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Report on

2015 Inspection of Grant Thornton LLP
(Headquartered in Chicago, Illinois)

Issued by the

Public Company Accounting Oversight Board

February 8, 2017

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

PCAOB RELEASE NO. 104-2017-027

2015 INSPECTION OF GRANT THORNTON LLP

Preface

In 2015, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Grant Thornton LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.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, Appendix C, and Appendix D. 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 was effective as of December 31, 2016. In this report, citations to PCAOB auditing standards use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. A table cross-referencing the section numbers of those standards included in Part I of this report as reorganized is included at Appendix D.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures[1] for the inspection from July 2015 to September 2016. The inspection team performed field work at the Firm's National Office and at 20 of its approximately 54 U.S. practice offices.

A. Review of Audit Engagements

The inspection procedures included reviews of portions of 34 issuer audits performed by the Firm. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix 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 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.

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[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.

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

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

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

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[2] Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on its previously expressed audit opinions. The Board expects that firms will comply with these standards, and 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 Part I.A.1 through I.A.15, below.

Effects on Audit Opinions

Of the issuer audits that appear in Part I.A, deficiencies in nine audits relate to testing controls for purposes of the ICFR opinion, and deficiencies in all audits relate to the substantive testing performed for purposes of the opinion on the financial statements, as noted in the table below.[3] Four audits included deficiencies in substantive testing that the inspection team determined was caused by a reliance on controls that was excessive in light of deficiencies in the testing of controls.

	Number of Audits
Deficiencies included in Part I.A related to both the financial statement audit and the ICFR audit	9
Deficiencies included in Part I.A related to the financial statement audit only	5
Total	14

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 four 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 evaluate significant assumptions or test data that the issuer used in developing an estimate.	7 Audits: A, B, C, F, J, K, and L

3 For important information concerning this table, see Part I.A.15.

Issue	Part I.A Audits
Failure to perform sufficient testing related to an account or significant portion of an account or to address an identified risk.	6 Audits: B, H, I, K, M, and N
Failure to sufficiently test controls over or sufficiently test the accuracy and completeness of data and/or reports.	4 Audits: A, D, E, and G
Failure to sufficiently test the design and/or operating effectiveness of controls that the Firm selected for testing.	4 Audits: A, C, D, and K

Audit Deficiencies

A.1. Issuer A

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. In addition, see the deficiency described in Part I.A.15.

- The issuer provided a significant amount of services to its customers that were billed based on the number of transactions processed by the issuer. The Firm failed to perform sufficient procedures related to the revenue from these services. Specifically –

  - o The Firm selected for testing two controls that consisted of management's review of invoices and the related supporting documentation. The Firm's procedures to test these two controls were limited to inquiring of the control owners, observing a signature or supporting documentation attached to an invoice as evidence that a review had occurred, obtaining certain schedules used in the operation of these controls, and comparing billing rates included in the invoices to supporting documentation. These procedures did not include ascertaining and evaluating the nature of the review procedures performed by the control owners, including the criteria used by the control owners to identify matters for follow up and how those matters were resolved. Further, other than with respect to one category of this revenue, the Firm failed to identify and test any controls over the accuracy and completeness of certain data and system-generated reports that the issuer used in the performance of these controls. (AS No. 5, paragraphs 39, 42, and 44)

- The Firm failed to perform sufficient substantive procedures to test a significant portion of this revenue. Specifically, the Firm failed to sufficiently test the accuracy and completeness of the quantity data that the issuer used to calculate this portion of this revenue, as its procedures were limited to comparing amounts on selected invoices to reports obtained from the same application that generated the invoices. (AS No. 15, paragraph 10)

- The Firm's procedures related to the valuation of goodwill and other intangible assets were insufficient. Specifically –

  - The Firm selected for testing one control over the issuer's analyses of the possible impairment of goodwill and other intangible assets, which consisted of management's review of the analyses. The Firm failed to sufficiently test this control, as its procedures were limited to (1) participating in calls between management and the valuation specialist; (2) inspecting written correspondence between management and the valuation specialist; and (3), obtaining updated drafts of the analyses, and noting signatures as evidence of review. The Firm failed to ascertain and evaluate the nature of the review procedures performed by the control owner, including the criteria used to identify items for follow up and how those items were resolved. In addition, the Firm failed to identify and test any controls over the accuracy and completeness of the data that management provided to the valuation specialist. (AS No. 5, paragraphs 39, 42, and 44)

  - The Firm failed to sufficiently evaluate the reasonableness of the projected financial information that was a significant input into both (1) the issuer's analyses of the possible impairment of goodwill and other intangible assets and (2) the calculation of the amount of the impairment of certain of these assets. The issuer based its projected financial information on its current year's actual results and applied certain assumptions to these amounts to estimate financial information for future periods. The Firm's procedures to test the projected financial information were limited to comparing the current-year actual results to the general ledger and testing the mathematical accuracy of certain calculations used in developing the projected financial information; the Firm failed to evaluate the reasonableness of the assumptions that the issuer used to estimate the financial information for future periods. (AU 328, paragraphs .26 and .28)

