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Staff Inspection Brief

The staff of the Public Company Accounting Oversight Board ("PCAOB" or "Board") prepares Inspection Briefs to assist auditors, audit committees, investors, and preparers in understanding the PCAOB inspection process and its results. The statements contained in Staff Inspection Briefs do not establish rules of the Board or constitute determinations of the Board and have not been approved by the Board.

Information about 2017 Inspections

The PCAOB Division of Registration and Inspections has prepared this Inspection Brief to provide information about the 2017 PCAOB inspections of registered audit firms and their audits of issuers.

Key areas of inspection focus in 2017 include:

- *Recurring audit deficiencies* - Audit areas in which the most frequent and recurring audit deficiencies were identified in previous inspections, including procedures performed related to the audit of internal control over financial reporting, assessing and responding to risks of material misstatement, and auditing accounting estimates.
- *Economic factors* - Audit areas affected by factors related to current economic conditions, including Brexit and its effect in the European financial sector, the continued high rate of merger and acquisition activity, the search for higher yielding investment returns in a low interest rate environment, and the fluctuations in oil and natural gas prices.
- *Financial reporting areas* - Audit areas that may involve significant judgment from management and/or auditors, such as the auditor's consideration of the entity's ability to continue as a going concern, and income tax disclosures.
- *New Form AP reporting requirements* - Firm implementation of new PCAOB audit rules and related amendments designed to provide investors and other financial statement users with information about engagement partners and accounting firms that participate in audits of issuers.
- *New accounting standards* - Changes firms may have made in their processes and/or the procedures that firms plan to undertake in light of new accounting standards issued by the Financial Accounting Standards Board ("FASB") related to revenue recognition and lease accounting. For certain issuer audits, Inspections staff is discussing with the auditor matters related to the audit of the issuer, including how it is addressing pending accounting changes with the issuer.
- *Multinational audits* - Work performed by other firms at the request of the principal auditor ("referred work engagements"), as well as audit work performed by the principal auditor with respect to the use of the work of other auditors.
- *Information technology* - Auditors' use of software audit tools in the audit, and audit

procedures performed to assess and address risks of material misstatement to the financial statements posed by cybersecurity.

- *Firm's system of quality control* - Policies and procedures for (1) identifying the "root causes" of audit deficiencies and positive quality events, (2) monitoring and maintaining independence, (3) performing engagement quality reviews with due professional care, and (4) applying professional skepticism throughout the audit.

Overview

PCAOB Inspections staff has historically planned each year's inspections by selecting issuer[1] audits based largely on an analysis of risk. Risks may emanate, for example, from economic trends, company or industry developments, size of and changes between years in issuer market capitalization, and the audit firm, including audit partner and inspection history. Inspections staff typically focuses on audit areas that present auditing challenges and significant audit risk, including risks of material misstatement in the financial statements, as well as areas of recurring audit deficiencies both within and across firms.

During the 2017 inspections, Inspections staff is primarily reviewing portions of selected audit work performed by firms on the 2016 financial statements of issuers (including referred work engagements where a firm played a role in the audit but was not the principal auditor). Where relevant, audit work related to internal control over financial reporting is also being selected for review.

Audit engagements and areas of inspection focus are usually not selected randomly, and selections of audits are not necessarily representative samples of a firm's audits. Rather, audits and areas of focus are generally selected on a risk-weighted basis. Accordingly, areas of focus vary among selected audits and firms, but often involve audit work on the most challenging audit areas, including financial statement accounts and disclosures that require a higher degree of management judgment.

Consistent with the approach in 2016, Inspections staff is also selecting a number of audits for review using a random approach.

2017 Inspections by the Numbers*

195 Firms

Planned to be reviewed by our inspectors which includes:

11 U.S. Firms

that issued audit reports for more than 100 issuers, and

55 non-U.S. Firms

in 26 jurisdisctions.

*Numbers are approximate

Additional information about the inspection program, along with certain characteristics of audits inspected and areas of past inspection focus, is provided in the Appendix.

1 For purposes of the PCAOB's inspection authority, the term "issuer" is defined in Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 and essentially includes public companies with Securities and Exchange Commission ("SEC") reporting obligations.

Information gathered as a result of inspection procedures performed is also expected to further inform PCAOB standard-setting activities and related analyses.

Key Areas of Inspection Focus

Recurring Audit Deficiencies

Inspections staff considers deficiencies cited in previous inspections to evaluate how an audit firm performed in those areas in the current inspection, including reviewing remedial actions taken in response to past inspection findings and information about the potential root causes of those findings. The most frequent and recurring audit deficiencies identified in recent inspections were in the following audit areas:

- **Internal Control Over Financial Reporting.** Inspections staff continued to identify audit deficiencies in 2016 related to noncompliance with AS 2201, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*. Inspections staff continues to consider, among other things, the sufficiency of auditors' procedures performed to identify, test, and evaluate controls that address the auditors' assessed risks of material misstatement, including auditors' testing of controls that contain a review element.

- **Assessing and Responding to Risks of Material Misstatement.** During the 2016 inspections, Inspections staff frequently identified audit deficiencies related to AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*, AS 2810, *Evaluating Audit Results*, and AS 1105, *Audit Evidence*. In 2017, Inspections staff continues to focus on audit work related to: (1) the sufficiency of testing the design and operating effectiveness of controls to support the auditors' planned level of control reliance, including the testing of controls over the accuracy and completeness of system-generated data and reports;[2] (2) whether the substantive procedures were specifically responsive to fraud risks and other significant risks of material misstatement that were identified by the auditor;[3] (3) the evaluation of the presentation of the financial statements, including the accuracy and completeness of the disclosures[4] for those focus areas included in the inspection; and (4) the evaluation of relevant audit evidence that appeared to contradict certain assertions in the financial statements.[5]

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2 Paragraph 10 of AS 1105 provides that auditors should test the accuracy and completeness of information produced by the company or test the controls over such information that is used as audit evidence.

3 See AS 2301.11 and .13.

4 See AS 2810.30 - .31.

5 See AS 2810.03 and .34.

- **Auditing Accounting Estimates, including Fair Value Measurements.** Audit procedures related to accounting estimates continues to be a focus of Inspections staff during 2017 due to the increased risk of material misstatement the estimates may pose to the financial statements. Auditing deficiencies in this area have commonly related to evaluating impairment analyses for goodwill and other long-lived assets, and the valuations of assets and liabilities acquired in business combinations. Inspections staff continues to take a close look at auditors' procedures performed to understand how estimates were developed as well as auditors' testing of data and evaluation of the assumptions used by management that are significant to the estimate.[6]

While Inspections staff observed improvements in the audit work performed at some firms in these areas in recent years, it continued to find high numbers of deficiencies at many firms. The persistent deficiencies related to these areas indicate that auditors should continue to consider these matters when planning and performing their audits. Inspections staff continues to evaluate auditors' processes for identifying and assessing risks of material misstatement at the financial statement assertion level. Proper identification of the risks of material misstatement, including the types of potential misstatements that can occur and the likely sources of those potential misstatements, is necessary when selecting appropriate controls to test, evaluating whether those controls adequately address the risks, and designing and executing substantive procedures.

