to other data. The control owner compared certain assumptions in the external valuation report to (1) the issuer's and the acquired business's historical results, (2) assumptions used by the issuer in prior acquisitions, and (3) a goodwill analysis unrelated to this acquisition. The control owner identified differences between certain significant assumptions included in the external valuation report and the data used for comparison. The Firm failed to sufficiently test these controls because the Firm failed to assess the control owner's evaluation of these differences, including whether they indicated that the assumptions were inappropriate or unsupported. In addition, these controls were not designed to address the risk that the models used in the valuation process were inappropriate, and the Firm failed to identify and test any other controls that did so. (AS 2201.39, .42, and .44)

  - The Firm failed to perform sufficient substantive procedures to test the valuation of these assets and liabilities. Specifically, the Firm failed to perform any procedures to evaluate (1) whether the models that the issuer used were appropriate and (2) the reasonableness of the royalty rates, which were important assumptions that the issuer used to determine the value of certain intangible assets. In addition, the Firm failed to sufficiently evaluate the reasonableness of the useful lives of customer relationships, which were an important assumption that the issuer used to determine the value of customer-relationship intangible assets. Specifically, the Firm failed to evaluate differences that it identified between the useful lives that the issuer used to determine the fair value of these assets and those that the issuer used to amortize such assets. (AS 2502.26, .28, .31, and .36)

- The Firm failed to perform sufficient tests of controls over capitalized internally developed software and accumulated amortization. The issuer used two IT systems to track costs capitalized to internally developed software and to calculate and record the amount of amortization of internally developed software at certain divisions. The balances of internally developed software and accumulated amortization recorded at the issuer's divisions that did not use the two systems noted above represented a significant portion of total internally developed software and accumulated amortization, and the Firm determined that the portions of these accounts that were from divisions that did not use these two systems represented separate significant accounts. The Firm, however, failed to identify and test any controls over these portions of the internally developed software and accumulated amortization. (AS 2201.39)

A.16. Issuer P

In this audit of an issuer in the financial services industry, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as the Firm failed to perform sufficient procedures to test deposit liabilities. The Firm sent positive confirmation requests to the issuer's customers for certain deposit accounts that the Firm determined to present more than a low risk. The Firm, however, failed to sufficiently test the deposit accounts for which the requested confirmations were not returned. For these accounts, the Firm limited its alternative procedures to comparing certain information from the confirmation to the original deposit agreement, the customer signature card, and the issuer's deposit system from which the relevant information included in the confirmation was derived. (AS 2310.31)

A.17. Issuer Q

The Firm was engaged by the principal auditor of the issuer to (1) audit the financial statements and ICFR of one of the issuer's subsidiaries and (2) perform certain procedures on the financial statements and ICFR of another subsidiary of the issuer to support the principal auditor's opinions on the consolidated financial statements and the effectiveness of ICFR of the issuer. The Firm failed in the following respects to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in the audits –

- The Firm's procedures related to estimates for sales discounts and product returns, including accrued sales discounts and product returns, were not sufficient. Specifically –

    - For both subsidiaries, the Firm selected for testing a control that consisted of the preparation and review of analyses of sales discounts and product returns. The Firm's testing of this control was limited to (1) inquiring of issuer personnel, (2) obtaining certain of the analyses and tracing certain amounts in the analyses to the general ledger, and (3) obtaining evidence that the control owners and other members of management had approved the analyses. The Firm failed to evaluate the nature of the review procedures performed by the control owners, including the criteria used to identify matters for follow up and the resolution of such matters. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of certain data used in the performance of this control. (AS 2201.39, .42, and .44)

    - The Firm's substantive procedures to test estimates for sales discounts, including accrued sales discounts, for the subsidiary for which the Firm was instructed to audit the financial statements and ICFR were not sufficient. Specifically, 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 control testing that are discussed above. As a result, the sample sizes the Firm used to test sales discounts, including accrued sales discounts, were too small to provide sufficient evidence. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