- The Firm selected for testing one control over income taxes, which consisted of the review and approval of the quarterly income tax provision. The Firm's procedures to test this control were not sufficient, as they were limited to obtaining documentation used in the operation of the control, observing signatures as evidence of review, and comparing certain amounts in the income tax provision calculation 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 by the control owner to identify matters for follow up and how those matters were resolved. (AS No. 5, paragraphs 42 and 44)

A.2. Issuer B

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

- The Firm failed to perform sufficient procedures to test a significant category of revenue. Specifically –

  - o The Firm's planned approach for testing this revenue included the performance of substantive analytical procedures. Due to deficiencies in these procedures, however, they provided little to no substantive assurance. These procedures consisted of a comparison of expected gross margins, which were based on the prior-year margins, to actual gross margins and the investigation of differences; because these procedures did not include evaluating the components from which gross margins were derived, they were not sufficiently disaggregated to identify potential misstatements in the recorded revenue. (AU 329, paragraphs .05, .13, and .17)

- The Firm reduced its sample size for a test of details of this revenue based, in part, on its plan to obtain assurance from analytical procedures. The analytical procedures, however, were the procedures described above, which provided little to no assurance as to revenue. As a result, the Firm's sample was too small to provide sufficient evidence. (AU 350, paragraphs .19, .23, and .23A)

- The Firm failed to sufficiently test the valuation of a significant account receivable with no recorded reserve. The account receivable was due from a customer that was assigned a credit rating of B or lower by multiple credit rating agencies, and the account receivable had remained uncollected for several years. The Firm's procedures to test the collectability of the account receivable were limited to reading an issuer-prepared memorandum and inquiring of management, without obtaining corroboration of the information contained in the memorandum or the responses to the inquiries. (AU 342, paragraph .04)

- The issuer performed its annual analysis of the possible impairment of goodwill as of an interim date and recorded a goodwill impairment charge for one of its reporting units. During the period between the annual impairment test date and year end, the issuer's share price decreased significantly. The Firm failed to evaluate whether the decrease in share price represented a sustained decrease that, under generally accepted accounting principles ("GAAP"), required further analysis of possible goodwill impairment, as the Firm's procedures were limited to noting that the issuer's shares were thinly traded and that certain analysts projected a significant increase in the issuer's share price. (AS No. 13, paragraph 8)

- The Firm failed to perform any substantive procedures to test the existence of inventory held at customer locations; this inventory aggregated to approximately 30 times the Firm's established level of materiality. (AU 331, paragraph .01)

A.3. Issuer C

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. In addition, see the deficiency described in Part I.A.15.

- The Firm failed to perform sufficient procedures to test revenue. Specifically, for one of the issuer's significant categories of revenue, the Firm failed to identify and appropriately address what appeared to the inspection team to be an instance in which the financial statements were not presented fairly, in all material respects, in conformity with GAAP that it should have identified and addressed before issuing its audit opinion. The issuer recognized revenue for certain contracts using the percentage-of-completion ("POC") method of accounting. For POC contracts in process at year end for which it expected to incur losses, the issuer recorded a provision to account for such losses. At the same time, the issuer also recorded the revenue that was expected to be earned related to these contracts, and the costs that were expected to be incurred, for the remaining life of these contracts. As a result, revenue and cost of sales for the year were overstated by equal amounts. (AS No. 14, paragraph 30)

- The Firm failed to perform sufficient procedures related to the issuer's allowance for excess and obsolete inventory. Specifically –

  - The Firm failed to sufficiently test the control over the allowance for excess and obsolete inventory that it selected for testing, which consisted of management's annual review of an analysis of the inventory allowance. Specifically, the Firm limited its testing to (1) inquiring of management, (2) inspecting evidence that the analysis had been prepared and reviewed, and (3) comparing certain inventory items and amounts in reports used in the operation of the control to supporting documents and the general ledger. The Firm failed to evaluate whether this control operated at a level of precision that would prevent or detect material misstatements, as it failed to ascertain and evaluate the nature of the review procedures performed, including the criteria used to identify items for follow up and how those items were resolved. (AS No. 5, paragraphs 42 and 44)

- o The Firm failed to evaluate the reasonableness of certain significant assumptions that the issuer used in determining its allowance for excess and obsolete inventory. (AU 342, paragraph .11)

A.4. Issuer D

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

- The issuer had operating facilities in multiple locations. For a number of the issuer's locations that, in the aggregate, presented a reasonable possibility of material misstatement, the Firm failed to perform sufficient procedures to test controls over revenue. The Firm selected for testing three controls over revenue at these locations, which consisted of the issuer's (1) review of each location's budget, and of the comparison of each location's operating results to its budget and prior-period amounts; (2) review of the reconciliation of each location's general ledger to the consolidated general ledger; and (3) review of the consolidated financial statements and related disclosures. The Firm's testing of these controls was insufficient in the following respects –