Audit Areas Potentially Affected by Economic Factors

Inspectors consider the current economic environment and related developments in planning their inspections. Certain economic developments that factor into the 2017 selections include:

- **Brexit and the Effect in the European Financial Sector.** While the effects of Brexit are potentially wide ranging and some of them may not be fully known for some time into the future, the 2017 inspections consider Brexit's effects on the European financial sector. That sector has been affected by the risk-off[7] environment that has been expanding within financial markets in the aftermath of the United Kingdom's vote to leave the European Union as well as low interest rates, including negative interest rates in certain countries. Inspections staff considers audit risks that may arise on issuer audits related to changes in the European financial markets. Specifically, Inspections staff considers the auditor's assessment of significant risks and the related audit responses to these risks, and the assessment of financial statement disclosures.

How did auditors consider the effect of the Brexit vote on issuers when assessing risks of material misstatement to the financial statements?

6 See AS 2501.10 - .11.

7 Risk-off describes a process where investors move to lower yielding investments that are perceived to have lower risk. Lower-risk investments may be sought out by investors during periods of global market uncertainty.

- **Continued High Rate of Merger and Acquisition Activity.** Merger and acquisition activity has continued to be prevalent in the United States. For companies looking to fulfill their growth objectives, mergers and acquisitions are an alternative to general economic expansion while low interest rates still provide inexpensive financing.

  These transactions may include highly subjective estimates that are susceptible to management bias and have an increased risk of material misstatement related to the valuation of assets acquired and liabilities assumed. Additionally, risks of material misstatement may be associated with the identification of all intangible assets, assignment of goodwill to reporting units, and contingent consideration measurements. In past years, Inspections staff has observed that auditors frequently did not appropriately apply professional skepticism when testing estimates, including not considering contradictory or potentially inconsistent information when testing these areas.

- **Search for Higher Yielding Investment Returns in a Low Interest Rate Environment.** Some issuers invest in higher-risk instruments, including loans or securities with potentially higher investment returns. These instruments may be complex and harder to value, which may lead to an increased risk of material misstatement. While Inspections staff has not recently observed a significant number of audit deficiencies related to the testing of investments, periods of economic uncertainty may increase the risk of improper valuation of these assets.

- **Continued Fluctuations in Oil and Natural Gas Prices.** Debt defaults and bankruptcies continued to occur in the oil and gas industry during 2016. These economic risks are not isolated to the United States or to companies in the oil and gas industry. For example, the decline in oil prices may have affected corporate lending of some banks. Specific areas of focus related to this economic trend include impairment and valuation risks, the collectability of loans and receivables, and the issuer's ability to continue as a going concern.

How did the auditor respond to asset valuation risks related to continued fluctuations in oil and natural gas prices?

Financial Reporting Areas

Inspections staff selects certain financial reporting areas for inspection using a risk-based approach, and these areas vary for each inspected audit. Some areas are selected due to commonly identified risks while other areas represent new or emerging developments or risk factors.

The most frequently selected financial reporting areas in 2016 included revenue and receivables, nonfinancial assets (assets acquired in business combinations, including goodwill and other intangible assets, and other long-lived assets), inventory, financial instruments, the allowance for loan losses, income taxes, benefit-related liabilities, and equity transactions. These audit areas continue to be frequently selected for inspection in 2017.

Certain economic developments and other factors that were present in 2016 also result in additional financial reporting focus areas for 2017 and include:

- **Auditor's Consideration of the Entity's Ability to Continue as a Going Concern.** Economic factors may have a significant effect on a company's ability to continue as a going concern. These factors may include risks discussed within this document, such as fluctuations in oil and natural gas pricing and recent debt defaults. This area often involves subjective factors, so it is important for auditors to apply professional skepticism and consider all of the relevant facts, regardless of whether they support or contradict management's assertions.

Has the auditor considered current economic factors that might impact the issuer's ability to continue as a going concern?

  Auditors should continue to look to the existing requirements in AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, when evaluating whether substantial doubt regarding the company's ability to continue as a going concern exists for purposes of determining whether the audit report should be modified to include an explanatory paragraph regarding going concern.

- **Evaluation of Income Tax Accounting and Disclosures.** For issuers that have large and growing undistributed earnings in foreign jurisdictions, Inspections staff focuses on the audit procedures that were performed to evaluate and test management's assertion related to the indefinite reinvestment of those earnings, including the impact of events, such as significant cash transfers from a foreign subsidiary to the U.S. parent.

  Another area of focus is the auditor's evaluation of the design and operating effectiveness of controls related to income taxes. Income tax accounting is an area that often involves testing and evaluation of prospective financial information, which may involve a high degree of subjectivity on the part of management.

New Form AP Reporting Requirements

Rule 3211, *Auditor Reporting of Certain Audit Participants*, was adopted in 2015 and has a phased effective date of the following: (1) the engagement partner is required to be disclosed for auditors' reports issued on or after January 31, 2017, and (2) the other accounting firms involved in the audit are required to be disclosed for auditors' reports issued on or after June 30, 2017. This newly adopted rule will allow investors and others to know who is leading and participating in audits through a new Form AP that firms are required to complete and submit on the PCAOB website.

The 2017 inspection program includes procedures to assess the effectiveness of firms' implementation of Rule 3211, including by reviewing firms' systems of quality control in this area and assessing compliance with the new rule for particular audit engagements.

New Accounting Standards

The FASB adopted new standards in recent years related to revenue recognition and lease accounting.[8] While the audit requirements have not changed as a result of the issuance of these

8 See FASB, *Revenue from Contracts with Customers* (Topic 606), and FASB, *Leases* (Topic 842).

new standards, Inspections staff expects to gain an understanding of changes firms may have made in their processes and/or the procedures that firms plan to undertake in light of the new accounting standards. For certain issuer audits, Inspections staff is discussing with the auditor (1) how it is addressing pending accounting changes with the issuer, (2) communications related to management's readiness or technical ability with the audit committee, and (3) the process to ensure the auditor maintains independence with respect to the issuer's implementation of the new standard(s).

Multinational Audits

Inspections staff routinely inspects portions of multinational audits, including the audit work performed by both domestic and non-U.S. firms that played a role in the audits, but were not the principal auditors. Inspection selections may include referred work engagements as well as the audit work performed by the principal auditor with respect to the decision to use the work of the other auditor.

Inspections staff has identified inspection deficiencies when some firms used the work of other auditors. In recent years, Inspections staff has observed a decrease in audit deficiencies in inspected referred work engagements at some firms. Some firms have enhanced their methodology or tools for multi-location audits and moved to greater levels of supervision, including review, of the work of other audit firms participating in the engagement. While it is still too early to judge how effective these changes are, these efforts may have contributed to the recent decrease in audit deficiencies. Other firms, however, that have not made significant improvements may have greater risk of lower quality audits when they use other auditors. Inspections staff continues to review referred work engagements to evaluate the quality of the work performed.