- The Firm's procedures related to the valuation of inventory were not sufficient. Specifically –
  - With respect to the subsidiary for which the Firm was instructed to audit the financial statements and ICFR –
    - The Firm selected for testing a control that consisted of the preparation and review of the inventory allowance. The Firm's testing of this control was limited to (1) inquiring of the preparer of the allowance, (2) comparing certain amounts from the allowance calculation to supporting documentation, and (3) inspecting evidence that the control owners had approved the allowance. The Firm failed to ascertain and evaluate the nature of the review procedures performed by the control owners, including the criteria used to identify matters for follow up and the resolution of such matters. (AS 2201.42 and .44)
    - The Firm failed to perform any substantive testing of the inventory allowance. (AS 2301.36)
  - With respect to the subsidiary for which the Firm was instructed to perform certain procedures on the financial statements and ICFR, the Firm tested a control that consisted of the preparation and review of the inventory allowance and deemed this control to be ineffective; the Firm did not identify and test any other controls that addressed the inventory allowance. The Firm, however, designed its procedures to test the inventory allowance – including the sample size used in those procedures – using a control risk assessment of less than the maximum. As a result, the sample size the Firm used in its testing was too small to provide sufficient evidence. (AS 2301.16, .33, and .37; AS 2315.19, .23, and .23A)

A.18. <u>Issuer R</u>

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the issuer's revenue were not sufficient. The issuer entered into revenue arrangements with multiple elements, including subscription services and professional services; these multiple-element arrangements represented a significant portion of total revenue. The issuer allocated the consideration from multiple-element arrangements between subscription services and professional services using best estimate of selling price ("BESP"), and it concluded that list price, or a factor of list price, represented BESP for these services. The Firm failed to sufficiently evaluate the issuer's assertion that vendor-specific objective evidence or third-party evidence of selling price did not exist for the subscription services in these multiple-element arrangements. Specifically, the Firm's procedures were limited to (1) reading the issuer's memoranda that summarized the issuer's revenue recognition policies and (2) performing a test of details of revenue transactions by comparing the revenue recognized in the general ledger to the invoice or contract and cash receipts. In addition, the Firm failed to perform any procedures to test the issuer's assertion that list price, or a factor of list price, approximated BESP for the subscription and professional services in the multiple-element arrangements. (AS 2810.30)

A.19. Issuer S

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

- As a result of several business combinations during the year, the issuer acquired significant intangible assets. The Firm selected for testing a control over the valuation of acquired intangible assets that consisted of management's review of the cash-flow forecasts and other significant assumptions that the issuer used in determining the fair value of such assets. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its procedures to inquiring of management and comparing the significant assumptions and inputs that the issuer used to value the acquired intangible assets to supporting documentation. The Firm failed to ascertain and evaluate the nature of the review procedures performed by the control owners, including the expectations applied in the review, the criteria used to identify matters for follow up, and the resolution of such matters. (AS 2201.42 and .44)

- The Firm selected for testing a control over the valuation of inventory held at one of the issuer's significant locations; this control consisted of the preparation and review of the inventory reserve calculation. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its procedures to (1) inquiring of management, (2) testing the mathematical accuracy of the reserve calculations, (3) noting signatures as evidence of review, and (4) tracing the calculated reserve amounts to the general ledger. The Firm failed to ascertain and evaluate the nature of the review procedures performed by the control owner, including the criteria used to identify matters for follow up and the resolution of such matters. (AS 2201.42 and .44)

A.20. Issuer T

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as it failed to perform sufficient procedures to test controls over the 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 documenting 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, for certain of these controls, the criteria used to identify matters for follow up or review and, for all of these controls, whether matters identified for follow up 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. (AS 2201.39)

A.21. Issuer U

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. As a result of multiple business combinations during the year, the issuer acquired significant intangible assets, including customer-relationship intangible assets. The Firm's procedures related to the valuation of these assets were insufficient. Specifically –

- The Firm selected for testing two controls over the internally developed estimates that were significant inputs to the valuation of acquired intangible assets. These controls consisted of (1) management's review of the revenue growth rates underlying the cash-flow forecasts that the issuer used to determine the fair value of such assets and (2) management's annual review of the reasonableness of the attrition rate, which was an important assumption that the issuer used to determine the value of customer-relationship intangible assets. The Firm's testing of these controls was not sufficient. Specifically, the Firm limited its testing to inquiring of management and inspecting certain documents with signatures or other notations that indicated that reviews were performed as part of the controls. The Firm failed to evaluate the nature of the review procedures performed by the control owner, including the criteria used to identify matters for follow up and the resolution of such matters. (AS 2201.42 and .44)