  - o The Firm's procedures to test these controls were limited to observing evidence that the reviews had occurred. The Firm's testing did not include ascertaining and evaluating the nature of the procedures performed by the control owners, including the criteria used by the control owners to identify matters for investigation and how those matters were resolved. As a result, the Firm failed to evaluate whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

- Regarding the accuracy and completeness of data and reports that were used in the performance of the controls discussed above –
  - For certain locations, the Firm failed to identify and test any controls over the accuracy and completeness of the data and reports. (AS No. 5, paragraph 39)
  - For the remaining locations, the Firm concluded that ITGCs over the application from which the data and reports were derived were ineffective. The Firm, however, failed to identify and test any other controls that would address the accuracy and completeness of those data and reports. (AS No. 5, paragraph 39)

- Based in part on its reliance on controls, the Firm determined that its substantive procedures to test revenue at the locations described above would consist of analytical procedures. As a result of the deficiencies in testing controls that are described above, however, these procedures, which consisted of comparing current- and prior-period revenue amounts and obtaining explanations from management for differences that exceeded a threshold, did not provide sufficient audit evidence regarding revenue at these locations. (AS No. 13, paragraphs 16, 18, and 37)

A.5. Issuer E

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

- The issuer had operating facilities in multiple locations. For a number of the issuer's locations that, in the aggregate, presented a reasonable possibility of material misstatement, the Firm failed to perform sufficient procedures to test controls over revenue, accounts receivable, and inventory. The Firm's procedures related to controls over these accounts at these locations were limited to testing an entity-level control, which consisted of management's monthly review of each location's (1) account reconciliations and (2) financial information compared to prior periods and forecasted results, and the investigation of differences over an established threshold. The Firm failed to sufficiently test controls over the accuracy and completeness of data and reports that were used in the operation of this control. Specifically –

- For certain of these locations, the Firm failed to identify and test any controls over the accuracy and completeness of the data and reports. (AS No. 5, paragraph 39)

- For the remainder of these locations, the data and reports were derived from an IT application that operated at each of these locations, as well as at one other location where the Firm had performed procedures. The Firm had tested ITGCs over this application at this other location, but failed to evaluate whether the ITGCs that it tested were also operating over the applications in use at these remaining locations, and the Firm did not identify and test any other controls over the accuracy and completeness of the data and reports for these remaining locations. (AS No. 5, paragraph 39)

- Based in part on the Firm's reliance on controls, the Firm determined that its substantive procedures to test revenue, accounts receivable, and inventory at the locations described above would consist of analytical procedures. As a result of the deficiencies in testing controls that are described above, however, these procedures, which consisted of comparing the current-period amounts for these accounts to amounts for prior periods and obtaining explanations from management for differences that exceeded a threshold, did not provide sufficient audit evidence regarding revenue, accounts receivable, and inventory at these locations. (AS No. 13, paragraphs 16, 18, and 37)

A.6. Issuer F

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

- The Firm's testing of controls over the valuation of the issuer's oil and gas properties was insufficient. Specifically –

- o For proved properties, the Firm failed to identify and test any controls over the reasonableness of the assumptions, and the accuracy of the data, that the issuer used in its impairment analysis. (AS No. 5, paragraph 39)

- o For unproved properties, the Firm failed to identify and test any controls over the issuer's process for evaluating these assets for possible impairment. (AS No. 5, paragraph 39)

- The Firm failed to perform sufficient substantive procedures to test the valuation of oil and gas properties. Specifically –

  - o For proved properties, the issuer inappropriately excluded certain relevant cash flows from the impairment analysis it used to calculate a recorded impairment loss. The Firm failed to perform any procedures to evaluate the effect of the exclusion of these cash flows. (AS No. 14, paragraph 30)

  - o For unproved properties, the Firm failed to perform any substantive procedures to test the issuer's analysis of potential impairment, beyond inquiring of management regarding the future plans for these assets and reading drilling plans and budgets. (AU 342, paragraph .11)

A.7. Issuer G

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. For one significant category of revenue, the issuer determined the quantity of services provided based on customer-usage data that it received from an external party that measured the usage. The issuer used the data as an important input in determining the amount of revenue recognized for this category. The Firm's procedures related to this revenue were not sufficient. Specifically –

- The Firm identified a significant deficiency related to the controls over the accuracy and completeness of the customer-usage data. The Firm identified and tested a control that it determined was related to the accuracy and completeness of the data. This control consisted of (1) a comparison of the current-period data to prior-period data, (2) an analysis of changes in monthly billings to customers that exceeded an established threshold, and (3) a procedure to determine whether data were provided from each of the external party's locations. This control, however, was designed to address only certain aspects of the completeness and accuracy of the customer-usage data, and the Firm failed to identify and test any other controls that would address the completeness and accuracy of the customer-usage data. (AS No. 5, paragraph 39)

- The Firm's substantive procedures to test this revenue were not sufficient. Specifically –
    - The Firm designed its substantive procedures – including its sample size – 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 this revenue was too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19, .23, and .23A)
    - The Firm failed to test the accuracy and completeness, or (as described above) to sufficiently test controls over the accuracy and completeness, of the customer-usage data that it used in its substantive testing of this revenue. (AS No. 15, paragraph 10)