Inspections staff continues to evaluate how a firm that is using the work of another auditor in its audit evaluated the competence of, and the work performed by, the other auditor.

Information Technology

Firm Software Audit Tools

Some firms continue to develop and use software audit tools to provide opportunities to perform audit work more effectively and efficiently, including increasing the likelihood of identifying and testing audit areas or specific transactions associated with higher risk. Inspections staff has observed that the software audit tools used by the firms vary, and some firms have customized purchased tools or have internally developed their own tools. Most software audit tools that have been observed by Inspections staff are being used for performing substantive audit procedures, while some tools may also be used for risk assessment. Examples of audit areas in which these tools are being used include testing manual journal entries for fraud indicators, assisting the auditor in evaluating the appropriate sample size for testing a population of transactions, and assisting the auditor in evaluating pricing of investment securities. Certain firms have also begun to consider the development of tools with artificial intelligence.

During 2017, Inspections staff continues to conduct procedures to further understand current and future efforts regarding the use and development of software audit tools. Inspections staff is evaluating the processes that the firms have in place to provide the firms with assurance that (1) current tools used to analyze the data meet the audit objectives, (2) engagement teams are effectively using these tools and evaluating the results of screening large data populations, and (3) engagement teams are applying due care, including professional skepticism, when using these tools during the performance of the audit work, including the evaluation of results of that work. PCAOB staff continues to gain an understanding of these types of processes related to tools that firms are planning to deploy in the future.

Cybersecurity Risks

Incidents and breaches of information systems occur frequently, and this is an area continuing to be considered by auditors and others as both a business risk and an information technology risk.

Inspections staff has observed that some firms have provided guidance to their auditors to consider cybersecurity risks. This includes considering cybersecurity when performing risk assessment procedures and addressing risk in the audit of internal control over financial reporting and in the audit of the financial statements.

During 2017, Inspections staff continues to understand and evaluate the procedures performed and documentation prepared by engagement teams to determine whether certain cybersecurity risks pose risks of material misstatement to the company's financial statements. Inspections staff also seeks to understand whether modifications to the engagement team's risk assessments and planned audit approach occurred or were necessary in response to these risks, including modifications to the procedures to test the design and operating effectiveness of relevant controls or test financial statement accounts and disclosures.

Audit Firm's System of Quality Control

Inspections staff is assessing each firm's quality control system for weaknesses or deficiencies that could lead to deficiencies in audit performance. Some of these areas include the firm's "tone at the top" as it relates to audit quality; policies, procedures, and practices concerning audit performance; training; partner management; and the firm's self-monitoring through internal inspections and responses thereto.

Root Cause Analysis

Inspections staff continues to focus on identifying the "root causes" of audit deficiencies and positive quality events through analyses of specific events, as well as evaluating the results of those firms that also perform their own internal root cause analyses. The specific procedures performed by Inspections staff to evaluate the root causes of audit deficiencies and positive quality events vary according to the size of the firm.

Root cause analysis is important to understand why audit deficiencies have not been detected prior to the issuance of an audit report and thus they merit continued focus by audit firms. While Inspections staff has observed improvement at some firms, this result is not the same across all firms. Firms are in varying stages of development of their root cause analyses. Firms that have responded to recurring audit deficiencies with meaningful, carefully considered actions to address underlying issues and causes are beginning to see improved results.

Inspections staff has observed that, in addition to analyzing identified deficiencies, certain firms have recently begun to analyze their own positive quality events in order to identify the underlying reasons for those positive quality events and determine their most effective actions. As firms begin to get a better understanding of what drives audit quality, they will be able to more effectively drive their remedial efforts, and ultimately improve and sustain audit quality.

Independence

Inspections staff continued to identify deficiencies in 2016 that indicated that the systems of quality control of certain firms did not provide sufficient assurance that the firm's personnel understood the independence requirements and that the firm and its personnel complied with independence requirements. Deficiencies observed in 2016 included instances in which some auditors provided impermissible non-audit services and instances in which auditors did not obtain pre-approval from the audit committee prior to performing non-audit services.

Inspections staff continues to focus on and assess how a firm's independence quality controls provide reasonable assurance that the firm maintains independence from its audit clients, including how those systems stay abreast of the growth in consulting and other non-audit services, such as audit firms' acquisitions of consulting practices. Those inspection procedures typically include, among other things, assessment of firms' processes to consider independence issues in connection with accepting new clients, something that, for some firms, may occur more often than in the past as a result of EU mandatory audit tendering and audit firm rotation requirements that took effect in 2016.[9]

Engagement Quality Review

In 2016, inspection results indicated the engagement quality review continues to be an area of frequent deficiencies. Deficiencies were observed in areas identified with significant risks of material misstatement and where an engagement quality reviewer reviewed, or should have reviewed, the audit work and related conclusions in the specific areas involved as those reviews were ineffective at identifying significant audit deficiencies. It is important for engagement quality reviewers to devote sufficient attention to their reviews not only during the year-end audit procedures but throughout the planning, execution, and completion of the audit.

In 2017, Inspections staff continues to focus on whether auditors complied with AS 1220, *Engagement Quality Review*. Specifically, Inspections staff continues to consider the engagement quality reviewer's evaluation of significant judgments made by the engagement team, including the engagement team's assessment of and responses to fraud risks, and whether the engagement quality reviewer evaluates if the audit documentation he or she reviewed indicates appropriate audit responses and supports the conclusions reached.

Professional Skepticism

Inspection observations continue to raise concerns about whether some auditors appropriately apply professional skepticism in the course of their audits, particularly in those areas that involve significant management judgments or transactions outside the normal course of business, as well as the auditor's consideration of fraud. For example, Inspections

9 See Regulation (EU) No. 537/ 2014 of European Parliament and of the Council (April 16, 2014).

staff continued to observe situations in which auditors sought to obtain only evidence that would support significant judgments or representations made by management, rather than to critically assess the reasonableness of management's judgments or representations, taking into account all relevant evidence, regardless of whether it confirmed or contradicted management's assertions.

Appendix

Inspections of Registered Firms that Audit Issuers

The PCAOB oversees the audits of issuers in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. PCAOB inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits. To achieve that goal, Inspections staff evaluates a firm's performance in selected audit engagements and the design and other matters related to a firm's quality control system.