- The Firm failed to perform sufficient substantive procedures to test the valuation of the acquired intangible assets. Specifically, the Firm failed to evaluate the reasonableness of (1) the revenue growth rates underlying the cash-flow forecasts that the issuer used to value acquired intangible assets and (2) the customer-attrition rate and customer-relationship life assumptions that the issuer used to value the customer-relationship intangible assets. (AS 2502.26 and .28)

A.22. Issuer V

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The issuer's board of directors approved a proposal to sell certain properties. The issuer did not classify these properties as held-for-sale. The Firm failed to sufficiently evaluate whether these properties met the criteria set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 360, Property, Plant, and Equipment, that would have required the issuer to classify them as held-for-sale. Specifically, the Firm's procedures were limited to (1) obtaining documentation evidencing the board of directors' approval of management's intent to sell these properties and (2) obtaining a memorandum prepared by the issuer documenting management's assessment of the criteria to classify these properties as held-for-sale. The Firm, however, failed to obtain corroboration of management's statements in the memorandum that certain criteria that would require these properties to be classified as held-for-sale were not met. (AS 2810.30)

Audit Deficiencies Related to the Originally Reviewed Financial Institution Issuer Engagements

A.23. Issuer AAA

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

- The Firm's procedures related to the valuation of collateral-dependent loans that were individually evaluated for impairment using external appraisals were insufficient. Specifically –

  - The Firm selected for testing a control consisting of the review of the loan impairment calculation. This review included (1) a comparison of loan information used in the valuation to the external appraisals and (2) an evaluation of the reasonableness of the external appraisals that were used to determine the fair value of the loan collateral. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its testing to (1) inquiring of management, (2) inspecting documentation used in the operation of this control, (3) comparing collateral valuations to applicable appraisals, and (4) testing the mathematical accuracy of the calculation of the allowance for certain impaired loans. The Firm, however, failed to ascertain and evaluate how the control owner determined that the significant assumptions used to determine the fair value of the collateral were appropriate for that purpose. (AS 2201.42 and .44)

  - o The Firm failed to perform sufficient substantive procedures to test the valuation of the collateral for these loans, as its procedures were limited to comparing collateral valuations to applicable appraisals, without performing any procedures to understand the assumptions used in the appraisals or to evaluate them for reasonableness. (AS 2502.26 and .28)

- During the year, the issuer acquired certain significant assets in a business combination. The Firm selected for testing a control that consisted of management's review of the assumptions that were used to determine the fair value of certain of these assets. The Firm's testing of this control was not sufficient. Specifically, the Firm limited its testing to (1) inquiring of the control owners, (2) observing meetings between management and the external valuation specialist who was used to value two of these assets, (3) inspecting documentation used in the operation of this control, and (4) comparing the assumptions used by the external specialist to those approved by management. The Firm failed to evaluate the nature of the review procedures performed by the control owners, including the criteria used to identify matters for follow up and the resolution of such matters. (AS 2201.42 and .44)

- The Firm failed to identify and test any controls over the valuation of certain available-for-sale securities, which aggregated to an amount that was several times the Firm's established level of materiality. (AS 2201.39)

A.24. <u>Issuer BBB</u>

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

- The Firm failed to perform sufficient procedures to test deposit liabilities. Specifically –

- o The Firm sent positive confirmation requests to the issuer's customers for a sample of the accounts that the Firm determined to present more than a low risk. The Firm's confirmation procedures were deficient, as –

  - ▪ The Firm failed to maintain control over the confirmation requests. Specifically, the Firm allowed a service organization engaged by the issuer to send the requests. (AS 2310.28)

  - ▪ The Firm's alternative procedures with regard to each confirmation request that was not returned by a customer were limited to (1) verifying that a depositor existed by comparing information on the confirmation request to depositor account files and, for one type of account, reviewing certain correspondence from the account owner; (2) comparing beginning and ending balances and interest payment information from a system-generated report to the subsidiary ledger; and (3) comparing information for one transaction for the selected account, which generally occurred several months prior to the confirmation date, from the system-generated report to supporting documentation. These procedures did not provide evidence that the account balance was accurate as of the confirmation date. (AS 2310.31)

- o The Firm failed to perform any procedures to address the risk that deposit liabilities were not complete. (AS 2301.36)

- o The issuer placed items in deposit liability-related suspense accounts when the items needed further evaluation or processing. The Firm limited its procedures to test certain of these accounts to inspecting evidence that certain items that had been placed in these accounts were subsequently cleared. The Firm failed to test whether the items that had been cleared from these accounts were appropriately resolved. (AS 2301.08)

- The Firm failed to perform sufficient procedures to test certain assets, consisting of derivative instruments, whose recorded value totaled approximately five times the Firm's established level of materiality.