A.8. Issuer H

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The issuer had investments in multiple entities and it determined that many of these were variable interest entities ("VIEs"). The Firm's procedures related to the issuer's investments in VIEs were insufficient. Specifically –

- The Firm failed to identify and test any controls over (1) the identification of investments in VIEs, (2) the determination of the initial method of accounting for those investments, and (3) the identification and evaluation of reconsideration events that could potentially result in a change in accounting method for the relevant VIEs. (AS No. 5, paragraph 39)

- The Firm's substantive procedures to test VIEs were limited to inquiring of management, reading board of directors' and certain committee meeting minutes that noted investment-related transactions and events that had occurred during the year, and, for three investments that the issuer had identified for further consideration, evaluating the issuer's analysis and conclusions regarding the method of accounting for those investments. The Firm failed, however, to perform any procedures to (1) test whether the issuer had identified all of its investments in VIEs and (2) except for the three investments noted above, evaluate whether the method of accounting for identified investments in VIEs was appropriate. (AS No. 13, paragraph 8; AS No. 14, paragraph 30)

A.9. Issuer I

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

- The issuer was self-insured for certain liabilities, and it used service organizations to administer the related claims. The issuer provided its external actuary with the claims data processed by these service organizations, and the external actuary used the claims data to calculate the issuer's self-insurance liabilities. The Firm failed to sufficiently test the self-insurance liabilities, as it failed to perform sufficient procedures related to the claims data. Specifically —

    - o The Firm obtained service auditors' reports that described controls that needed to be implemented by the user in order to address certain risks related to the accuracy and completeness of the claims data provided by the service organizations. The Firm, however, failed to identify and test any controls that addressed these risks. (AS No. 5, paragraph 39)

- o The Firm failed to perform any substantive procedures to test the accuracy of the claims data. (AU 336, paragraph .12)

- The Firm failed to perform any substantive procedures to test the existence of one category of supplies; the recorded balance of this category was over six times the Firm's established level of materiality. (AS No.13, paragraph 8)

A.10. Issuer J

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The issuer recognized revenue from contracts using the POC method. The Firm identified a fraud risk related to the estimation of the cost to complete open POC contracts; the cost to complete is a significant input to the calculation of the related revenue. The Firm's testing of revenue recognized using POC was not sufficient because the Firm failed to sufficiently evaluate the estimated cost to complete contracts that were open as of year end. Specifically, the Firm's testing of the estimated cost to complete was limited to the following procedures, which in the aggregate did not provide sufficient evidence regarding this significant assumption (AU 342, paragraph .11) –

- The Firm attended two monthly meetings in which the progress of all open projects over a threshold was reviewed and cost estimates were approved by management. While this procedure provided the Firm with an understanding of the issuer's process for evaluating the estimated cost to complete, it provided the Firm with little substantive assurance, since the Firm did not evaluate the reasonableness of the judgments and assumptions that management used to estimate the cost to complete.

- The Firm selected for testing contracts with changes in contract value, estimated costs, or profit margin from quarter to quarter that were over certain thresholds. For these contracts, the Firm's procedures were limited to inquiring of management and obtaining evidence to support certain changes in total contract revenue, without testing changes in estimated contract costs.

- The Firm performed a look-back analysis, in which it compared the issuer's profit margin that was forecasted at the inception of the contract to the actual profit margin for contracts that were completed during the year. For any completed contract for which the change exceeded a threshold, the Firm limited its procedures to using the results of the procedures described in the preceding paragraph, or inquiring of management, to evaluate the appropriateness of the change in profit margin.

- The Firm selected for testing contracts for which the estimated cost to complete had changed after year end in an amount that was over a threshold. The Firm's procedures related to these contracts were limited to noting that decreases in the estimated cost to complete those contracts were consistent with its expectation that the remaining estimated costs would be less than the costs estimated at year end. The Firm, however, did not evaluate whether the amount and timing of the change was appropriate.

A.11. Issuer K

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR, as it failed to perform sufficient procedures related to inventory. Specifically –

- A significant portion of the issuer's inventory was subject to cycle counts, and the issuer used system-generated reports that specified which items to count each day. The Firm's procedures to test the existence of, and controls over the existence of, this inventory were insufficient. Specifically, although the Firm tested ITGCs over the inventory system that produced the reports, in determining that the cycle-count procedures that the issuer used for this inventory were sufficiently reliable, the Firm failed to determine the extent of the inventory items counted and the frequency of the counts that were specified in the system-generated reports. (AS No. 5, paragraphs 42 and 44; AU 331, paragraph .11)

- The Firm failed to sufficiently test the issuer's allowance for excess and obsolete inventory. Specifically, the Firm's procedures were limited to inquiring of management regarding the methodology used to estimate the allowance; testing the mathematical accuracy of the issuer's calculations; and, for one subsidiary, comparing the current-year allowance to the prior-year allowance, noting that the balance did not change significantly. The Firm, however, failed to evaluate the reasonableness of the significant assumptions that the issuer used in determining its allowance for excess and obsolete inventory. (AU 342, paragraph .11)