The PCAOB regularly inspects U.S. and non-U.S. firms that issue audit reports opining on the financial statements of issuers. The actual number of firms that the PCAOB regularly inspects fluctuates since certain registered firms cease to issue audit reports for issuers while other firms will begin to issue audit reports for the first time. In general, the PCAOB inspects each firm in this category either annually or triennially, depending upon whether the firm provides audit reports for more than 100 issuers (annual inspection) or 100 or fewer issuers (triennial inspection). At any time, the PCAOB might also inspect any other registered firm that plays a role in the audit of an issuer, and the PCAOB has a practice of inspecting, in each year, some firms in that category.[10]

For operational purposes in administering the inspection program, Inspections staff groups firms that audit issuers into two programs:

Global Network Firms

This program encompasses inspections of registered audit firms that are members of BDO International Limited, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Grant Thornton International Limited, KPMG International Cooperative, and PricewaterhouseCoopers International Limited. Measured by the number of non-U.S. firms registered with the PCAOB, these networks are currently the six largest. Each member firm is a separate legal entity in the global network, and individual firm inspection reports are issued on each member firm. Six U.S. member firms of these networks are required to be annually inspected. Approximately 145 other member firms of these networks regularly issue audit reports for issuers and are required to be inspected at least triennially.

Non-Affiliate Firms

This program encompasses inspections of registered firms that are not covered by the Global Network Firm program. Many of the firms in this program, however, are members of other international networks, alliances, or affiliations.

The firms subject to inspection in this program vary widely in the number of issuers they audit, or the role they play in the auditing, and those issuers vary widely in size and nature. Five of these firms are required to be inspected in 2017 because they issued audit reports for more than 100 issuers in 2016. These firms are Crowe Horwath LLP, MaloneBailey, LLP, Marcum LLP, Cohen & Company, Ltd., and RSM US LLP. Approximately 375 other domestic and non-U.S. Non-Affiliate Firms regularly issue audit reports for issuers and are required to be inspected at least triennially.

10 For more information and individual firm inspection reports see http://pcaobus.org/Inspections/Pages/default.aspx. Many PCAOB-registered firms perform no work that is within the scope of the PCAOB's statutory responsibility and authority to assess. The PCAOB does not inspect those firms.

The summary of all registered and inspected firms is shown below (numbers are approximate):[11]

	Total	Global Network Firms	Non-Affiliate Firms
Registered Firms	1,991	344	1,647
Firms Required to Be Inspected Annually	11	6	5
Firms Required to Be Inspected At Least Triennially	524	148	376

Characteristics of Audits Inspected

An inspection typically does not involve reviewing all of a firm's audits or all aspects of the audits selected for review. Inspections staff selects specific portions of those audits for review. The inspected firms do not have the ability to limit or influence the selections.

Each year, Inspections staff, with the assistance of the PCAOB Office of Economic and Risk Analysis, performs a risk analysis to identify higher risk audits and audit areas for closer consideration. Audit engagements are selected based on this analysis, and the nature of the audits selected, the portions of the audits selected, and the related inspection focus areas will vary over time and among firms. Below is an overview of selected characteristics of issuer audits inspected in recent inspections.

Issuer Market Capitalization of Audits Inspected

Inspections staff considers the market capitalization[12] of an issuer, including the size and the changes between years, when selecting engagements for inspection. Issuer audits inspected each year are depicted below by market capitalization range.[13]

Global Network Firms audited approximately 99 percent of the total market capitalization of issuers audited by firms registered with the PCAOB during the 2014 – 2016 inspections.

11 Data as of June 30, 2017. Some of the non-U.S. firms included in these data are located in jurisdictions where the PCAOB is currently denied access to the information necessary to conduct inspections, due to asserted restrictions under local law or objections based on national sovereignty.

12 Market capitalization (as shown in Exhibits 1 and 2 in millions (M) or billions (B)) is derived from data provided by Standard and Poor's, Reuters, and FactSet. Market capitalization is calculated as the common stock price multiplied by common shares outstanding. Issuer market capitalization is as of the last trading day for the calendar year preceding the inspection year.

13 Market capitalization information does not include the net assets held by employee benefit plans, mutual funds, and certain other investment companies. These types of audits are included in the "$0 - $100M" market capitalization range in Exhibits 1 and 2. These types of audits also tend to be more significant to the audit practice of Non-Affiliate Firms than to the audit practice of Global Network Firms, thus inspections of such audits occur more frequently in the Non-Affiliate Firm program.

Exhibit 1: Number of Audits Inspected at Global Network Firms by Year and Market Capitalization Range

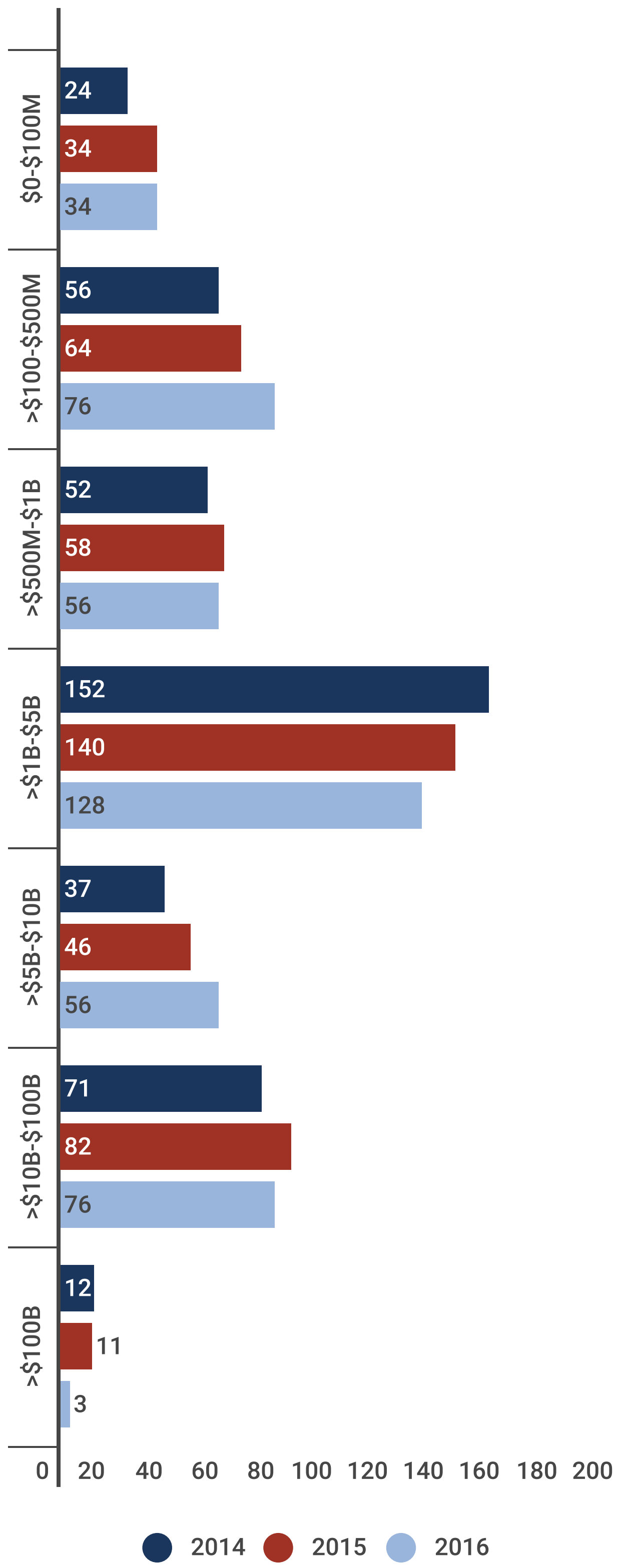


Exhibit 2: Number of Audits Inspected at Non-Affiliate Firms by Year and Market Capitalization Range

