

Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

**Based on Inspection Reports Issued
as of January 19, 2006 on 2004 Audits**

Issued May 2006

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Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

Executive Summary

Large Firm PCAOB Inspection Deficiency Analysis Firms with Greater than 100 SEC Issuer Audit Clients Executive Summary

Based on Inspection Reports Issued as of January 19, 2006 on 2004 Audits

The following analysis was prepared by gathering all of the deficiencies that were identified in the public portion of the PCAOB firm inspection reports dating from September 29, 2005 through January 19, 2006 for firms that audit greater than 100 SEC issuers (total of 248 deficiencies cited). This includes the deficiencies identified by the PCAOB on 2004 audits for BDO Seidman LLP, Crowe Chizek and Company LLC, Deloitte & Touche LLP, Ernst & Young LLP, Grant Thornton LLP, KPMG LLP, McGladrey & Pullen LLP, and PricewaterhouseCoopers LLP.

The analysis is organized into the following four categories of deficiencies. Deficiencies are placed in only one of the categories where they are most applicable and are not repeated in other categories (click on item for description).

- [Balance Sheet Line Item](#);
- [Income Statement Line Item](#);
- [Audit Performance](#); and
- [GAAP Departure](#)

Below is a list of recurring themes noted in the 8 firms' inspection reports that run through the analysis (i.e., the topic repeatedly appears across and within the categories noted above).

- ◆ **Confirmations** - Inadequacies in or lack of confirmation procedures, as well as improper use of negative confirmations
- ◆ **Estimates** – Insufficient audit procedures performed on management's assumptions and estimates used in establishing valuations of assets and allowances and reserves
- ◆ **Substantive/Analytical Procedures** – Failure to perform sufficient substantive procedures (e.g., improperly applying high-level analytical procedures as substantive procedures)
- ◆ **Documentation** – Inadequate documentation in work papers of audit procedures and/or audit evidence
- ◆ **Risk Assessment vs. Tests** - Failure to properly align tests of controls and audit procedures with risk assessments
- ◆ **Applicability with GAAP** – Failure to ensure the proper accounting and disclosures for certain transactions in accordance with GAAP
- ◆ **Materiality** – Inconsistent application of and/or inadequate documentation of materiality thresholds used
- ◆ **Third-Party Service Organizations** – Inappropriate reliance on controls of third-party service organizations without adequate testing
- ◆ **Sample Sizes** – Use of inadequate sample sizes
- ◆ **Arrangements and Side Agreements** – Failure to confirm and/or review contracts to identify and properly account for side agreements and multiple-element arrangements

There were a total of 248 deficiencies cited in the 8 firms' inspection reports. The number of times each of those deficiencies appeared within the respective categories and areas are noted below. The attached analysis provides more detailed information on the actual deficiency identified.

<u>Balance Sheet (120)</u>	<u>Income Statement (26)</u>	<u>Audit Performance (79)</u>	<u>GAAP Departures (23)</u>
Allowance for Loan Losses (17)	Revenue (10)	AU 319 – Consideration of Internal Control in Financial Statement Audit (26)	SFAS 133 – Derivatives (8)
Accounts Receivable (15)	Impairment Charges (6)	AU 312 – Audit Risk and Materiality in Conducting an Audit (17)	SFAS 131 – Segments (5)
Inventory (13)	Expenses (4)	AU 329 – Analytical Procedures (13)	SFAS 140 – Securitization Arrangements (3)
Loans (11)	Gains (3)	AU 324 – Service Organizations (10)	SFAS 57 – Related Parties (3)
Accruals (8)	Discontinued Operations (2)	AU 341 – Going Concern (4)	FIN 46R – Variable Interest Entities (2)
Leases (8)	Other Income (1)	AU 322 – Auditor’s Consideration of Internal Audit Function in Audit of Financial Statements (3)	AICPA SOP 90-1 - Fresh-Start Accounting (1)
Income Taxes (Assets, Liabilities and Expenses) (7)	Income Taxes (covered in Balance Sheet category)	AU 342 – Auditing Accounting Estimates (2)	SFAS 106 – Postretirement Benefits (1)
Goodwill (6)		AU 316 – Consideration of Fraud in Financial Statement Audit (Related to Journal Entry Testing) (2)	
Marketable Securities (6)		AU 336 – Using the Work of a Specialist (2)	
Capitalized Costs (5)			
Debt (5)			
Interest-Only Strip Assets (3)			
Investments (3)			
Allowance for Doubtful Accounts (2)			
Cash and Cash Equivalents (2)			
Deposits (2)			
Fixed Assets / PP&E (2)			
Deferred Costs (1)			
Assets (1)			

Category Descriptions

The **Balance Sheet category** is organized in a balance sheet format and all deficiencies that relate to assets, liabilities or equity are classified in this category on their respective line item.

The **Income Statement category** is organized in an income statement format and all deficiencies that relate to revenue, expenses, or other income statement items (i.e., discontinued operations, extraordinary items, earnings per share, etc.) are classified in this category on their respective line item.

The **Audit Performance category** includes deficiencies, not identified in the Balance Sheet category or the Income Statement category, that relate to the performance of the audit and include items that an auditor should consider during the course of planning and performing the audit.

The **GAAP Departure category** includes all remaining deficiencies that are not identified on the Balance Sheet, Income Statement, or Audit Performance categories due to the fact that the deficiency relates to a general application and/or footnote disclosure issue within the financial statements. These additional GAAP departures have the possibility to affect more than one financial statement line item.

The attached analysis does not include the small firm inspection reports (firms with less than 100 SEC issuer audit clients). The CPCAFA Analysis for the Small Firm Inspection Reports can be accessed at http://www.aicpa.org/cpcaf/download/PCAOB_Inspection_Deficiency_Analysis_January2006.pdf.

Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

By Balance Sheet Line Item

Large Firm PCAOB Inspection Deficiency Analysis - By Balance Sheet Line Item
[Firms with Greater than 100 SEC Issuer Audit Clients]

Based on Inspection Reports Issued as of January 19, 2006 on 2004 Audits

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

ASSETS:	1 Firm's sample size for testing the additions to an asset account was insufficient because it did not meet the requirements for calculating sample sizes.
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Cash & Cash Equivalents	2 Firm failure to evaluate the appropriateness of an issuer's classification of certain investments as cash equivalents as the issuer subsequently realized that a significant portion of its reported cash and cash equivalents were invested in securities that were not appropriate for classification as cash and cash equivalents under SFAS No. 95, <i>Statement of Cash Flows</i> .
	3 Incorrect accounting that was not identified by the firm for investments in securities that were inappropriately classified as cash & cash equivalents, which was not in accordance with SFAS 95, <i>Statement of Cash Flows</i> .

Marketable Securities	4 Firm did not address the classification of investments in marketable securities or US government securities.
	5 In auditing the issuer's pricing of securities, the firm relied on a financial pricing model that the issuer used but the firm failed to test the data inputs to the model and failed to document the basis for reliance.
	6 Failure to send confirmations to third parties to verify the existence of unsettled purchases of securities at year-end.
	7 In evaluating the issuer's assertion regarding the fair value of marketable securities, the firm failed to perform procedures to assess whether the fair value included on confirmations from third parties was determined in a manner consistent with GAAP.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	8 Most of the issuer's investments were classified as available for sale and carried at fair market value. The firm failed to test the valuation of the marketable securities, which represented the majority of the investment portfolio.
	9 Failure to perform sufficient tests of the market values of available-for-sale securities. The firm's audit procedures were limited to testing, at an interim date, the market value of three of the securities, representing less than 3% of the total population.