A.12. Issuer L

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. The issuer asserted that earnings from certain of its foreign subsidiaries would be permanently reinvested outside of the U.S., and it therefore did not include those earnings in the calculation of its deferred tax liabilities. The Firm failed to sufficiently evaluate management's assertion, as its procedures were limited to inquiring of management and reading an issuer-prepared memorandum that described management's plans for permanently reinvesting earnings outside of the U.S. In performing these procedures, the Firm failed to evaluate the feasibility of management's reinvestment plans for those foreign earnings. (AS No. 13, paragraph 8)

A.13. Issuer M

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 capitalized costs for internally developed software were insufficient. During the year, the issuer capitalized certain payroll costs related to software development associated with several projects. To test whether it was appropriate to capitalize these costs, the Firm obtained an issuer-prepared memorandum that indicated that the projects associated with the payroll costs that were capitalized were in the application development phase. The Firm, however, failed to ascertain the nature of the software developers' activities related to those costs and to evaluate whether the activities were directly related to these projects. (AS No. 13, paragraph 8)

A.14. Issuer N

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 liability for unpaid insurance claims were insufficient. The issuer used an external actuary to calculate the liability, and it provided the actuary with historical insurance claims data as a significant input to the calculation. The Firm failed to sufficiently test the accuracy of an important element of the historical claims data. Specifically, for the sample of claims that the Firm selected to test accuracy, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed any procedures to test the claims payment information, beyond comparing the claims payment amounts to system-generated reports that it did not test. (AU 336, paragraph .12)

A.15. Deficiencies Related to Substantive Testing of Revenue

In one audit,[4] plus two additional audits included in Part I.A above,[5] due to deficiencies related to testing revenue, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. In these audits, when determining the size of the sample to test certain revenue amounts, the Firm considered certain factors, but did not appropriately take into account tolerable misstatement for the population. The resulting sample was too small to provide sufficient evidence. (AU 350, paragraphs .16, .18, .18A, and .23)

The table on page 4 does not include the one audit for which the only deficiency relates to determining the sample size used to test revenue. The tables on pages 21 through 24 do not include the deficiencies related to sampling in either this or the two additional audits.

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.

4 Issuer O

5 Issuers A and C

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

AS No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement. AS No. 15, *Audit Evidence*, paragraph 4, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of ICFR) and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in 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.[6] 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.

[6] For important information concerning this table, *see* Part I.A.15.

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	Issuer A Issuer C Issuer D Issuer E Issuer F Issuer G Issuer H Issuer I Issuer K	3 1 3 2 2 1 1 1 1
AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*	Issuer B Issuer D Issuer E Issuer G Issuer H Issuer I Issuer L Issuer M	1 1 1 1 1 1 1 1
AS No. 14, *Evaluating Audit Results*	Issuer C Issuer F Issuer H	1 1 1
AS No. 15, *Audit Evidence*	Issuer A Issuer G	1 1
AU 328, *Auditing Fair Value Measurements and Disclosures*	Issuer A	1
AU 329, *Substantive Analytical Procedures*	Issuer B	1
AU 331, *Inventories*	Issuer B Issuer K	1 1
AU 336, *Using the Work of a Specialist*	Issuer I	1

PCAOB Auditing Standards	Audits	Number of Deficiencies per Audit
	Issuer N	1
AU 342, *Auditing Accounting Estimates*	Issuer B Issuer C Issuer F Issuer J Issuer K	1 1 1 1 1
AU 350, *Audit Sampling*	Issuer B Issuer G	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 each deficiency 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.[7]

	AS No. 5	AS No. 13	AS No. 14	AS No. 15	AU 328	AU 329	AU 331	AU 336	AU 342	AU 350
Impairment of goodwill and intangible assets	A	B			A					
Income taxes	A	L								
Insurance reserves	I							I, N		
Inventory and related reserves	C, E, K	E, I					B, K		C, K	
Investment securities	H	H	H							
Property, plant, and equipment	F	M	F						F	
Revenue, including accounts receivable, deferred revenue, and allowances	A, D, E, G	D, E, G	C	A, G		B			B, J	B, G

7 For important information concerning this table, see Part I.A.15.

B.3. Audit Deficiencies by Industry[8]

The table below lists the industries[9] of the issuers for which audit deficiencies were discussed in Part I.A of this report, and cross-references the issuer to the specific auditing standards related to the deficiencies.[10]

	AS No. 5	AS No. 13	AS No. 14	AS No. 15	AU 328	AU 329	AU 331	AU 336	AU 342	AU 350
Consumer Discretionary	E	E								
Consumer Staples	D	D								
Energy	F		F						F	
Financial Services	H	H	H					N		
Industrials	C, I, K	B, I	C			B	B, K	I	B, C, J, K	B
Information Technology	A, G	G, L, M		A, G	A					G

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.