Specifically, the Firm tested these assets by sending requests for confirmation; the Firm, however, failed to maintain control over the confirmation requests, as it allowed a service organization engaged by the issuer to send the requests. (AS 2310.28)

A.25. Issuer CCC

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR, as the Firm failed to perform sufficient procedures to test controls over the valuation of goodwill. As part of its annual analysis of the possible impairment of goodwill, the issuer used a discounted cash flow analysis, which included growth rates as a significant input, to estimate the fair values of its reporting units. The Firm selected for testing two controls over the valuation of goodwill that consisted of management's review of the assumptions underlying the valuation of goodwill, including the growth-rate assumptions. The Firm limited its procedures to test these controls to inquiring of the control owners, inspecting certain documentation used in the operation of these controls, and comparing the assumptions to supporting documentation. The Firm failed to test the aspect of these controls that consisted of the review of the growth-rate assumptions. (AS 2201.42 and .44)

B. Auditing Standards

Each deficiency described in Part I.A above could relate to several provisions of the standards that govern the conduct of audits. The paragraphs of the standards that are cited for each deficiency are 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. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in providing support for the related conclusions.

The paragraphs of the standards that are described immediately above are not cited in Part I.A, unless those paragraphs are the most directly related to the relevant deficiency.

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 Deficiencies per Audit
AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	Issuer A	4
	Issuer B	5
	Issuer C	2
	Issuer D	2
	Issuer E	7
	Issuer F	5
	Issuer G	2
	Issuer H	1
	Issuer I	2
	Issuer J	1
	Issuer K	2
	Issuer L	1
	Issuer M	2
	Issuer N	2

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer O Issuer Q Issuer S Issuer T Issuer U Issuer AAA Issuer CCC	2 2 2 2 1 3 1
AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer A Issuer B Issuer D Issuer E Issuer F Issuer G Issuer H Issuer I Issuer J Issuer L Issuer M Issuer N Issuer Q Issuer BBB	2 2 1 1 1 1 1 1 1 1 1 1 3 2
AS 2305, *Substantive Analytical Procedures*	Issuer H Issuer N	1 1
AS 2310, *The Confirmation Process*	Issuer A Issuer P Issuer BBB	2 1 3
AS 2315, *Audit Sampling*	Issuer A Issuer B Issuer D Issuer E Issuer F Issuer I Issuer J	1 1 1 1 1 1 1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer L Issuer M Issuer Q	1 1 2
AS 2401, *Consideration of Fraud in a Financial Statement Audit*	Issuer M	1
AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*	Issuer C	1
AS 2501, *Auditing Accounting Estimates*	Issuer A Issuer B Issuer D Issuer I Issuer K	1 1 1 2 2
AS 2502, *Auditing Fair Value Measurements and Disclosures*	Issuer C Issuer F Issuer J Issuer O Issuer U Issuer AAA	4 1 1 1 1 1
AS 2810, *Evaluating Audit Results*	Issuer R Issuer V	1 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 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2401	AS 2415	AS 2501	AS 2502	AS 2810
Business combinations	C, F, O, S, U, AAA								C, F, O, U	
Deposit Liabilities	A, B, E	A, B, E, BBB		A, P, BBB	A					
Going Concern	C						C			
Impairment of goodwill	C, F, CCC								C	
Income taxes	G, T									
Inventory	I, M, N, Q, S	I, M, N, Q			I, M, Q			I		
Investments, including derivatives	B, AAA	D		BBB	D					
Loans, including ALL	A, B, D, E, J, K, L, AAA	A, B, D, J, L		A	B, D, E, J, L			A, B, D, K	J, AAA	
Long-lived assets, including amortization	O									V
Revenue, including allowances	F, G, H, M, Q	F, G, H, Q	H, N		F, Q	M				R
Other (MSRs and Derivatives)	D									