Accounts Receivable	10 Firm requested accounts receivable confirmations, however, failed to request that the customers confirm key contract terms (i.e. rights of return) or the absence of side agreements, even though the firm's work papers implied that the customers had been requested to confirm terms and stated that the issuer's revenue agreements did not contain standard terms and conditions.
	11 Firm did not request that customers confirm the existence of accounts receivables. The firm performed alternative procedures; however, in each instance the firm either failed to obtain, or failed to document in the work papers that it had obtained, sufficient competent evidential matter regarding the existences of accounts receivables to support its audit opinion in accordance with AU 330, <i>The Confirmation Process</i> .
	12 In the Firm's testing of subsequent cash receipts that purportedly were received in payment of the accounts receivable, the sample size was inadequate for the testing required because the firm used the wrong method of sampling.
	13 Firm failure to test, or failure to include evidence in the work papers that it had tested, the accounts receivables that had not been paid.
	14 Firm failure to test a material difference between a supporting schedule used in the alternative procedures and the general ledger when testing accounts receivables.
	15 Firm utilized analytical procedures as alternative procedures in testing accounts receivables, however, the firm did not perform certain required steps such as developing expectations and defining a significant difference or threshold, when performing the analytical procedures.
	16 Firm failure to perform sufficient procedures on the activity in accounts receivables between the interim date as of which the alternative procedures were performed and year end. The firm only performed high level analytical procedures to test the activity during this period.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	17 Firm's documented reason for not requesting confirmations of accounts receivable was not one of the acceptable conditions for not performing this procedure.
	18 Firm's failure to document, as required by PCAOB standards, how it overcame the presumption that the auditor will request the confirmation of accounts receivable.
	19 In determining the sample size for accounts receivable confirmations, the firm assessed the risk of material misstatement as low based on part on the level of control testing the firm had anticipated while planning the audit. However, the control testing did not provide a basis for reliance on the controls, the low assessment was not appropriate and the sample size was smaller than it should have been.
	20 Firm audited accounts receivable balances at an interim date, but did not audit the issuer's analysis of the roll-forward of these balances to the year end.
	21 Based substantially on the firm's testing of the issuer's controls over granting credit, the firm concluded that they did not need to confirm accounts receivable balances. The existence of credit controls is not a sufficient substitute for testing the existence and accuracy of accounts receivable through the use of confirmations or other substantive testing.
	22 In addressing the accounts receivable controls, the firm did not document how the issuer addressed major credit overages, nor the nature and effect of certain netting agreements.
	23 Firm failed to consider appropriately the aggregate amount by which receivables from the issuer's customers exceeded those customer's credit limits with the issuer, and so failed to determine whether there was a material exposure in the valuation of accounts receivable.
	24 Firm's assessment that inherent risk for the existence of accounts receivable was low did not take into account all relevant factors, including that the issuer was a new client and one that the firm had accepted late in the issuer's fiscal year, had operating losses and negative cash flow from operations and had previously restated its financial statements for revenue recognition issues. As a result, the firm did not request a sufficient number of confirmations of customer balances.

Allowance for Doubtful Accounts	25 Firm recalculated the issuer's allowance for doubtful accounts based upon the issuer's methodology. There is no evidence in the work papers, however, that the firm either tested the issuer's methodology or followed one of the other methods prescribed in AU 342, <i>Auditing Accounting Estimates</i> .
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BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	26 The issuer reversed approximately 16% of the allowance for doubtful accounts into income, even though the accounts receivable balance increased by approximately 60% and the firm's work papers failed to include sufficient documentation or explanation of the issuer's allowance.
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Inventory	27 Firm failure to test the appropriateness of certain overhead costs that an issuer allocated to its raw material inventory and failure to recompute the raw materials overhead rate.
	28 Firm failure to perform tests of controls or substantive audit procedures to verify the completeness and accuracy of the non-routine report, generated from the issuer's inventory file, and that the issuer used in analyzing its slow-moving inventory and forming the reserve for inventory obsolescence.
	29 Firm failure to obtain sufficient evidence to corroborate the reasonableness of the issuer's reserve for inventory obsolescence.
	30 When auditing the issuer's inventory reserves, the firm failed to test the issuer-prepared reports that the firm used, and it failed to evaluate, or to include sufficient evidence in the work papers that it had evaluated, the issuer's estimated realizable amounts or the issuer's ability to make those estimates.
	31 Firm failure to test the issuer's purchase price variance account, which is an integral component of the issuer's valuation of its inventory.
	32 Firm samples for tests of the inventory account were smaller than necessary to obtain sufficient competent evidential matter because the firm used the wrong method of sampling.
	33 Firm used analytical procedures to test the labor and overhead components of the issuer's inventory and to test the activity in the inventory accounts between the interim dates when the firm observed the issuer's physical inventory counts and year end. These procedures, however, were not sufficient given the significant risk of material misstatement of the issuer's inventory and because they did not meet the requirements for substantive analytical procedures.
	34 No evidence that the firm evaluated the reasonableness of management's estimate used to record the provision for inventory shrinkage.
35 Failure to comply with the firm's policies concerning calculating the sample size, and accordingly, tested a smaller sample than it should have for a price test intended to be a dual-purpose test of both controls and account balances.	

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	36 Firm failure to perform sufficient audit procedures related to the write-down of inventory because it failed to test the new values the issuer assigned to the inventory, by comparing them to subsequent sales or otherwise obtaining evidence as to their appropriateness.
	37 Firm failure to perform adequate audit procedures to evaluate the issuer's inventory allowance for lower cost or market adjustments and for slow moving and defective items as the firm failed to test percentages of certain components of inventory; failed to identify plausible relationships for analytical procedures it performed; and failed to obtain corroboration of the explanations provided by the issuer's management.
	38 Firm failure to test inventory transactions between the interim physical inventory dates and year end, as required by PCAOB standards, and it failed to evaluate the need to test the physical inventories again at or near year end in light of the lack of the issuer having a perpetual inventory system for tracking raw materials and work in process.
	39 Firm failure to evaluate the potential implications of the interim inventory adjustments on the need for adjustments to the year-end inventory balances.

Fixed Assets/ PP&E	40 In auditing an issuer's equipment that was held at potential customers' locations, the firm determined that the information on a sample of shipping documents agreed with the issuer's fixed asset list, however, the firm failed to send confirmation requests to a sample of the potential customers or observe a sample of the equipment held by the potential customers to determine whether the customers still had the equipment and to assess its physical condition.
	41 Firm failure to test the overhead costs that an issuer capitalized as part of the costs of its fixed asset additions.

Deposits	42 Firm failed to perform sufficient tests of deposits. The firm assessed control risk at the maximum and used a combination of positive confirmation requests, analytical procedures, and a reconciliation of the subsidiary ledger to the general ledger to test the completeness assertion related to deposits. The firm failed to perform other procedures, such as testing the daily reconciliations, the daily proofs, access controls, dormant accounts, closed accounts, depositor account statements, and/or employee accounts.
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BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	<p>43 Firm did not perform sufficient audit procedures by testing controls related to customer deposits; using high level analytical procedures that did not meet the requirements for substantive procedures because the firm failed to establish expectations and identify plausible relationships among the deposits and other accounts; using negative confirmations inappropriately because the firm did not perform the necessary procedures to conclude that combined inherent and control risk assessment were low; and testing of controls was not sufficient to reduce the firm's substantive procedures.</p>
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<p>Investments</p>	<p>44 In auditing the fair value assigned to investments by the issuer, the firm failed to review all the information considered by the issuer in determining the fair value and failed to determine whether the issuer's valuation method conformed to the issuer's stated policy.</p>
	<p>45 Firm failed to identify the issuer's inappropriate allocation adjustments that resulted in inaccuracies in some of the fair value amounts reported on a required supplemental schedule of investments.</p>
	<p>46 While the firm recalculated the valuation of a sample of the non-marketable securities at an interim date, it failed to perform any roll-forward procedures between the interim date and year end.</p>

<p>Notes Receivable</p>	<p>47 Firm failure to test, or to include evidence in the work papers that it had tested, the note receivable that arose when the issuer transferred certain receivables, or the underlying receivables.</p>
	<p>48 Issuer had a note receivable from a shareholder that was secured by the shareholder's ownership interest in the issuer and the issuer considered the collection of the note to be uncertain and determined that the value of the note should be based on the value of the shareholder's ownership interest. However, the value of the shareholder's ownership interest was attributable in part to an anticipated settlement of the issuer's claim against a third party regarding the value of property that the issuer sold to a third party. In testing the amount asserted by the issuer to be realizable from the claim, and thus collectible under the note receivable, the firm inquired of management regarding the basis for the issuer's estimate and its assessment of the likelihood of collection, however, the firm failed to obtain information to corroborate management's representations by, for example, making inquiries of the issuer's lawyers.</p>
	<p>49 Firm failure to control the notes receivable confirmation process by permitting the issuer's employees to select the notes to be confirmed, with no supervision or control by the firm.</p>

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

Capitalized Costs	
50	Issuer capitalizes certain installation costs upon acquiring new customers and amortizes them over the contract term and the firm failed to perform, or to include evidence in the work papers that it had performed, sufficient procedures when auditing these costs.
51	While the firm concluded that the issuer had applied its capitalization methodology in a consistent manner from year-to-year, there was no evidence that the firm had tested the appropriateness of the methodology in the current or prior years.
52	Firm failure to test whether the costs capitalized were capitalizable under GAAP.
53	Firm failure to test the issuer's schedules of the current year's additions to capitalized installation costs, including the underlying data supporting the number of installations, which is a key component of the capitalization calculation.
54	Firm did not evaluate the issuer's capitalized software costs for impairment in accordance with SFAS 86, <i>Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed</i> .