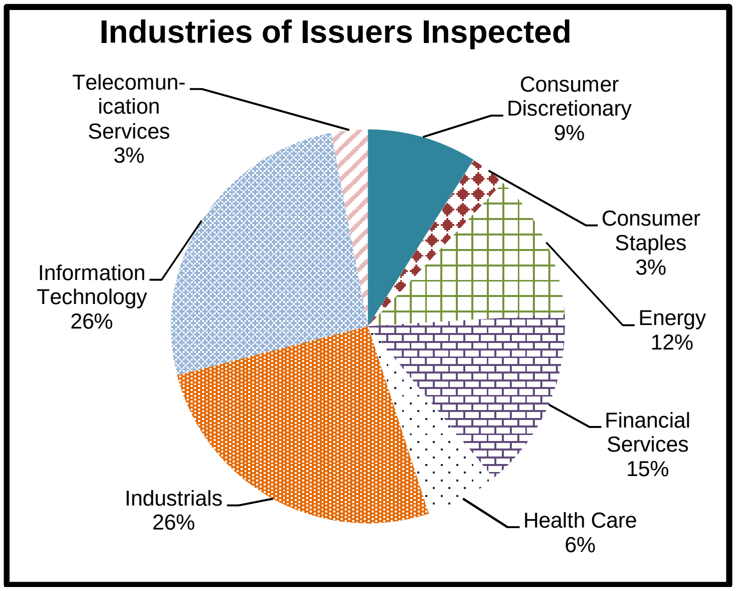
9 Where identifying the industry of the issuer may enhance the understanding of the description of a deficiency in Part I.A, industry information is also provided there, unless doing so would have the effect of making the issuer identifiable.

10 For important information concerning this table, *see* Part I.A.15.

C. Data Related to the Issuer Audits Selected for Inspection

C.1. Industries of Issuers Inspected

The chart below categorizes the 34 issuers whose audits were inspected in 2015, based on the issuer's industry.[11]



Industry	Number of Audits Inspected	Percentage
Consumer Discretionary	3	9%
Consumer Staples	1	3%
Energy	4	12%
Financial Services	5	15%
Health Care	2	6%
Industrials	9	26%
Information Technology	9	26%
Telecommuni-cation Services	1	3%

C.2. Revenue Ranges of Issuers Inspected

The chart below categorizes, based upon revenue, the 34 issuers whose audits were inspected in 2015.[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

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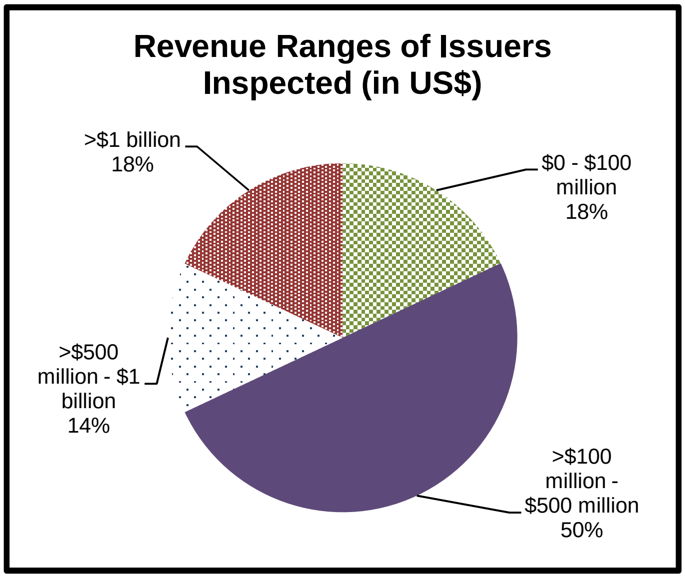
[11] *See* Footnote 8 for additional information on how industry sectors were classified.

[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.

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 Inspected	Percentage
$0 - $100 million	6	18%
>$100 million - $500 million	17	50%
>$500 million - $1 billion	5	14%
>$1 billion	6	18%

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

The inspection team selects the audits, and the specific portions of those audits, that it will review, and the inspected firm is not allowed an opportunity to limit or influence the selections. Audit deficiencies that the inspection team may identify include a firm's failure to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[13] as well as a firm's failure to perform, or to perform sufficiently, certain necessary 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.

[13] 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.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS No. 3, *Audit Documentation,* provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence. In reaching its conclusions, 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 the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.[14]

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.

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[14] 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.

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 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 considers the nature, significance, and frequency of deficiencies;[16] related firm methodology, guidance, and practices; and possible root causes.

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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.

[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.

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 members of the firm's leadership and review significant management reports and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.

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 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]

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[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 17, 2017

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

Re: Response to Part I of the Draft Report on the 2015 Inspection of Grant Thornton LLP

Dear Ms. Munter:

On behalf of Grant Thornton LLP (the "Firm"), we are pleased to provide our response to the Public Company Accounting Oversight Board's (the "PCAOB") Draft Report on the 2015 Inspection of our Firm, principally related to our 2014 audits (the "Draft Report").