B.3. Audit Deficiencies by Industry

The table below lists the industries[8] 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.[9]

	AS 2201	AS 2301	AS 2305	AS 2310	AS 2315	AS 2401	AS 2415	AS 2501	AS 2502	AS 2810
Consumer Discretionary	H, I, M	H, I, M	H		I, M	M		I		
Consumer Staples	S									
Energy	C						C		C	V
Financials	A, B, D, E, J, K, L, T, AAA, CCC	A, B, D, E, J, L, BBB		A, P, BBB	A, B, D, E, J, L			A, B, D, K	J, AAA	
Health Care	U								U	
Industrials	F	F			F				F	
Information Technology	G, N, O	G, N	N						O	R
Materials	Q	Q			Q					

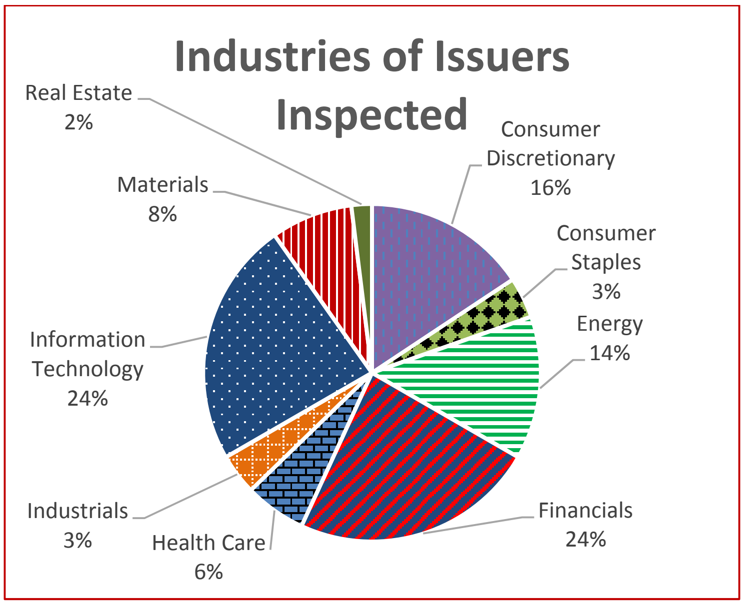
8 The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

9 Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

C. Data Related to the 51 Audits Inspected[10]

C.1. Industries of Issuers Inspected

The chart below categorizes the 51 Audits based on each issuer's industry.[11]



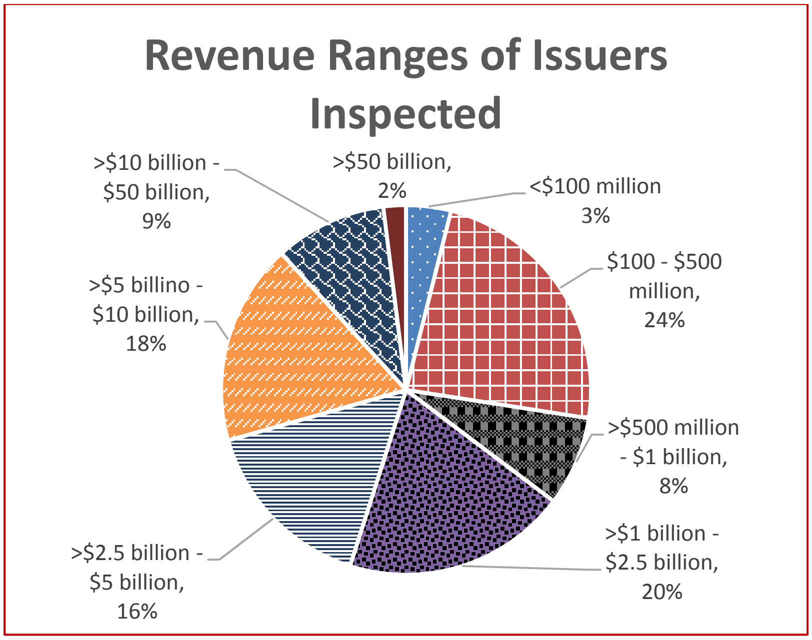
Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	8	16%
Consumer Staples	2	3%
Energy	7	14%
Financials	12	24%
Health Care	3	6%
Industrials	2	3%
Information Technology	12	24%
Materials	4	8%
Real Estate	1	2%
Total	51	100%

10 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 50 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.