Loans	
55	Firm used negative confirmations to test the existence of real estate and installment loans even though the combined level of inherent and control risk was not assessed as low. PCAOB standards permit the use of negative confirmations to reduce audit risk to an acceptable level, but only when certain conditions are present, one of which is that the combined assessed level of inherent and control risk is low.
56	To test the existence of mortgage loans and consumer loans, the firm used negative confirmation requests for the consumer loans and a combination of positive confirmations requests and negative confirmation requests for the mortgage loans. PCAOB standards permit the use of negative confirmations to reduce audit risk to an acceptable level, but only when certain conditions are present, one of which is that the combined assessed level of inherent and control risk is low. The firm did not conclude that the combined assessed level of inherent and control risk was low.
57	Firm failure to perform, or failure to include evidence in the work papers that it had performed, sufficient procedures to evaluate whether the issuer's accounting for the sales and servicing of loan participations complied with SFAS 140, <i>Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities</i> . In addition, the firm failed to document the issuer's responsibilities, if any, for servicing the loan participations and the basis for the firm's determination of the number of items tested.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

58	Firm failure to perform sufficient tests of loan sales. The firm planned to employ a substantive audit approach, but it failed to perform, or to include evidence in the work papers that it had performed, detailed tests of the items on the client's summary spreadsheet of loan sales, and its primary audit procedures, which were analytical procedures, did not meet the requirements for substantive analytical procedures. In addition, the firm identified errors relating to the completeness of the spreadsheet, but failed to resolve them, or to include evidence in the work papers that it had resolved them.
59	Firm requested confirmations for a sample of loans that the issuer serviced and for the loans which there were no responses, the firm compared the information on the requests to the system from which the loans had been selected rather than comparing the information to the underlying documents.
60	Firm failure to compare, or to include evidence in the work papers that it had compared, the master loan sales agreement to the requirements of SFAS No. 140.
61	Firm tests of loan data, key assumptions, and models used to value the retained interest were not performed at the individual tranche or loan-type level, rather, various tranches or loan types were aggregated and the tests were performed at an aggregated level. (Securitization arrangement)
62	Firm failure to test, or to include evidence in the work papers that it had tested, the data and assumptions used in the issuer's analysis of the relative fair values of the mortgage servicing rights on mortgage loans. (Securitization arrangement)
63	Firm's substantive audit procedures included sending negative confirmations for outstanding loans at an interim date and one of the conditions that must be met to use negative confirmations is that the combined inherent and control risk assessment is low. The firm did not take into account the number of decentralized employees performing manual processes; the increase in the volume of loans processed, and the potential for errors and fraudulent transactions, in determining that inherent risk was low. In addition, the firm failed to perform sufficient tests of controls to support a low control risk assessment. (Loan originations)
64	Firm's substantive audit procedures included testing the roll-forward of the interim balances to the year-end balances and the firm inappropriately relied on the controls over the loan origination processes when testing the roll-forward of the outstanding loans. (Loan originations)

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	<p>65 To test the issuer's capitalized mortgage servicing rights and the related amortization expense related to the issuer's portfolio of mortgage loans, the firm performed substantive analytical procedures that were deficient because the firm failed to establish expectations and the amounts of the difference from the expectations that the firm could accept without further investigation. In addition, the firm failed to evaluate significant variances that the analytical procedures identified that indicated that the issuer may not have properly accounted for the mortgage servicing rights and the amortization expense.</p>
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<p>Allowance for Loan Losses (ALL)</p>	<p>66 Issuer maintained an ALL to cover losses inherent in its loan portfolio. According to the firm's planning document, these allowances presented specific identified risks related to inadequate or excessive reserves, as well as risks related to non-compliance with GAAP. Despite these risks, the firm did not test certain key assumptions and data used in the allowance calculation; the control testing performed did not cover certain key controls over the issuer's process for accumulating historical data and developing the key assumptions used in the allowance calculation; and specific impairment reserve calculations were not tested for sample of loans tested for impairment.</p>
	<p>67 Firm failure to obtain sufficient evidence, or to include sufficient evidence in its work papers, that the unallocated component of the bank issuer's ALL represented a supportable estimate of probable losses inherent in the issuer's loan portfolio.</p>
	<p>68 Firm's documented testing specific to the unallocated aspect of the banks' ALL was limited to certain high level analytical procedures that were not substantive tests and, while the firm had performed various procedures related to the ALL generally and to the other components of ALL, the work papers did not contain any evaluation of how the results of these procedures affected the firm's assessment of the unallocated component of ALL.</p>
	<p>69 The firm was aware of indications of deficiencies in the operating effectiveness of the issuer's controls over the ALL, and in light of this knowledge and the highly judgmental nature of the area, the firm's assessment of the control risk with respect to the ALL as "minimum" was inappropriate.</p>
	<p>70 The issuer primarily calculated its ALL by applying certain reserve percentages, adjusted for qualitative considerations, to various identified risk-rated loan classifications and pools of loans. The firm failed to perform, or failed to include evidence in the work papers that it had performed, either audit procedures to determine whether the reserve factors used to calculate the allowance were supportable or, in the alternative, audit procedures to develop an independent expectation regarding the ALL.</p>

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	71 Firm failure to perform sufficient tests of the issuer's ALL for which the firm assessed control risk and inherent risk at the maximum. The classification of loans within the loan categories serves as the issuer's basis for determining the ALL. In order to test the classification of loans, the firm examined a sample of loan files, only one of which was selected from the issuer's classified listing. In addition, the firm reviewed the results of the issuer's third-party loan reviewer's tests; however, it did not rely on the reviewer's work.
	72 Firm did not perform sufficient audit procedures to conclude that adjustments for specific groups of loans and unallocated reserves were appropriate since it did not test the reasonableness of the assumptions in management's and the firm's own calculations.
	73 Failure to evaluate, or failure to include evidence in the work papers that it had evaluated, the loan loss factors the issuer used to determine its allowance.
	74 Failure to link the various allowance, charge-off and delinquency ratio analyses it performed, or the results of them, to the loan loss factors the issuer used. The Firm could instead have chosen to audit the allowance by developing an independent expectation of the allowance to obtain corroboration of the reasonableness of the issuer's allowance, but the firm did not do so.
	75 Audit approach for ALL testing on an engagement called for the firm's internal loan credit review specialists to perform a detailed review of a sample of commercial loans, however, for some loans, the specialist did not complete their procedures and the firm inappropriately relied on the results of the tests in the prior year for those loans that were no completed.
	76 For certain loans during the ALL testing, the firm made inquires of the issuer's internal loan reviewer, but failed to obtain corroboration of the loan reviewer's response.
	77 Firm specialists involved in the ALL testing determined that the issuer had assigned a risk classification that was too high to one of the items that they analyzed, however, the firm failed to evaluate, or to include evidence in the work papers that it had evaluated, the discrepancy in relation to the issuer's ability to perform this.
	78 Firm determined that the issuer had a weak loan review function; however, the firm failed to quantify the effects of these deficiencies on the financial statements, and rather, on the basis of a high level trend analysis, concluded that deficiencies offset each other. This analysis did not meet the requirements for substantive analytical procedures for the ALL.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	79	Firm failure to obtain sufficient evidence to support its conclusion that the unallocated allowance represented a supportable estimate of the probable losses inherent in the issuer's loan portfolio.
	80	Firm's audit procedures related to the unallocated allowance inappropriately consisted solely of certain high level trend analyses.
	81	The firm developed its own independent expectations of the allowance and compared this estimate to the issuer's to determine that it was reasonable, however, the firm failed to support or to include evidence in the work papers that supports, certain significant assumptions, such as loan loss factors, when developing its estimate.
	82	Firm failure to evaluate or to include evidence in the work papers that it had evaluated the effects on income of the elimination during the year of the excess allowance that the firm identified.