We support the PCAOB's mission to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. The PCAOB inspection report and dialogue with the inspections staff is an integral component in focusing our efforts. Our Firm continues to invest in resources so we can drive continuous quality improvement, as quality is the foundation of our audit practice and we consider it our highest priority.

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

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

Respectfully submitted,

By:

J. Michael McGuire

J. Michael McGuire
Chief Executive Officer

Jeffrey L. Burgess

Jeffrey L. Burgess
National Managing Partner of Audit Services

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 No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
USING A TOP-DOWN APPROACH		
AS No. 5.39	The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.	Issuers A, D, E, F, G, H, and I
TESTING CONTROLS		
Testing Design Effectiveness		
AS No. 5.42	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, C, D, and K

AS No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*		
Testing Operating Effectiveness		
AS No. 5.44	The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively. 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.	Issuers A, C, D, and K

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*		
RESPONSES INVOLVING THE NATURE, TIMING, AND EXTENT OF AUDIT PROCEDURES		
AS No. 13.8	The auditor should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure.	Issuers B, H, I, L, and M
TESTING CONTROLS		
Testing Controls in an Audit of Financial Statements		
AS No. 13.16	*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/] 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.	Issuers D, E, and G

AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

Footnotes to AS No. 13.16

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 No. 13.18	*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 D, E, and G
SUBSTANTIVE PROCEDURES		
AS No. 13.37	As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.	Issuers D, E, and G

AS No. 14, *Evaluating Audit Results*

Evaluating the Presentation of the Financial Statements, Including the Disclosures		
AS No. 14.30	The auditor must evaluate whether the financial	Issuers C, F, and

AS No. 14, *Evaluating Audit Results*		
	statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework. Note: AU sec. 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles,* establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, *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.	H

AS No. 15, *Audit Evidence*		
SUFFICIENT APPROPRIATE AUDIT EVIDENCE		
Using Information Produced by the Company		
AS No. 15.10	When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:[3/] • Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and • Evaluate whether the information is sufficiently precise and detailed for purposes of the audit.	Issuers A and G
Footnote to AS No. 15.10 [3/] When using the work of a specialist engaged or employed by management, see AU sec. 336, *Using the Work of a Specialist.* When using information produced by a service organization or a service auditor's report as audit evidence, see AU sec. 324, *Service Organizations*, and for integrated audits, see Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.		

AU 328, *Auditing Fair Value Measurements and Disclosures*		
Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data		
AU 328.26	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.	Issuer A
AU 328.28	Where applicable, the auditor should evaluate whether the significant assumptions used by management in measuring fair value, taken individually and as a whole, provide a reasonable basis for the fair value measurements and disclosures in the entity's financial statements.	Issuer A

AU 329, *Substantive Analytical Procedures*		
AU 329.05	Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations: a. Financial information for comparable prior period(s) giving consideration to known changes b. Anticipated results—for example, budgets, or forecasts including extrapolations from interim or annual data c. Relationships among elements of financial	Issuer B

AU 329, *Substantive Analytical Procedures*

	information within the period d. Information regarding the industry in which the client operates—for example, gross margin information e. Relationships of financial information with relevant nonfinancial information	
ANALYTICAL PROCEDURES USED AS SUBSTANTIVE TESTS		
Plausibility and Predictability of the Relationship		
AU 329.13	It is important for the auditor to understand the reasons that make relationships plausible because data sometimes appear to be related when they are not, which could lead the auditor to erroneous conclusions. In addition, the presence of an unexpected relationship can provide important evidence when appropriately scrutinized.	Issuer B
Precision of the Expectation		
AU 329.17	The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph .20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant 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 B

AU 331, *Inventories*

AU 331.01	Observation of inventories is a generally accepted auditing procedure. The independent auditor who issues an opinion when he has not employed them must bear in mind that he has the burden of justifying the opinion expressed. [As amended, effective for fiscal periods ending after June	Issuer B

AU 331, *Inventories*		
	15, 1992, by Statement on Auditing Standards No. 67.]	
INVENTORIES		
AU 331.11	In recent years, some companies have developed inventory controls or methods of determining inventories, including statistical sampling, which are highly effective in determining inventory quantities and which are sufficiently reliable to make unnecessary an annual physical count of each item of inventory. In such circumstances, the independent auditor must satisfy himself that the client's procedures or methods are sufficiently reliable to produce results substantially the same as those which would be obtained by a count of all items each year. The auditor must be present to observe such counts as he deems necessary and must satisfy himself as to the effectiveness of the counting procedures used. If statistical sampling methods are used by the client in the taking of the physical inventory, the auditor must be satisfied that the sampling plan is reasonable and statistically valid, that it has been properly applied, and that the results are reasonable in the circumstances. [Revised, June 1981, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 39.]	Issuer K
Footnote to AU 331 fn 3 See section 901 for Special Report of Committee on Auditing Procedure.		