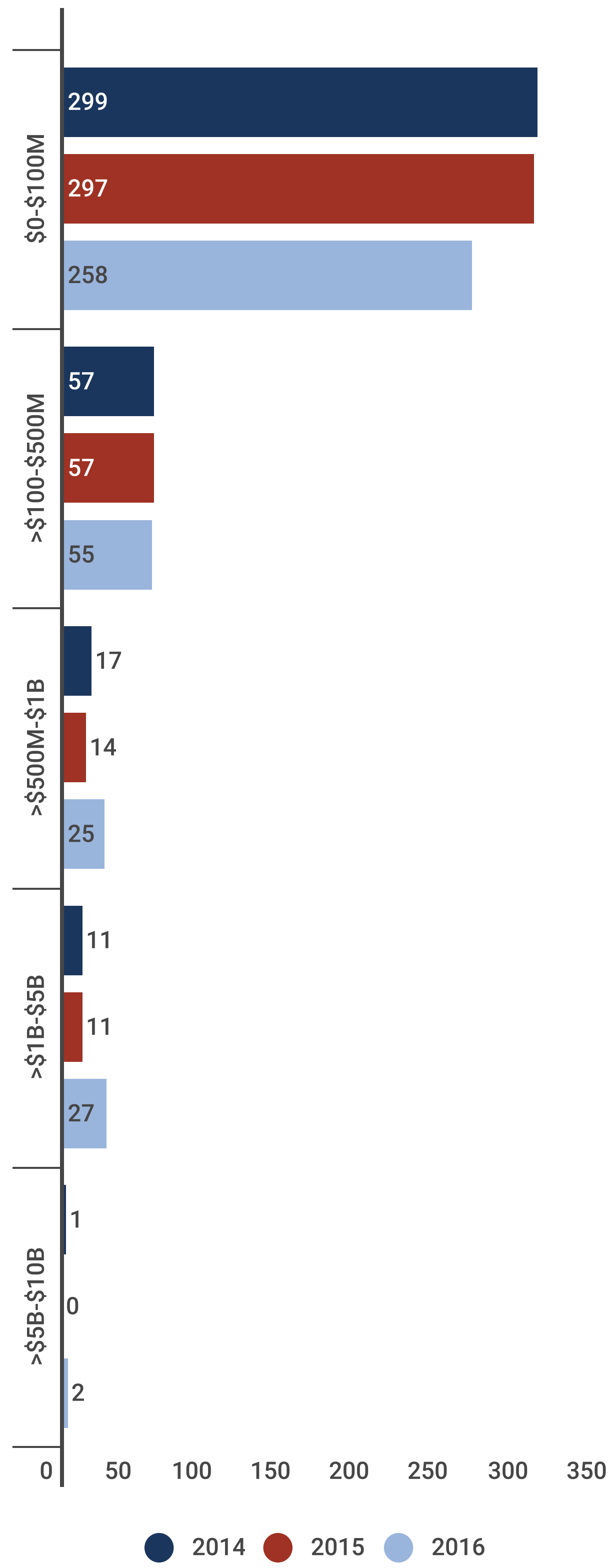
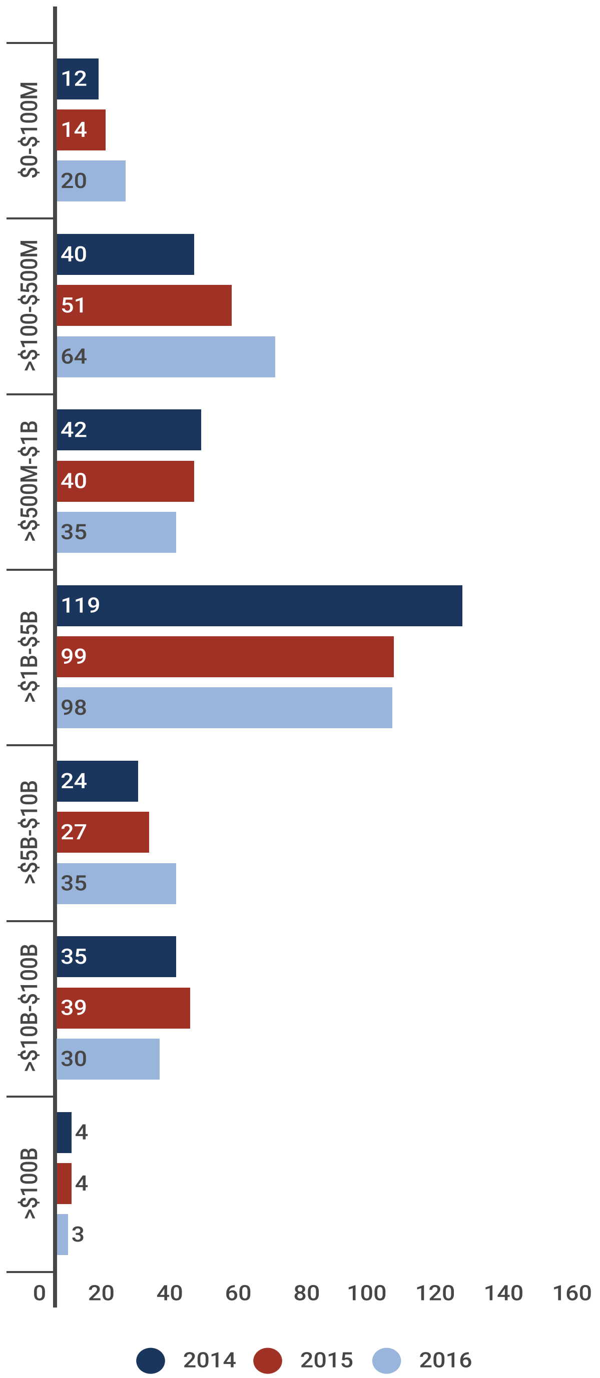


Exhibit 3: Number of Audits Inspected at Domestic Global Network Firms by Year and Market Capitalization Range



Issuer Industry Sector of Audits Inspected[14]

Inspections staff considers the industry sector and any related industry developments since the firm's last inspection when selecting engagements for inspection.

The population of domestic and non-U.S. triennially inspected firms is diverse and may have a different concentration of industry sectors associated with their respective issuer audit practices and referred work engagements. This diversity partly affects the overall annual concentration of audits inspected by industry sector.

14 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 were assigned based upon industry sectors utilizing North American Industry Classification System data. Further, as benefit plan audits are separate and distinct from the plan sponsors' audits, benefit plans are classified as a separate industry sector and are presented with the Financial Services sector for the purposes of this report.