Leases	83	Firm failure to identify and address the incorrect accounting for lease incentives received from landlords as a reduction of depreciation expense, rather than as a reduction of rental expense as required by EITF No. 88-3 <i>Rental Concessions Provided by a Landlord</i> and FASB Technical Bulletin No. 88-1 <i>Issues Relating to Accounting for Leases</i> . This resulted in an understatement of depreciation expense and an overstatement of lease expense, as well as an understatement of deferred liabilities and fixed assets.
	84	Firm failure to identify and address the issuer's inappropriate accounting under SFAS No. 13, <i>Accounting For Leases</i> , for accounting for a lease as an operating lease, despite the presence of conditions that made such accounting inappropriate.
	85	Inappropriate accounting for a sale-leaseback transaction using normal sale-leaseback accounting despite the presence of conditions that made such accounting inappropriate under SFAS 98, <i>Accounting for Leases</i> . In addition, lack of documentation and non-disclosure in the issuer's financial statements related to this transaction.
	86	Failure to disclose in the financial statements certain lease arrangements in accordance with SFAS 13.
	87	Uncertainty of possible side agreements and undisclosed guarantees related to lease transactions which led to additional work that needed to be performed on lease analyses.
	88	Certain leases that were accounted for as operating leases should instead have been accounted for as capital leases.
	89	The accounting for certain operating leases with rent escalators should be changed to accrue total rent expense on a straight-line basis over the lease term rather than recording actual rent paid under these leases.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	90 Failure to include any leases in the audit testing that contained rental step-down clauses, which provide for a reduction in the annual base rent if the renewal option is exercised by the lessee and which affect the calculation of income to be recognized over the lease term.
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Interest-Only Strip Assets (I/Os)	91 Issuer told the firm that the recorded value of its interest-only strip assets and the related interest income were overstated 2 days prior to filing and the firm devoted less than 2 days completing audit procedures related to this issue and allowed the issuer to proceed with the revised accounting for the securitization transactions. The firm's work papers included no indication that the original assumptions were erroneous, nor were they communicated to the audit committee as erroneous, nor were they disclosed as corrections of errors in the financial statements filed by the issuer.
	92 Firm's work papers failed to evidence that the firm evaluated whether the issuer accounted for the I/Os at fair value and the accounting policy disclosure in the financial statements did not indicate whether the I/Os were accounted for at fair value after securitization.
	93 Financial statements did not disclose certain information regarding key assumptions used to measure the fair value of the I/O's retained at the balance sheet date, as required by SFAS No. 140, <i>Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities</i> , and the firm should have identified and addressed the issuer's failure to disclose this required information.

Deferred Costs	94 The issuer amortized certain deferred costs over the estimated useful lives of the related products. The firm failed to test management's assertions regarding the estimated useful lives.
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Goodwill	95 An issuer performed an interim goodwill-impairment analysis because it sold a large portion of its operations and concluded that a small portion of its goodwill was impaired. The firm failed to test or challenge the assumptions the issuer made when the issuer assessed the goodwill for impairment and also failed to address why goodwill was not fully impaired in light of the issuer's deteriorating financial performance.
	96 Firm failure to include in the work papers evidence that the firm assessed the appropriateness of an addition to goodwill that the issuer recorded subsequent to its initial accounting for an acquisition, to adjust the purchase accounting for a contingency in a contract assumed as part of the acquisition.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	97	Failure to audit the issuer's goodwill impairment analysis
	98	Firm failure to evaluate the recoverability of goodwill and long-lived assets because the firm failed to evaluate the reasonableness of the issuer's assumptions and other than a signed audit program, there were no work papers relating to the impairment analysis for long-lived assets.
	99	Firm failure to perform sufficient procedures to evaluate the goodwill impairment charge that the issuer recorded upon adoption of SFAS 142, <i>Goodwill and Other Intangible Assets</i> , as the firm did not have a person with the appropriate knowledge or skills in the valuation area review the issuer's estimate of the fair value of its reporting units and the firm did not obtain evidence to support the issuer's critical assumptions.
	100	The issuer's interim goodwill impairment analysis concluded that goodwill was not impaired, however, the 4th quarter results of the issuer were lower than expected and the issuer was in violation of its debt covenants at year end. According to documents in the firm's work papers, when the issuer was negotiating revised debt covenants, it used more conservative assumptions than the ones used previously in its goodwill impairment analysis. In light of these circumstances, the firm should have evaluated whether the issuer should have performed another impairment test at the end of the year, however, other than making an inquiry of management, the firm failed to do so.

LIABILITIES:

Accruals	101	Firm failure to demonstrate it had assessed the assumptions used by the issuer in recording accrued liabilities on a sublease associated with a significant store closing.
	102	Firm failure to adequately evaluate the appropriateness of the issuer's accrued liability for certain medical costs. The issuer was created years ago as a result of a spin-off and under the terms of the spin-off agreement, the former owner of the issuer agreed to continue to pay certain medical costs for certain employees, and these costs were subject to reimbursement by the issuer. The issuer maintained an accrued liability related to the reimbursable medical costs even though the firm's work papers indicate that, in a prior year, the previous owner had represented to the issuer's treasurer that the issuer did not owe any additional amounts and that the issuer would not be billed for any additional costs. In accepting the issuer's accrued liability for reimbursable medical costs, the firm relied on a letter from the issuer's legal counsel that had not been updated.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	103	Firm failure to test the claims data a third party administrator provided to the issuer to enable the issuer to calculate its workers compensation and general, health, and dental insurance liabilities.
	104	Firm failure to assess or include in their work papers audit evidence related to the overstatement of accruals and the accounts receivable reserve and whether this indicated a bias in management's estimates that could result in material misstatement due to fraud, even though the firm assessed the fraud risk factors for these items as high.
	105	In auditing the oil and gas reserve estimates, the firm compared the prior year reserves estimates to the current year's production for one geographic area only, but it did not do so for the geographic area that accounted for the majority of the issuer's production.
	106	Failure to document its understanding of the issuer's method for selecting the reserves that the issuer included in its partial assessment of reserves related to oil and gas.
	107	Oil and gas reserve estimates were prepared by engineers who are employees of the issuer and the firm failed to perform any procedures to address the objectivity of the issuer's reserve engineers.
	108	Firm failure to obtain an appropriate understanding or to include evidence in the work papers that it had obtained an appropriate understanding, of the status of an issuer's environmental issue to support the lack of an accrual or disclosure.

Income Taxes (Assets, Liabilities and Expenses)	109	Firm failure to address the incorrect accounting of a deferred tax liability that was not recorded and the firm was aware that the issuer did not record the deferred tax liability for a portion of its accumulated foreign currency translation adjustment that was associated with the unremitted earnings from its non-U.S. subsidiaries that were included in other comprehensive income. SFAS No. 109, <i>Accounting for Income Taxes</i> , requires that the deferred tax liability be recorded in this situation.
	110	Firm failure to evaluate the appropriateness of an issuer's classification of its net deferred income tax liability as non-current.
	111	Firm assessed the potential effects of the exercise of stock options on the appropriateness of the net amount of the deferred income tax assets, but failed to assess its effect on the classification of those assets.
	112	No evidence in the work papers that indicate that the Firm audited the income tax provision beyond comparing the issuer's tax schedules to the financial statement disclosures.

BALANCE SHEET LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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BALANCE SHEET

	113 Tax provision review memorandum was dated seven months after the audit opinion date and contained no signatures.
	114 No evidence in the firm's work papers to support that the firm had evaluated the appropriateness of the valuation allowance against the issuer's net deferred tax asset.
	115 Firm failure to evaluate whether the issuer's deferred tax assets were recoverable and whether the current classification for a portion of those assets was appropriate.