AU 336, *Using the Work of a Specialist*		
USING THE FINDINGS OF THE SPECIALIST		
AU 336.12	The appropriateness and reasonableness of methods and assumptions used and their application are the responsibility of the specialist. The auditor should (a) obtain an understanding of the methods and assumptions used by the specialist, (b) make appropriate tests of data provided to the specialist, taking into account the auditor's assessment of control risk, and (c) evaluate whether the specialist's findings support the related assertions in the financial statements. Ordinarily, the auditor would use the work of the specialist unless the auditor's procedures lead him or her to believe the findings are unreasonable in the circumstances. If the auditor believes the findings are unreasonable, he or she should apply additional procedures, which may include obtaining the	Issuers I and N

AU 336, *Using the Work of a Specialist*		
	opinion of another specialist.	

AU 342, *Auditing Accounting Estimates*		
AU 342.04	The auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole. As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.	Issuer B
Evaluating Reasonableness		
AU 342.11	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	Issuers C, F, J, and K

AU 342, *Auditing Accounting Estimates*		
	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 (section 336, Using the Work of a Specialist). i. Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.	

AU 350, *Audit Sampling*		
SAMPLING IN SUBSTANTIVE TESTS OF DETAILS		
Planning Samples		
AU 350.16	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 A, C, and O
AU 350.18	Evaluation in monetary terms of the results of a sample for a substantive test of details contributes directly to the auditor's purpose, since such an evaluation can be related to his or her judgment of the monetary amount of misstatements that would be material. When planning a sample for a substantive test of details, the auditor should consider how much monetary misstatement in the related	Issuers A, C, and O

AU 350, *Audit Sampling*		
	account balance or class of transactions may exist, in combination with other misstatements, without causing the financial statements to be materially misstated. This maximum monetary misstatement for the account balance or class of transactions is called *tolerable misstatement*.	
AU 350.18A	Paragraphs 8 - 9 of Auditing Standard No. 11, *Consideration of Materiality in Planning and Performing an Audit*, describe the auditor's responsibilities for determining tolerable misstatement at the account or disclosure level. When the population to be sampled constitutes a portion of an account balance or transaction class, the auditor should determine tolerable misstatement for the population to be sampled for purposes of designing the sampling plan. Tolerable misstatement for the population to be sampled ordinarily should be less than tolerable misstatement for the account balance or transaction class to allow for the possibility that misstatement in the portion of the account or transaction class not subject to audit sampling, individually or in combination with other misstatements, would cause the financial statements to be materially misstated.	Issuers A, C, and O
AU 350.19	The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed." After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details.[fn 3] Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.	Issuers B and G
Footnote to AU 350.19 [fn 3] Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant		

AU 350, *Audit Sampling*		
in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.		
AU 350.23	To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements.	Issuers A, B, C, G, and O
AU 350.23A	Table 1 of the Appendix describes the effects of the factors discussed in the preceding paragraph on sample sizes in a statistical or nonstatistical sampling approach. When circumstances are similar, the effect on sample size of those factors should be similar regardless of whether a statistical or nonstatistical approach is used. Thus, when a nonstatistical sampling approach is applied properly, the resulting sample size ordinarily will be comparable to, or larger than, the sample size resulting from an efficient and effectively designed statistical sample.	Issuers B and G

APPENDIX D

REORGANIZED STANDARDS REFERENCED IN REPORT

On March 31, 2015, the PCAOB adopted the 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). On September 17, 2015, the SEC approved the PCAOB's adoption of the reorganization. The reorganized standards were effective as of December 31, 2016. The citations to PCAOB auditing standards included in this report use the numbering system and titles of standards that were in effect at the time of the primary inspection procedures. This table provides the section numbers of those standards included in Part I of this report as reorganized, as well as the titles of the standards both before and after the reorganization. The complete standards are available on the PCAOB's website at http://pcaobus.org/STANDARDS/Pages/default.aspx.

Auditing Standards – before the reorganization		**Auditing Standards – as reorganized**	
AS No. 3	*Audit Documentation*	AS 1215	*Audit Documentation*
AS No. 5	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*	AS 2201	*An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*
AS No. 13	*The Auditor's Responses to the Risks of Material Misstatement*	AS 2301	*The Auditor's Responses to the Risks of Material Misstatement*
AS No. 14	*Evaluating Audit Results*	AS 2810	*Evaluating Audit Results*
AS No. 15	*Audit Evidence*	AS 1105	*Audit Evidence*
AU 230	*Due Professional Care in the Performance of Work*	AS 1015	*Due Professional Care in the Performance of Work*
AU 328	*Auditing Fair Value Measurements and Disclosures*	AS 2502	*Auditing Fair Value Measurements and Disclosures*
AU 329	*Substantive Analytical Procedures*	AS 2305	*Substantive Analytical Procedures*
AU 331	*Inventories*	AS 2510	*Auditing Inventories*
AU 336	*Using the Work of a Specialist*	AS 1210	*Using the Work of a Specialist*
AU 342	*Auditing Accounting Estimates*	AS 2501	*Auditing Accounting Estimates*
AU 350	*Audit Sampling*	AS 2315	*Audit Sampling*