Exhibit 4: Global Network Firm Audits Inspected by Industry Sector by Year (as a percentage of the total number of audits inspected)

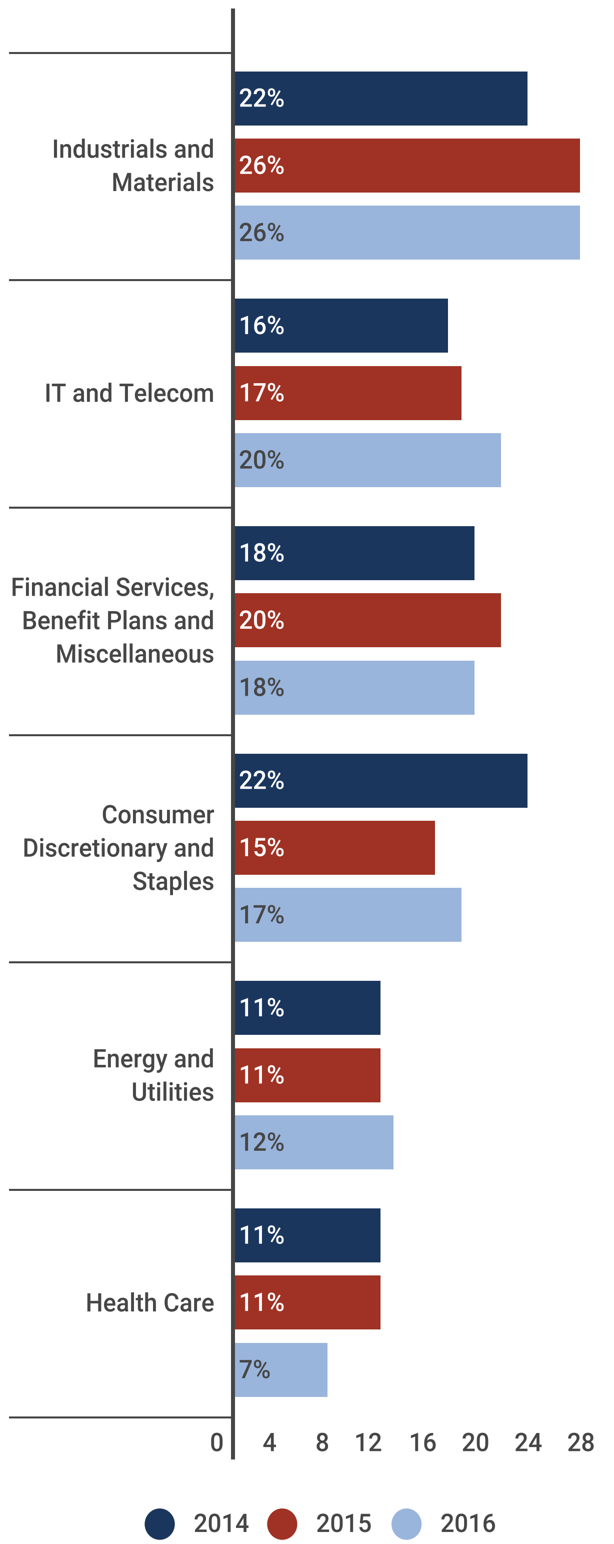


Exhibit 5: Non-Affiliate Firm Audits Inspected by Industry Sector by Year (as a percentage of the total number of audits inspected)

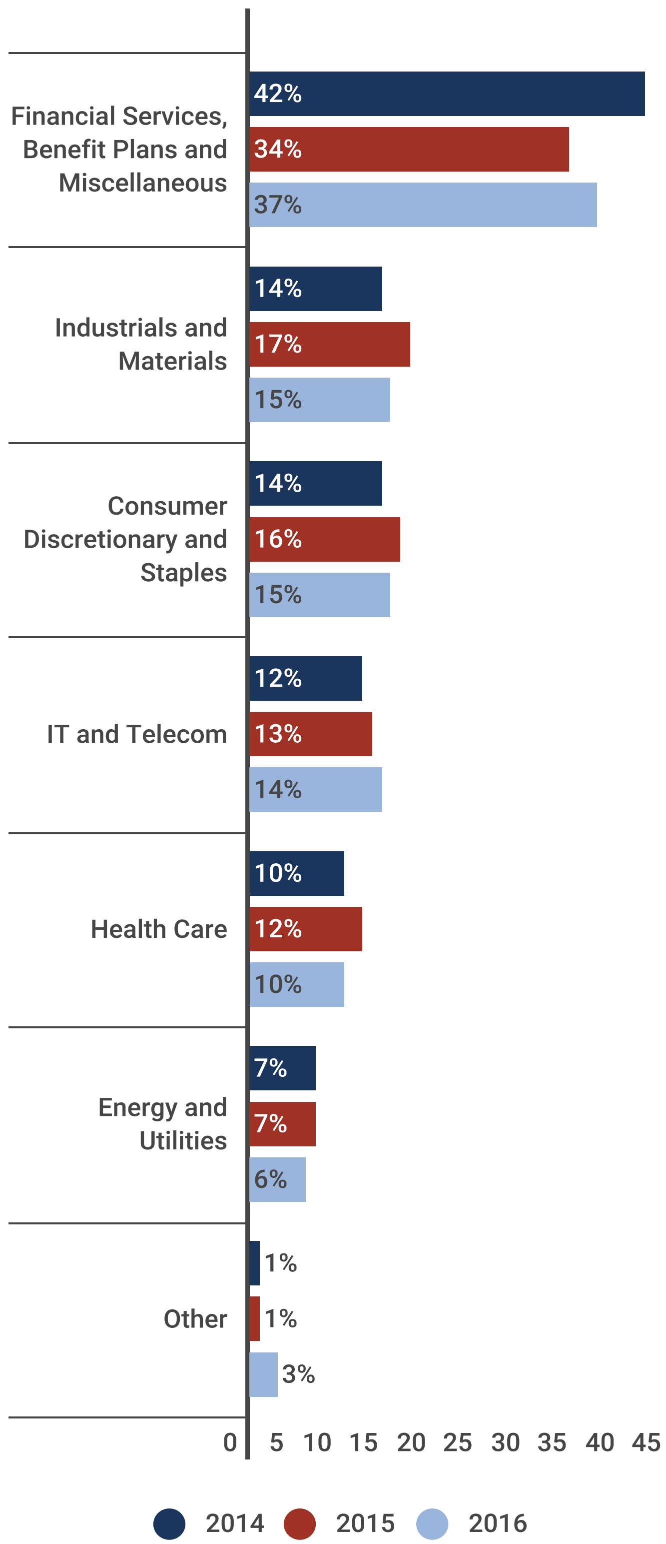
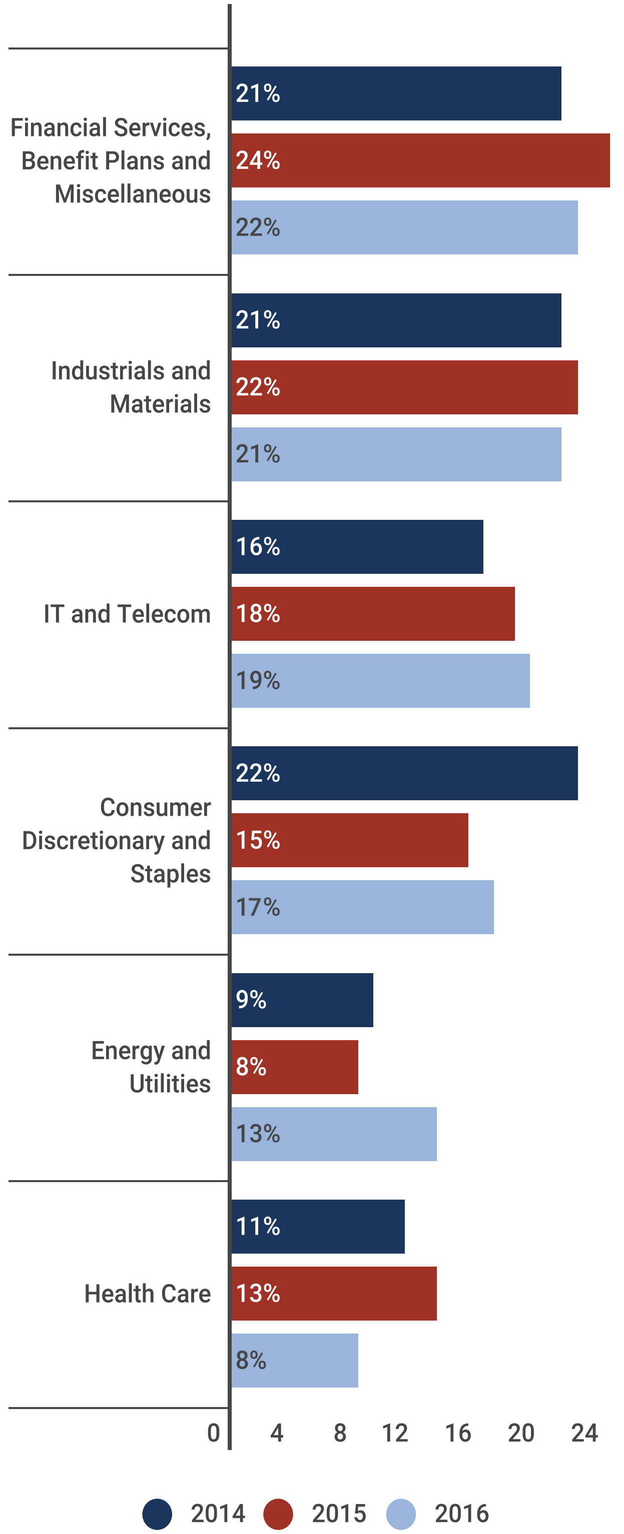