Debt	116 Firm's failure to identify and address the issuer's misclassification of its revolving line of credit as a long-term liability rather than a current liability in accordance with EITF 95-22, <i>Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Arrangements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement</i> .
	117 Firm deficiencies in the auditing of fair value assumptions resulting in the firm failing to obtain sufficient competent evidential matter to support its audit opinion and the firm's failure to test, or to include evidence in the work papers that it had tested, the assumptions an issuer made when valuing the warrants it had granted to its creditors in exchange for an extension of the payment terms and modifications to its debt.
	118 Firm's failure to identify and address the incorrect accounting for a balance under a revolving line of credit as long-term liability, despite the presence of conditions that made such accounting inappropriate under EITF 95-22, <i>Balance Sheet Classification of Borrowings under Revolving Credit Agreements that Include both a Subjective Acceleration Clause and a Lock-Box Arrangement</i> . This misclassification caused an understatement of current liabilities and an overstatement of working capital.
	119 Firm failure to evaluate the issuer's compliance with its debt covenants and such evaluation was necessary to conclude that the classification of debt as long-term was appropriate given the issuer's violation of its debt covenants in the prior year, its debt covenant violations during the second quarter, the scheduled debt maturities during the year, and the amendments to a debt agreement during the year.
	120 Firm failure to obtain corroboration of whether the conditions in an amendment to a debt agreement had been met for an executed debt waiver to be in place.

Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

By Income Statement Line Item

Large Firm PCAOB Inspection Deficiency Analysis - By Income Statement Line Item
[Firms with Greater than 100 SEC Issuer Audit Clients]

Based on Inspection Reports Issued as of January 19, 2006 on 2004 Audits

INCOME STATEMENT LINE ITEM CLASSIFICATION	TYPES OF DEFICIENCIES NOTED
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INCOME STATEMENT

REVENUE:	1	Firm failure to obtain sufficient competent evidential matter to support its audit opinion relating to deficiencies in the auditing of revenue recognition.
	2	Firm failure to review an issuer's contracts with its major customers to evaluate whether the issuer's revenue recognition practices were appropriate.
	3	An issuer recorded revenue related to a fee received in conjunction with the issuance of a letter of credit on behalf of a customer with whom it was negotiating a significant construction contract. Firm failed to obtain sufficient evidence, through confirmation with the customer or otherwise, regarding the substance of the agreements entered into between the issuer and the customer which was necessary in order to evaluate the appropriateness of the issuer's recognition of fee revenue from the issuance of the letter of credit.
	4	Firm failure to consider the appropriateness of including a settlement that the issuer reached with a customer, in net sales and not disclosing that fact. This resulted in net sales increasing, however, had the settlement been omitted, net sales would have decreased.
	5	When auditing the completeness, existence and valuation assertions for deferred revenue, the sample of items tested by the firm was inadequate because the firm used the wrong method of sampling.
	6	No evidence in the work papers to indicate that the Firm considered the effects of distributor agreements on revenue recognition, even though sales to third party distributors contributed 64% of net sales.
	7	Firm failure to consider contracts and the effects their terms may have on revenue recognition.

INCOME STATEMENT LINE ITEM CLASSIFICATION		TYPES OF DEFICIENCIES NOTED
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INCOME STATEMENT

	8	Firm failure to perform procedures on the revenue recognition trigger process for a segment of revenue that represented approximately 40% of total revenue.
	9	Firm failure to perform a step in the audit program to test the underlying data supporting a portion of deferred revenue.
	10	Firm failure to evaluate the issuer's sales contracts for multiple-element arrangements that would affect the issuer's recognition of revenue.

GAINS:	11	Issuer received cash proceeds from the sale of certain investments and did not recognize the associated gains until the subsequent year, however, the firm did not perform an analysis to determine whether the deferral of the gains was appropriate.
	12	Firm failure to identify a departure from GAAP that it should have identified and addressed before issuing its audit report related to the issuer including in income the gain from the sale of an operating property to a related party. In accordance with SFAS 66, <i>Accounting for Sales of Real Estate</i> , the gain should not have been recorded in income because the sale was to a related party.
	13	Firm failure to perform sufficient audit procedures with respect to reported gains and the value of the issuer's retained interests on the sales of certain loans through securitization transactions.

OTHER INCOME:	14	An issuer recognized as other income the remaining portion of deferred revenue related to agreements made three years previously granting certain distribution rights and technology licenses. In previous years, revenue from similar agreements was recognized on a straight-line basis over the life of the agreements. Firm failed to evaluate, or to include in the work papers evidence that it had evaluated, the propriety of either the original method of revenue recognition or the recognition of all remaining deferred revenue.
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EXPENSES:	15	Firm assessed the risk of misstatements as high for expenses, however, with the exception of procedures related to depreciation, interest expense, and restructuring charges, the firm failed to perform sufficient substantive procedures on the expense balances.
	16	Firm failed to document a rationale for the appropriateness of the issuer's expensing of certain costs incurred prior to the receipt of a signed contract and also failed to address the issuer's failure to disclose the accounting policy regarding such costs.

INCOME STATEMENT LINE ITEM CLASSIFICATION		TYPES OF DEFICIENCIES NOTED
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INCOME STATEMENT

	17	Firm tested certain expenses and accrual balances by comparing various reports to the payroll system without having tested the payroll system and thus without basis to rely on the reports.
	18	Firm failure to test the relevant assertions regarding cost of goods sold and the firms test were limited to inventory tests.

INCOME TAXES:		Refer to the Balance Sheet Tab
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IMPAIRMENT CHARGES:	19	Firm failure to identify that the impairment charge related to the shutdown of a manufacturing facility had an error in the computation causing the amount of the charge to be overstated.
	20	Firm failure to identify and address the issuer's misclassification of certain amounts within the statement of cash flows related to an impairment charge.
	21	Firm failure to perform an appropriate evaluation of management's assertion that it was not necessary to record an impairment loss related to a plant that the issuer had in a country that was severely curtailed. The firm's work papers included issuer generated support for the determination, but the support did not include detailed calculations of the estimated future cash flows or probability-weighted cash flows, nor did it address when, or if, the plant would be able to return to near capacity.
	22	Firm failure to disclose in the financial statements information concerning an impaired asset and the issuer's method for determining the fair value of the assets in accordance with SFAS 144, <i>Accounting for the Impairment or Disposal of Long-Lived Assets</i> .
	23	Issuer performed an impairment analysis concerning its operations in a country where, for tax reasons, the issuer had curtailed its operations and had submitted a claim to the country's government for lost profits and other damages. The firm, without any documentation or evidence of appropriate audit scrutiny, and despite indications that this assumption was not the most probable outcome, inappropriately accepted the assumption concerning recovery on the claim.
	24	Firm failure to evaluate, or to include evidence in the work papers that it had evaluated, whether an issuer's property that was placed on the Comprehensive Environmental Response Compensation and Liability Information System, was impaired in light of the municipality's rejection of the property and the issuer's continuing inability to sell the property.

INCOME STATEMENT LINE ITEM CLASSIFICATION		TYPES OF DEFICIENCIES NOTED
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INCOME STATEMENT

DISCONTINUED OPERATIONS:	25	Firm failure to perform, or to include in the work papers evidence that it performed, a sufficient analysis to assess the appropriateness of the issuer's classification of a divested business as a discontinued operation.
	26	Firm failure to identify a departure from GAAP that it should have identified and addressed before issuing its audit report related to the issuer's classification of the results of operations of certain properties and gains and losses on the sales of those properties, in discontinued operations, when, because of the issuer's significant continuing involvement after the dates of the sales of these properties, it did not meet the criteria in SFAS 144, <i>Accounting for the Impairment or Disposal of Long-Lived Assets</i> , for classification as discontinued operations.

Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

By Audit Performance

Large Firm PCAOB Inspection Deficiency Analysis - By Audit Performance
[Firms with Greater than 100 SEC Issuer Audit Clients]

Based on Inspection Reports Issued as of January 19, 2006 on 2004 Audits

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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Consideration of Internal Control in a Financial Statement Audit: An Amendment to Statement on Auditing Standards No. 55 (AU 319)	1	Firm failure to change its level of controls assurance from “moderate” to “basic” when it identified certain weaknesses in the issuer’s IT general controls and as a result the firm performed insufficient audit work on accounts receivable and inventories.
	2	Firm relied on certain controls, in particular general computer controls, automated application controls and security controls, without performing, or without documenting in the work papers the performance of, sufficient testing to support reliance on those controls.
	3	Firm’s documentation of testing of certain controls only covered activities occurring outside the audit period.
	4	Firm’s work papers indicated that it used reports generated by the payroll department to perform certain tests of controls, but the firm did not document any test work over the completeness of those reports.
	5	Firm did not document the sample sizes, or how they were determined, for the testing of certain controls.
	6	Firm’s work papers indicated that it relied on an instruction manual as documentation that a control existed and operated effectively without indicating how the manual supported that conclusion.
	7	Firm did not document its testing or understanding of certain key relevant systems and system controls of another company that had merged with the issuer during the year.
	8	Firm failure to test, or to perform sufficient tests of, controls that the firm relied on in designing and performing its substantive audit procedures.
	9	Firm reliance on IT application controls that had not been tested for several years.
	10	Firm did not sufficiently address the effects of deficiencies in IT program access controls, change-management controls, or application controls.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	11 Firm reliance on change-management controls that had been tested only for the first half of the year without performing appropriate updating procedures.
	12 Firm reliance on IT system-generated data without testing the IT general computer and/or application controls.
	13 Firm tested controls using samples that were smaller than necessary to support the reliance on the types of controls being tested.
	14 Firm assessed risk of misstatement for revenue as below the maximum, without having performed the sufficient tests of the issuer's general computer controls to support that assessment. For the controls that the firm did test, the work papers did not provide evidence that the systems tested and relied upon during the audit continued to operate effectively throughout the period of intended reliance.
	15 Firm tested the operating effectiveness of the controls over certain processes as of interim testing dates, but work papers do not evidence any procedures to roll forward these tests to the balance sheet date and the firm therefore lacked a reasonable basis for extending its conclusions to the balance sheet date.
	16 The engagement team used certain reports generated by the issuer's computer systems when testing inventory, revenue, accounts receivable and payroll. The firm, however, failed to test the completeness and accuracy of those reports even though the firm had assessed control risk at the maximum. Thus, the firm's reliance on the reports was not warranted.
	17 Firm relied on the issuer's controls surrounding the revenue cycle, but the firm's only testing of those controls was of a period subsequent to the year under audit.
	18 Firm's audit approach was to test and rely on the issuer's controls over the loan origination process; however, the firm failed to perform appropriate tests of the operating effectiveness of those controls. Firm was aware of significant weaknesses in these controls, however, the firm did not address whether compensating controls, if any, addressed those weaknesses.
	19 Firm's test of controls over loan origination were limited and the firm should have increased the sample size as a result of weaknesses in access controls, but the firm failed to do so.
	20 Firm failure to test the completeness of the population from which the sample was selected for the issuer's controls over the loan origination process; and the firm could not explain to the inspection team how the sample was selected.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	21	Firm concluded that controls were effective over the loan origination process based on the premise that the issuer's internal audit department had tested the relevant controls; however, the firm was unable to demonstrate that the controls tested by internal audit were the appropriate controls to justify the conclusion.
	22	Firm's test of the operating effectiveness of the issuer's access security and program change controls did not provide assurance that the controls operated effectively throughout the audit period.
	23	Firm concluded that the issuer's IT general controls were designed effectively and the firm assessed control risk as "below maximum" and thus reduced the extent of its detailed substantive audit procedures regarding the existence and cutoff of revenue, however, the firm's control risk assessment was inappropriate because it was based primarily on inquiries and did not include any additional tests of the issuer's IT general controls or the application controls over the revenue process. As a result, the firm's detailed substantive audit procedures regarding the existence and cutoff of revenue was inadequate to obtain sufficient evidential matter.
	24	Firm's internal control testing and substantive procedures related to revenue were deficient because the firm assessed control risk for revenue as "below maximum" in an environment that the firm concluded had "pervasive weaknesses" in IT general controls. Thus, the nature and extent of the firm's substantive procedures were not sufficient in a high control risk environment and the firm inappropriately relied on system generated information without testing the source data.
	25	Firm did not test controls over the securitization process and the firm's substantive procedures were not sufficient.
	26	The firm's IT audit personnel participated in evaluating and testing general computer controls to assess control risk below the maximum level for auditing revenue. The IT audit personnel only documented their understanding of the design of controls and identified potential control issues primarily through inquiry, however, the firm failed to perform numerous tests and observations in its internal control work program due to time constraints, therefore, the firm failed to obtain sufficient evidence to assess control risk below the maximum level, and thus its substantive audit procedures for revenue were not sufficient.

The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (AU 341)	27	In connection with the firm's consideration of an issuer's ability to continue as a going concern, the firm failed to evaluate, or to include in the work papers evidence that it had evaluated, management's plans for dealing with the issuer's adverse liquidity position as required by AU 341.
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AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	28	Inadequate evaluation of the issuer's ability to continue as a going concern.
	29	Firm's going concern conclusion was based, in part, on the availability of the issuer's revolving credit facility, however this credit facility was dependent on the issuer's compliance with all the debt covenants and the firm failed to assess the likelihood that the issuer would be able to meet one of these covenants. As a result, the firm's report did not include a going-concern paragraph and the firm did not obtain a management representation covering projections and assumptions related to the covenant.
	30	Firm failure to evaluate, or to include evidence in the work papers that it had evaluated, whether there was substantial doubt about the issuer's ability to continue as a going concern for a reasonable period of time given the fact that the issuer had violated its debt covenants, had a liquidity dependency on a maturing line of credit, and had insufficient cash to pay its current liabilities and maturing debt.

Using the Work of a Specialist (AU 336)	31	Firm's work papers failed to evidence any evaluation of assumptions and methods used by a specialist or the results of the specialist's work in relation to the value of properties and favorable lease agreements acquired in a significant merger.
	32	Firm used a firm specialist to assess the reasonableness of the issuer's recorded asbestos liability and the specialist's conclusion was that the issuer's recorded liability was not unreasonable, however, the exhibits to the specialist's memorandum indicated that the issuer's recorded liability was not within the range of values estimated. The firm's work papers failed to evidence the firm's evaluation of this difference or how the matter was resolved.

Auditing Accounting Estimates (AU 342)	33	Firm failure to assess, or to include evidence in the work papers that it assessed, whether offsetting adjustments (one adjustment proposed by the firm relating to increasing the issuer's reserve for excess and obsolete inventory offset by the CEO's adjustment to increase the value of inventory received in a bankruptcy settlement) indicated a bias in management's estimates that could result in material misstatement of the financial statements, and/or a need for the firm to reevaluate planned audit procedures.
	34	Firm failure to assess, or to include evidence in the work papers that it assessed, whether the offsetting year-end adjustments relating to the accounting for a major construction contract indicated a bias in management's estimate that could result in material misstatement of the financial statements, and/or need for the firm to reevaluate planned audit procedures.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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<u>The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements (AU 322)</u>	35	Firm represented that it relied on the work of internal audit related to the portion of the issuer's loan portfolio that is serviced by third parties, however, the firm failed to perform, or to include evidence in the work papers that it had performed, procedures to understand and evaluate the internal controls at the service organization; substantive audit procedures on the activity on that portion of the portfolio between the period covered by the internal auditor's work and year end, except for high-level fluctuation analyses; and procedures to address the adverse findings in the internal auditors' report.
	36	Firm used the issuer's internal auditors to assist in auditing cash at an interim date, however, the firm failed to perform, or failed to have the internal auditors perform, audit procedures on the activity in the cash accounts between the interim date and year end.
	37	Firm relied on the work performed by the issuer's internal audit department, related to IT general controls, but the Firm's summaries of the internal auditor's reports did not sufficiently describe the procedures or test results that would indicate that the internal auditors assessed or tested those IT general controls.