11 See Footnote 8 for additional information on how industry sectors were classified.

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 51 Audits.[12] This presentation of revenue data is intended to provide information about the size of issuer audits that 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.



Revenue (in US$)	Number of Audits inspecte d	Percentage
<100 million	2	3%
100-500 million	12	24%
>500 million -1 billion	4	8%
>1-2.5 billion	10	20%
>2.5-5 billion	8	16%
>5-10 billion	9	18%
>10-50 billion	5	9%
>50 billion	1	2%
Total	51	100%

[12] 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

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audit work and defects or potential defects in the firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools. Further, the inclusion in an inspection report of certain deficiencies, defects, and potential defects should not be construed as an indication that the Board has made any determination about other aspects of the inspected firm's systems, policies, procedures, practices, or conduct not included within the report.

D.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements and, where applicable, audits of ICFR. 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 any review of additional work papers or other documentation, the inspection team ordinarily provides the firm with a written comment form on the matter and the firm is allowed the opportunity to provide a written response to the comment form. If the response does not resolve the inspection team's concerns, the matter is considered a deficiency and is evaluated for inclusion in the inspection report. 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.[13]

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[13] The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process. In addition, any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings for purposes of imposing legal liability.

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,[14] as well as a firm's failure to perform, or to perform sufficiently, certain necessary tests of controls and substantive audit procedures. 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, a Board inspection report should not be understood to provide any assurance that a firm's audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In 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.

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[14] 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 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.

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm's practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

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 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.[15] 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

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[15] 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.

considers the nature, significance, and frequency of deficiencies;[16] 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 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

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[16] 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.

members of the firm's 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 Foreign Operations of the Firm's U.S. Issuer Audits

The inspection team may review the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the firm's U.S. issuer audits, review available information relating to the most recent 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 monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team may interview members of the firm's management and review documents 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, operation, and evaluation of findings of the firm's internal inspection program, and may compare the results of its review of audit work to those from the internal inspection's review of the same audit work.

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.[17]

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

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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 2016 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 2016 Inspection of KPMG LLP dated December 14, 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 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
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, E, F, H, I, K, L, M, N, O, Q, T, and AAA
TESTING CONTROLS		
Testing Design Effectiveness		
AS 2201.42	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. 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.	Issuers A, B, C, D, E, F, G, I, J, K, O, Q, S, T, U, AAA, and CCC
Testing Operating Effectiveness		
AS 2201.44	The auditor should test the operating effectiveness	Issuers A, B, C,

AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
	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. 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.	D, E, F, G, I, J, K, N, O, Q, S, T, U, AAA, and CCC

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, L, N, and BBB
Responses to Fraud Risks		
AS 2301.13	*Addressing Fraud Risks in the Audit of Financial Statements*. In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in accordance with paragraphs .16-.17 of this standard, the auditor should perform tests of those controls.	Issuer H
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS 2301.16	*Controls to be Tested.* 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]	Issuers A, B, D, F, I, J, M, and Q

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
	However, the auditor is not required to assess control risk at less than the maximum for *all* relevant assertions and, for a variety of reasons, the auditor may choose not to do so.	
Footnotes to AS 2301.16 [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. [13] Terms defined in Appendix A, *Definitions*, are set in **boldface type** the first time they appear.		
AS 2301.18	*Evidence about the Effectiveness of Controls in the Audit of Financial Statements*. In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence.	Issuers A, B, D, F, I, J, M, and Q
Assessing Control Risk		
AS 2301.33	Control risk should be assessed at the maximum level for relevant assertions (1) for which controls necessary to sufficiently address the assessed risk of material misstatement in those assertions are missing or ineffective or (2) when the auditor has not obtained sufficient appropriate evidence to support a control risk assessment below the maximum level.	Issuer Q
SUBSTANTIVE PROCEDURES		
AS 2301.36	The auditor should perform substantive procedures for each relevant assertion of each significant account and disclosure, regardless of the assessed level of control risk.	Issuers A, Q, and BBB
AS 2301.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence	Issuers A, B, D, F, I, J, M, and Q

AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*		
	provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	