Exhibit 6: Domestic Global Network Firm Audits Inspected by Industry Sector by Year (as a percentage of the total number of audits inspected)

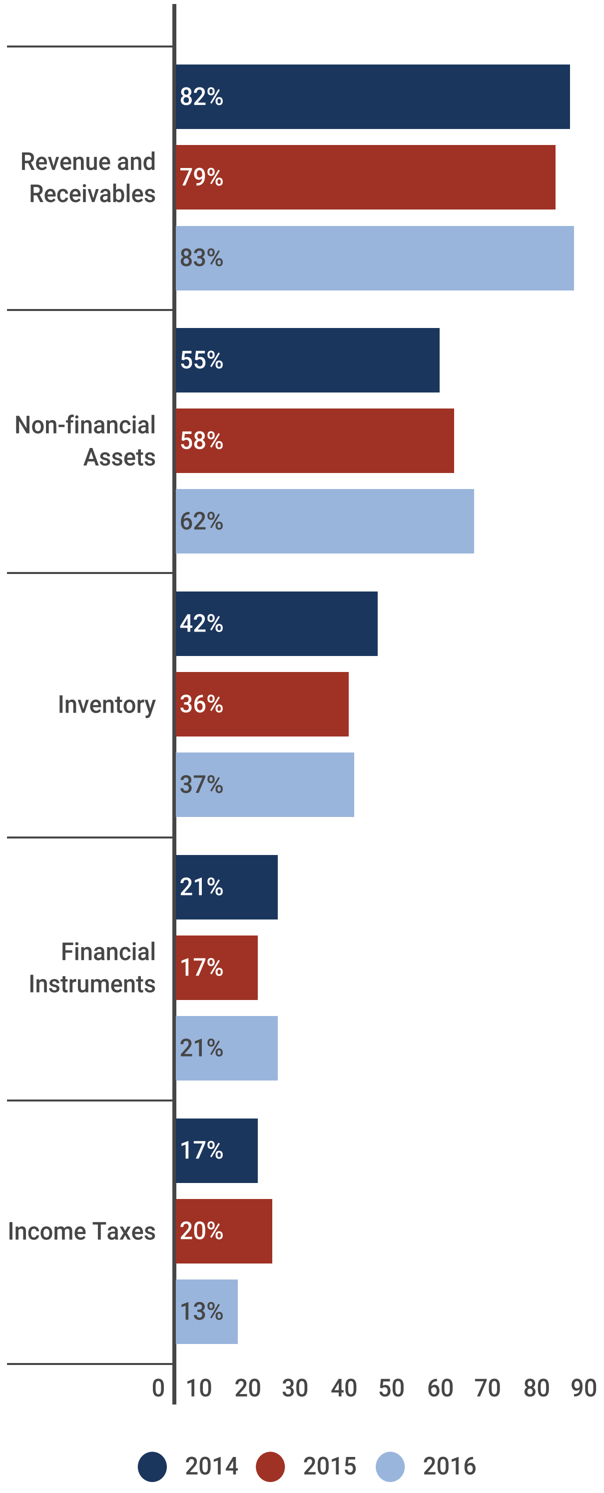


Financial Reporting Areas Inspected

Revenue is the most frequent auditing area selected for inspection as it often is one of the largest accounts in the financial statements and an important driver of a company's operating results. Revenue is also frequently associated with significant risk (including fraud risk).

Exhibits 7 through 9 summarize the audited financial reporting areas most frequently inspected, by inspection program, for the 2014 through 2016 inspections. Other commonly inspected financial reporting areas included the allowance for loan losses, other liabilities (e.g., accounts payable and accrued liabilities), debt, other investments (e.g., equity method, joint ventures, variable interest entities) and others (e.g., discontinued operations, various income statement items, other assets).

Exhibit 7: Top 5 Audited Financial Statement Reporting Areas Selected for Inspection in Global Network Firms by Year (as a percentage of total number of audits inspected)



The nature of the issuer audits inspected at Non-Affiliate Firms contributed to selecting revenue, non-financial assets, inventory, and income taxes less frequently when compared to inspections of Global Network Firms. For example, many of the Non-Affiliate Firm audits that were inspected were of employee benefit plans, development stage, or shell companies, and therefore the issuers had little or no revenue and inventory, fewer or immaterial non-financial assets, and deferred tax assets with full valuation allowances.