<u>Consideration of Fraud in a Financial Statement Audit (AU 316)- Journal Entry Testing</u>	38	Firm used a computer-assisted auditing procedure to identify potentially fraudulent journal entries which identified certain entries, however, the firm failed to examine them to determine whether any of them were fraudulent.
	39	No evidence in the work papers that indicates that the firm performed required journal entry testing or look-back testing of significant estimates

<u>Audit Risk and Materiality in Conducting an Audit (AU 312)</u>	40	Firm policy in calculating a measure of materiality was not followed. Firm used a percentage of total assets as a basis as opposed to using a percentage of pre-tax income. This resulted in a higher planning materiality which the firm based their threshold for determining the amount for which an error would be treated as inconsequential and thus would not be posted on the firm's summary of unadjusted misstatements.
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AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	41 For errors identified in the current year that resulted from the prior year, the firm decided to use a different posting threshold that was based on equity for the current year as opposed to prior year pre-tax income, therefore, certain uncorrected accounting errors were not included on the firm's summary of unadjusted misstatements because of the different thresholds used and thus they were not evaluated individually or in the aggregate for materiality. (Examples of these types of uncorrected errors omitted from the summary of unadjusted misstatements were: workers compensation under-accrual; overstatement of a liability for stock appreciation rights; understatements of customer rebates; and overcapitalization of interest.)
	42 Firm did not evaluate thoroughly known or likely errors to include on the summary of unadjusted misstatements that related to deferred costs that were inappropriately capitalized; note payable and interest expense; and revenue recognition.
	43 Firm combined the effects of known errors so that the net effect was less than the posting thresholds for the firm's summary of unadjusted misstatements.
	44 Firm did not reconsider its assessment of risk and materiality or revisit its audit scope in light of the known and likely errors.
	45 Firm did not give sufficient consideration to the qualitative nature of the uncorrected errors and did not reconsider its fraud risk assessment related to an issuer that is unwilling to correct known errors.
	46 Firm concluded that certain accrued liabilities were overstated but did not include these errors on the summary of unadjusted misstatements even though, in the aggregate, the errors exceeded the firm's planning materiality threshold.
	47 The issuer reduced certain accruals by an aggregate amount that equaled the firm's planning materiality threshold, but the firm's work papers did not include the rationale for this.
	48 Firm used an inappropriately high threshold for posting uncorrected errors to the firm's summary of unadjusted misstatements.
	49 Work papers did not document the firm's threshold for posting errors to the firm's summary of unadjusted misstatements.
	50 Several uncorrected errors noted in the work papers were not posted to the firm's summary of unadjusted misstatements, were not evaluated for materiality in the aggregate, and were not included in the management representation letter.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	51	Firm assessed risk of significant misstatement as moderate for most significant accounts but then reduced this to low during final audit procedures which resulted in the firm performing insufficient audit work on those accounts.
	52	No evidence in the work papers that indicates that the firm obtained testing results that supported the firm's assessment of control risk as below the maximum.
	53	Firm assessed risk of misstatement in one area as low without having performed sufficient tests of controls to support that assessment. The firm's control testing relied on system-generated reports, without the firm having tested the underlying data, general IT controls, or related system application controls to gain assurance that the reports were accurate and complete.
	54	The firm assessed control risk at the maximum and inappropriately used analytical procedures to test revenue and certain operating expenses.
	55	Firm assessed inherent risk and control risk at the maximum and used a combination of a limited number of positive confirmations, analytical procedures and review of certain reconciliations to test the completeness assertion related to deposits. The firm, however, failed to meet the requirements for substantive analytical procedures because the firm failed to establish the auditor's expectations or the amount of the difference that could be accepted without further investigation.
	56	Firm used an inappropriate amount for planning materiality and had they used an appropriate amount, the firm's sample sizes for confirming receivables and performing certain tests of inventory would have been approximately 3 times larger than the sample sizes actually used.

Service Organizations (AU 324)	57	Inappropriate reliance on the IT general controls at a service organization that managed and operated the infrastructure for the issuer's centralized general ledger system, without sufficient testing of those controls.
	58	Inappropriate reliance on the controls at a service organization for payroll services with respect to vacation expense and accrual testing, however, the firm never obtained an understanding of the internal controls at the service organization nor had it obtained an auditor's report prepared in accordance with AU 324.
	59	In auditing the issuer's self-insurance reserve, the firm relied on summary claims data obtained from the issuer's third-party processor, but no service auditor's report was available. In the absence of a service auditor's report, the firm should have performed additional audit procedures on the processor's claims data but failed to do so.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	60 Lack of sufficient basis for the reliance placed on the controls at a service organization because no service auditor's report was available and the firm did not perform the procedures necessary for it to rely on those controls.
	61 Inappropriate reliance on the service auditor's report from a pervious year as a substitute for the lack of a current year service auditor's report.
	62 Issuer used a service organization to process payroll and the firm placed no reliance on the service auditor's report on the service organization's internal controls and assessed control risk at the maximum for payroll expense. However, the firm failed to test the accuracy and completeness of the payroll reports from the service organization that the firm used in its audit tests of payroll expense and related accounts.
	63 Issuer used a third party service provider to process its loan and deposit transactions. The firm used the service auditor's report to obtain its understanding of the service provider's internal controls; however, the report did not cover the entire period subject to audit. The firm failed to perform any procedures to update its understanding of the service provider's controls from the date of the service auditor's report through the issuer's year end.
	64 Firm used the service auditors' reports for two third-party service providers in establishing its understanding of the service providers' controls over the loan and deposit processes and its testing of controls over the loan processes. The service auditors' reports, however, did not cover the entire period subject to audit, and the firm failed to perform any procedures to update its understanding of the service providers' controls.
	65 Firm failed to obtain the service auditor's report on the payroll service organization's internal controls or to gain an understanding of the service organization's controls by other means. Thus, the firm assessed control risk at the maximum for payroll expense. Nevertheless, the firm failed to test the accuracy and completeness of the payroll reports from the service organization that the firm used in its audit tests of payroll expense and related accounts. In addition, the firm used analytical procedures in its tests of payroll expense and related accounts, which did not meet the requirements for substantive analytical procedures because the firm's documented expectations were not precise enough to provide the desired level of assurance that differences which may represent potential material misstatements would be identified for the firm to investigate.
	66 Firm failed to gain an understanding of the payroll service organization's controls, and it assessed control risk at the maximum for payroll expense. Nevertheless, the firm failed to test the accuracy and completeness of the payroll reports from the service organization that the firm used in its audit tests of payroll expense and related accounts.

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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Analytical Procedures (AU 329)	67	Firm failure to test the validity of statistics that their substantive analytical procedures using expectations were based on.
	68	For certain analytical procedures, the firm failed to test either the data it used or the information system from which the data was derived.
	69	Firm's documented expectations were not precise enough to provide the desired level of assurance that differences that may be material misstatements would be identified for the firm to investigate.
	70	Because the issuer had multiple properties, the firm should have disaggregated the data when performing analytical procedures, but failed to do so.
	71	Firm used analytical procedures as the primary audit tests of payroll expense and related accounts, however, the procedures did not meet the requirements for substantive analytical procedures because the firm's documented expectations were not precise enough to provide the desired level of assurance that differences which may represent potential material misstatements would be identified for the firm to investigate.
	72	Firm performed analytical procedures on the quarterly financial information and cost of sales and operating expenses for the year, however, these procedures were not adequate because the firm's documented expectations were not precise enough to provide the desired level of assurance that differences which may represent potential material misstatements would be identified for the firm to investigate.
	73	Firm used analytical procedures as the primary audit test of investment income, fixed assets, other assets, interest and fee income, and interest expense. The analytical procedures, however, failed to meet or the work papers failed to include evidence that they met, the requirements for substantive analytical procedures.
	74	Firm assessed control risk at the maximum and used a combination of positive and negative confirmation requests and analytical procedures to test the completeness assertion related to deposits. The analytical procedures; however, failed to meet the requirements for substantive analytical procedures because the firm failed to establish the auditor's expectations or the amount of the difference from any expectations that could be accepted without further investigation.
75	Firm assessed control risk at the maximum and performed analytical procedures over income statement accounts; however, the firm failed to establish expectations that were precise enough to provide the desired level of assurance that differences which may represent potential material misstatements would be identified for the firm to investigate.	