AS 2305, *Substantive Analytical Procedures*		
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Availability and Reliability of Data		
AS 2305.16	Before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information. The auditor obtains assurance from analytical procedures based upon the consistency of the recorded amounts with expectations developed from data derived from other sources. The reliability of the data used to develop the expectations should be appropriate for the desired level of assurance from the analytical procedure. The auditor should assess the reliability of the data by considering the source of the data and the conditions under which it was gathered, as well as other knowledge the auditor may have about the data. The following factors influence the auditor's consideration of the reliability of data for purposes of achieving audit objectives: ▪ Whether the data was obtained from independent sources outside the entity or from sources within the entity ▪ Whether sources within the entity were independent of those who are responsible for the amount being audited ▪ Whether the data was developed under a reliable system with adequate controls ▪ Whether the data was subjected to audit testing in the current or prior year ▪ Whether the expectations were developed using data from a variety of sources	Issuer H

AS 2305, *Substantive Analytical Procedures*		
Precision of the Expectation		
AS 2305.17	The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (*see* paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor's identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.	Issuer H
Investigation and Evaluation of Significant Differences		
AS 2305.20	In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.	Issuer N

AS 2310, *The Confirmation Process*		
THE CONFIRMATION PROCESS		
Performing Confirmation Procedures		
AS 2310.28	During the performance of confirmation procedures, the auditor should maintain control over the confirmation requests and responses. Maintaining control [3] means establishing direct communication between the intended recipient and the auditor to minimize the possibility that the results will be biased because of interception and alteration of the confirmation requests or responses.	Issuer BBB
Footnote to AS 2310.28 [3] The need to maintain control does not preclude the use of internal auditors in the confirmation		

AS 2310, *The Confirmation Process*		
process. AS 2605, *Consideration of the Internal Audit Function*, provides guidance on considering the work of internal auditors and on using internal auditors to provide direct assistance to the auditor.		
ALTERNATIVE PROCEDURES		
AS 2310.31	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.	Issuers A, P, and BBB

AS 2315, *Audit Sampling*		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AS 2315.16	When planning a particular sample for a substantive test of details, the auditor should consider ▪ The relationship of the sample to the relevant audit objective. ▪ Tolerable misstatement. (*See* paragraphs .18-.18A.) ▪ The auditor's allowable risk of incorrect acceptance. ▪ Characteristics of the population, that is, the items comprising the account balance or class of transactions of interest.	Issuers E and L
AS 2315.19	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	Issuers A, B, D, F, I, J, M, and Q

AS 2315, *Audit Sampling*		
	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.	
Footnote to AS 2315.19 [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.		
AS 2315.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	Issuers A, B, D, E, F, I, J, L, M, and Q
AS 2315.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.	Issuers A, B, D, E, F, I, J, L, M, and Q

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
RESPONDING TO ASSESSED FRAUD RISKS		
Audit Procedures Performed to Specifically		

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
Address the Risk of Management Override of Controls		
AS 2401.61	The auditor should use professional judgment in determining the nature, timing, and extent of the testing of journal entries and other adjustments. For purposes of identifying and selecting specific entries and other adjustments for testing, and determining the appropriate method of examining the underlying support for the items selected, the auditor should consider: ▪ *The auditor's assessment of the fraud risk.* The presence of fraud risk factors or other conditions may help the auditor to identify specific classes of journal entries for testing and indicate the extent of testing necessary. ▪ *The effectiveness of controls that have been implemented over journal entries and other adjustments.* Effective controls over the preparation and posting of journal entries and adjustments may affect the extent of substantive testing necessary, provided that the auditor has tested the controls. However, even though controls might be implemented and operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items. ▪ *The entity's financial reporting process and the nature of the evidence that can be examined.* The auditor's procedures for testing journal entries and other adjustments will vary based on the nature of the financial reporting process. For many entities, routine processing of transactions involves a combination of manual and automated steps and procedures. Similarly, the processing of journal entries and other adjustments might involve both manual and automated procedures and controls. Regardless of the method, the auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items. In addition, the auditor should be aware that journal entries and other adjustments might exist in either electronic or paper form. When information technology (IT) is used in the financial reporting process, journal entries and other adjustments might exist only in electronic form. Electronic evidence often requires extraction of the desired data by an auditor with IT knowledge and skills or the use of an IT specialist.	Issuer M