Debt and equity instruments were more frequently selected as an area of focus in Non-Affiliate Firms because of the common use of convertible debt and share-based payments by smaller issuers that Non-Affiliate Firms typically audit.

Although not reflected in Exhibits 7 through 9, additional inspection procedures were generally performed on cash and cash equivalents for inspected audits of non-U.S. firms, and certain domestic Non-Affiliate Firms.

Exhibit 8: Top 5 Audited Financial Statement Reporting Areas Selected for Inspection in Non-Affiliate Firms by Year (as a percentage of total number of audits inspected)

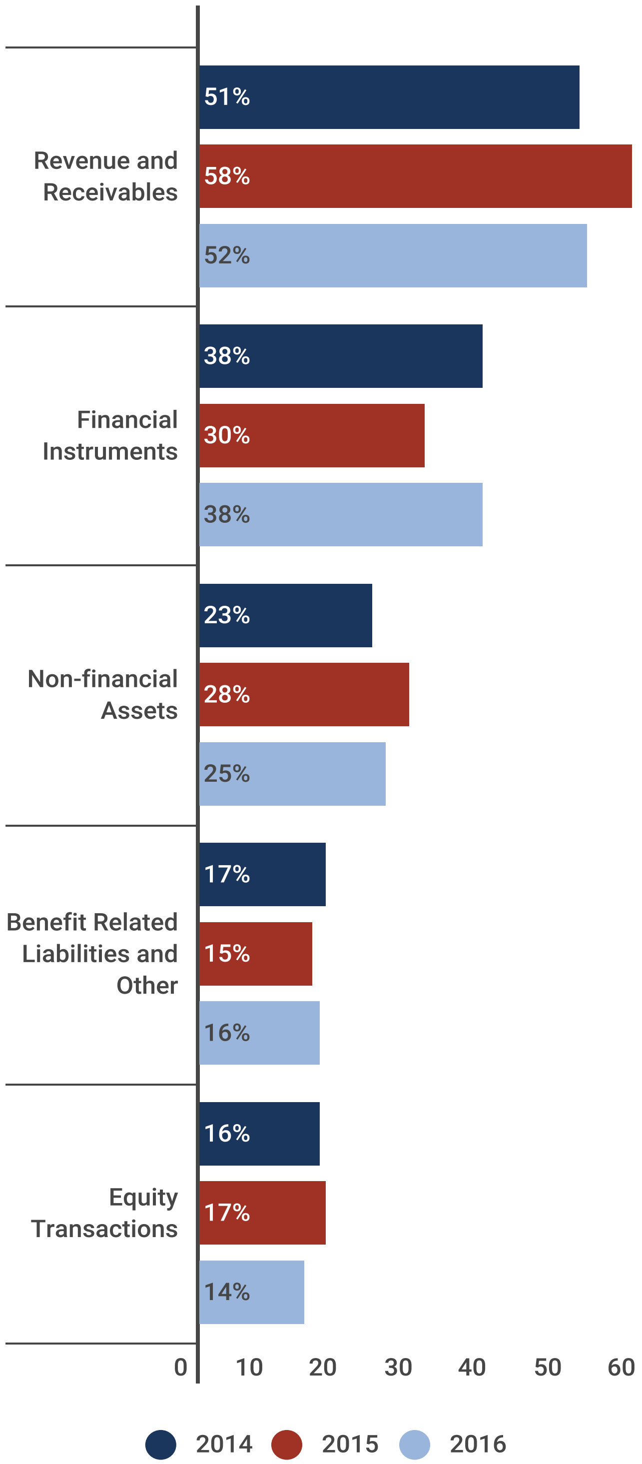
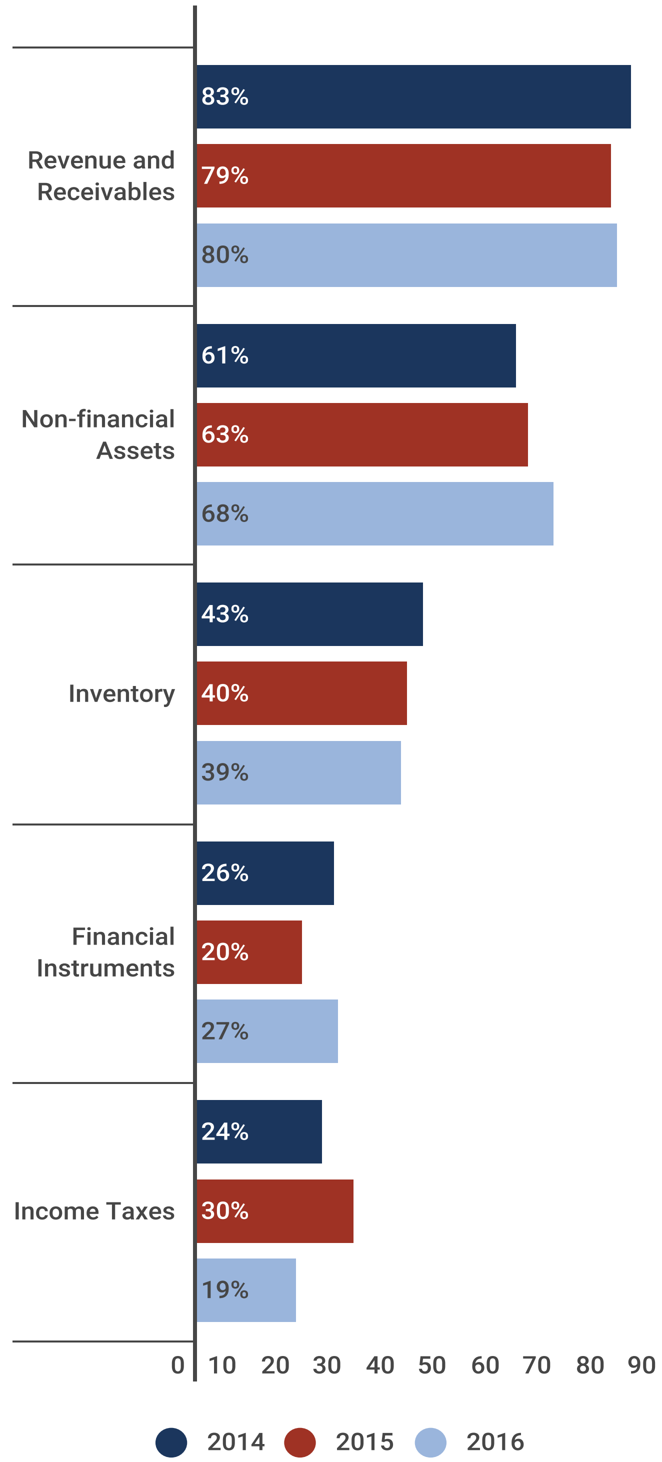


Exhibit 9: Top 5 Audited Financial Statement Reporting Areas Selected for Inspection in Domestic Global Network Firms by Year (as a percentage of total number of audits inspected)



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