AUDIT PERFORMANCE	TYPES OF DEFICIENCIES NOTED
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	76 Firm used analytical procedures as the primary audit procedures for revenue, cost of goods sold and payroll. The procedures did not meet the requirements for substantive analytical procedures because the firm failed to establish, or to include evidence in the work papers that it had established, expectations or the amounts of the differences from any expectations that could be accepted without further investigation. In addition, because the issuer had multiple product lines, the firm should have disaggregated the data when performing the analytical procedures but failed to do so.
	77 Firm used analytical procedures as the primary audit procedures for sales and payroll and as a component of the audit procedures for inventory and accounts receivable. Inherent risk and control risk were assessed at the maximum for all audit areas. The firm's analytical procedures did not meet the requirements for substantive analytical procedures because the firm failed to establish, or to include evidence in the work papers that it had established, expectations or the amounts of the differences from any expectations that could be accepted without further investigation.
	78 Firm employed analytical procedures as its primary audit procedures for revenues and expense accounts. The procedures did not meet the requirements for substantive analytical procedures because the firm failed to establish, or failed to include evidence in the work papers that it had established, expectations or the amounts of the differences from any expectations that could be accepted without further investigation.
	79 Firm assessed control risk at the maximum and performed analytical procedures to test payroll expense. However, the procedures did not meet the requirements for substantive analytical procedures because the firm failed to establish, or failed to include evidence in the work papers that it had established, expectations or the amount of the difference from any expectations that could be accepted without further investigation.

Large Firm PCAOB Inspection Deficiency Analysis

(Firms with Greater than 100 SEC Issuer Audit Clients)

By GAAP Departure

Large Firm PCAOB Inspection Deficiency Analysis - By GAAP Departures
[Firms with Greater than 100 SEC Issuer Audit Clients]

Based on Inspection Reports Issued as of January 19, 2006 on 2004 Audits

GAAP DEPARTURES		DEFICIENCIES CITED THAT WERE NOT SPECIFICALLY IDENTIFIED IN THE OTHER TABS
AICPA SOP 90-1 Financial Reporting by Entities in Reorganization Under the Bankruptcy Code (Fresh-Start Accounting)	1	An issuer applied fresh-start accounting in accordance with AICPA SOP 90-1, under which the issuer's assets and liabilities were remeasured and the allocation of reorganization value to the issuer's three operating segments was determined by the issuer with the assistance of a third party appraisal firm. The issuer relied on a draft appraisal for fair value allocation as a final appraisal had not been completed. The firm's work papers supporting the reorganization value allocation consisted only of spreadsheets that the issuer provided and did not include the draft appraisal report. In addition, the firm's work papers did not include evidence that the firm performed sufficient procedures to address the completeness and accuracy of the key underlying data used in the allocation, or whether the firm evaluated the significant assumptions and estimates management made in allocating fair value.
SFAS No 131, Disclosures about Segments of an Enterprise and Related Information	2	Firm failure to identify and address the issuer's inappropriate disclosure in the notes to the financial statements of two reportable segments despite the presence of information that indicated the issuer was organized into more than two reportable segments as defined in SFAS No 131. The improper aggregation of reporting segments resulted in the offsetting of operating profits at one segment with losses at another.
	3	Improper auditing of segment data because audit procedures were limited to a comparison of the data to management reports, while the firm's testing of the system that generated those management reports was inadequate, and therefore mere comparison was insufficient.
	4	Work papers did not support or document the rationale for aggregating two businesses into a single reportable segment.
	5	Work papers did not include any evidence that the firm assessed whether the issuer's presentation of a single reportable segment was consistent with SFAS 131, in circumstances where the issuer sold products through four distribution channels and the issuer's internal financial statements included a full income statement for each distribution channel.

GAAP DEPARTURES		DEFICIENCIES CITED THAT WERE NOT SPECIFICALLY IDENTIFIED IN THE OTHER TABS
	6	Firm failure to analyze whether the conclusion that the issuer had only one reportable segment was appropriate under SFAS No. 131. Several factors suggest that the issuer may have had more than one reportable segment, including that the issuer had three operating divisions with separate general ledgers, that the issuer's chief executive and financial officers used information from those ledgers for assessing the divisions' performance and allocating resources to them, and the divisions had different gross margin percentages.
SFAS 133, Accounting for Derivative Instruments and Hedging Activities	7	Firm failure to evaluate whether certain contracts to purchase a commodity constituted derivatives.
	8	Firm failure to test derivatives in the issuer's trading portfolio, despite the fact that the firm's planning documentation indicated that the firm would test them.
	9	Improper accounting that was not identified by the firm related to derivatives and the use of the normal purchases and normal sales (NPNS) exception under SFAS 133, which requires the use of accrual accounting instead of fair value accounting. The issuer did not satisfy the conditions for the NPNS exception, which resulted in improper use of the accrual accounting for these derivatives.
	10	Firm did not test the issuer's evaluation of a financial derivative, even though the issuer used different inputs for that evaluation than the forward price curve would indicate.
	11	Firm failure to perform sufficient audit procedures with respect to the completeness, existence, and valuation of financial instruments because they applied a substantive audit approach that did not include testing the issuer's controls over financial instruments and hedging activities and the firm was unable to reduce audit risk to an acceptably low level without testing the operating effectiveness of the issuer's controls.
	12	Insufficient substantive audit procedures related to financial instruments because the firm relied on reports it did not test; the populations from which the samples were selected were not tested for completeness; there was no apparent rationale for the sample sizes or the items selected, and the issuer's management picked the sample items for one test; an insufficient number of items were tested to conclude on the overall account balances; and the procedures that were performed at interim dates were not updated to the year-end.
	13	Firm failure to evaluate the issuer's hedge destination, risk management objectives, and hedging strategies and to test the issuer's assessments of hedge effectiveness for its outstanding foreign currency futures contracts.
14	Firm requested that the issuer provide documentation that supported hedge accounting treatment for the foreign currency futures contracts and the issuer was unable to support these contracts qualified for hedge accounting, and therefore, could not use hedge accounting.	

GAAP DEPARTURES		DEFICIENCIES CITED THAT WERE NOT SPECIFICALLY IDENTIFIED IN THE OTHER TABS
FIN 46R, Consolidation of Variable Interest Entities	15	Firm failure to evaluate, or to include evidence in the work papers that it had evaluated, the issuer's analysis that the option and contingent purchase contracts that it had entered into to acquire land were not the primary beneficiary of the contracts, and therefore, it was not required to consolidate them under FIN 46.
	16	Issuer adopted FASB Interpretation No. 46 and stated that it would not have a material effect on its financial condition or results of operations and the Firm's FIN 46 analysis incorrectly concluded that the issuer's VIE did not need to be consolidated or disclosed.
SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (Securitization Arrangements)	17	The issuer executed a securitization arrangement under which it sold its investments in bonds to an investment broker who transferred the bonds into a qualified special purpose entity. In assessing whether this transfer qualified as a sale under SFAS No. 140, the firm inappropriately relied on a legal opinion that was addressed to the investment broker and that described the transaction from the perspective of the investment broker.
	18	In analyzing whether the issuer's sale of receivables under a revolving securitization program met the accounting criteria for a sale, the firm inappropriately relied on a legal opinion obtained by the issuer that was restricted to the use of certain parties. Although the firm was not one of those parties, the firm did not obtain a waiver of those use restrictions and without a waiver, the firm should not have relied on the legal opinion as audit evidence.
	19	Firm failure to perform sufficient tests to determine whether the securitization transactions met the requirements of SFAS No. 140, to be recognized as sales.
SFAS 57, Related Party Disclosures	20	Failure to disclose in the financial statements information concerning related party transactions between the issuer and entities in which its chairman and chief executive officer had an ownership interest in accordance with SFAS 57.
	21	Firm agreed with the issuer that it was not required to disclose certain related party transactions, however, certain advances to key members of management, should have been disclosed based on qualitative considerations.
	22	Firm failure to audit the disclosure that certain other related party transactions were conducted at arm's length.
SFAS 106, Employers' Accounting for Postretirement Benefits Other Than Pensions	23	Firm failure to evaluate, or to include evidence in the work papers that it had evaluated, whether the reduction in personnel met the criteria in SFAS No. 106, <i>Employers' Accounting for Postretirement Benefits Other Than Pensions</i> , for a curtailment, and if so, what year the curtailment should be accounted for entirely.

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