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
	In an IT environment, it may be necessary for the auditor to employ computer-assisted audit techniques (for example, report writers, software or data extraction tools, or other systems-based techniques) to identify the journal entries and other adjustments to be tested. ▪ *The characteristics of fraudulent entries or adjustments.* Inappropriate journal entries and other adjustments often have certain unique identifying characteristics. Such characteristics may include entries (*a*) made to unrelated, unusual, or seldom-used accounts, (*b*) made by individuals who typically do not make journal entries, (*c*) recorded at the end of the period or as post-closing entries that have little or no explanation or description, (*d*) made either before or during the preparation of the financial statements that do not have account numbers, or (*e*) containing round numbers or a consistent ending number. ▪ *The nature and complexity of the accounts.* Inappropriate journal entries or adjustments may be applied to accounts that (*a*) contain transactions that are complex or unusual in nature, (*b*) contain significant estimates and period-end adjustments, (*c*) have been prone to errors in the past, (*d*) have not been reconciled on a timely basis or contain unreconciled differences, (*e*) contain intercompany transactions, or (*f*) are otherwise associated with an identified fraud risk. In audits of entities that have multiple locations or business units, the auditor should determine whether to select journal entries from locations based on factors set forth in paragraphs .11 through .14 of AS 2101, *Audit Planning.* ▪ *Journal entries or other adjustments processed outside the normal course of business.* Standard journal entries used on a recurring basis to record transactions such as monthly sales, purchases, and cash disbursements, or to record recurring periodic accounting estimates generally are subject to the entity's internal controls. Nonstandard entries (for example, entries used to record nonrecurring transactions, such as a business combination, or entries used to record a nonrecurring estimate, such as an asset impairment) might not be subject to the same level of internal control. In addition, other adjustments such as consolidating adjustments, report combinations, and reclassifications generally are	

AS 2401, *Consideration of Fraud in a Financial Statement Audit*		
	not reflected in formal journal entries and might not be subject to the entity's internal controls. Accordingly, the auditor should consider placing additional emphasis on identifying and testing items processed outside of the normal course of business.	

AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*		
The Auditor's Responsibility		
AS 2415.03	The auditor should evaluate whether there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time in the following manner: a. The auditor considers whether the results of his procedures performed in planning, gathering evidential matter relative to the various audit objectives, and completing the audit identify conditions and events that, when considered in the aggregate, indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. It may be necessary to obtain additional information about such conditions and events, as well as the appropriate evidential matter to support information that mitigates the auditor's doubt. b. If the auditor believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, he should (1) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (2) assess the likelihood that such plans can be effectively implemented. c. After the auditor has evaluated management's plans, he concludes whether he has substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, he should (1) consider the adequacy of disclosure about the entity's possible inability to continue as a going concern for a reasonable period of time, and (2) include an explanatory paragraph, including an appropriate title (immediately following the opinion paragraph), in his audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he should consider the need for disclosure.	Issuer C

AS 2501, *Auditing Accounting Estimates*		
EVALUATING REASONABLENESS		
AS 2501.11	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: 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 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. 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, *Using the Work of a Specialist*). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	Issuers A, B, D, I, and K

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	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: 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 C, F, J, O, U, and AAA
AS 2502.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.	Issuers C, F, J, O, U, and AAA
AS 2502.31	Assumptions ordinarily are supported by differing types of evidence from internal and external sources that provide objective support for the assumptions used. The auditor evaluates the source and reliability of evidence supporting management's assumptions, including consideration of the assumptions in light of historical and market information.	Issuer O
AS 2502.36	To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows),[5] individually and taken as a whole, need to be realistic and consistent with: a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances; b. Existing market information; c. The plans of the entity, including what	Issuer O

AS 2502, *Auditing Fair Value Measurements and Disclosures*		
	management expects will be the outcome of specific objectives and strategies; d. Assumptions made in prior periods, if appropriate; e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable; f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; and g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate. Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience.	
Footnote to AS 2502.36 [5] The auditor also should consider requirements of GAAP that may influence the selection of assumptions (*see* FASB Concepts Statement No. 7).		
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.	Issuer C

AS 2810, *Evaluating Audit Results*		
Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS 2810.30	The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Note: AS 2815, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles,"* establishes requirements for evaluating the presentation of the financial statements. AS 2820, *Evaluating Consistency of Financial Statements,* establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements. Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company.	Issuers R and V