



AUDIT INSPECTION UNIT

PUBLIC REPORT ON THE 2007/8 INSPECTION OF DELOITTE & TOUCHE LLP

8TH DECEMBER 2008

This report is issued by the Audit Inspection Unit of the UK's Professional Oversight Board ("the Oversight Board"), part of the Financial Reporting Council. It has been approved for publication by the Oversight Board.

Contents

	<i>Page</i>	
1	Scope, objectives and background information	2
<hr/>		
2	Findings	7
<hr/>		
	Appendix A - Firm's response	22
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1 Scope, objectives and background information

1.1 Introduction

This report sets out the principal findings arising from the inspection of Deloitte & Touche LLP (“Deloitte” or “the firm”) carried out by the Audit Inspection Unit (“the AIU”) of the Professional Oversight Board (“the Oversight Board”), part of the Financial Reporting Council (“the FRC”), in respect of the year to 31 March 2008 (“the 2007/8 inspection”). Our inspection was conducted principally in the period from November 2007 to March 2008 (referred to as “the time of our inspection”). The firm changed its name to Deloitte LLP on 1 December 2008.

This report is based on the AIU’s more detailed private report on its inspection of the firm to the Audit Registration Committee (“the ARC”) of the Institute of Chartered Accountants in England and Wales (“the ICAEW”) with whom the firm is registered for audit purposes. The AIU currently inspects the largest audit firms, including Deloitte, annually¹. The 2007/8 inspection was the AIU’s fourth inspection of the firm. The ARC considers whether audit registration should be continued for the firm following each inspection undertaken. The AIU’s 2007/8 report to the ARC, finalised in July 2008, recommended that the firm’s registration to conduct audit work should be continued.

This is the first year the AIU has reported publicly on individual firms. In the past the AIU issued an annual public report in which the principal findings arising from its inspections of the major audit firms in the UK were dealt with on an anonymous and aggregated basis.

The AIU exercises judgment in determining those findings which it is appropriate to include in a public report, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to areas of particular focus in the AIU’s overall inspection programme for the relevant year.

The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review by the AIU which, in turn, reflects the firm’s client base. An issue reported in relation to a particular firm might also apply to other firms without having arisen in the course of the AIU’s inspection fieldwork at those other firms in the relevant year. Also, only a small

¹ The Companies Act 2006, as amended with effect from 6 April 2008 by the Statutory Auditors and Third Country Auditors Regulations 2007, requires that full scope inspections of those audit firms conducting more than ten audits within the scope of independent inspection (as determined by the Professional Oversight Board) are undertaken at least every three years.

sample of audits is selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.

All findings requiring action set out in this report have been discussed with the firm together with the firm's proposed action plan to address them. Appropriate action may have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed by the AIU during its next inspection of the firm.

The Oversight Board undertook to publish all the reports for the 2007/8 cycle of inspections on a single date. The fieldwork at each firm is completed at different times during the year and comprehensive quality control procedures are applied before the AIU's private and public reports are finalised. As a result, there is necessarily a significant period of elapsed time between completion of the AIU's inspection fieldwork at firms and the publication of reports on the inspection findings.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix A.

The AIU acknowledges the co-operation and assistance received from the partners and staff of Deloitte in the conduct of the 2007/8 inspection.

1.2 Scope and objectives

The overall aim of the FRC is to promote confidence in corporate reporting and governance. One of the strategic outcomes contributing to this aim is for the users of audit reports to be able to place a high degree of reliance on audit opinions, including whether financial statements show a true and fair view. The AIU's programme of inspections is designed to contribute to the achievement of this strategic outcome.

Our inspections of the major audit firms, on which we report publicly, comprise a review of the firms' policies and procedures supporting audit quality and a review of the quality of selected audits of listed and other major public interest entities that fall within the scope of independent inspection, as determined each year by the Oversight Board.

We review firms' policies and procedures in the following areas:

- Leadership, strategy and communications
- Performance evaluation, promotions and remuneration
- Other human resource matters
- Client risk assessment and acceptance/continuance

- Consultation and review
- Audit quality monitoring
- Independence and ethics
- Audit methodology

Our reviews of individual audits include an assessment of the appropriateness of significant audit judgments exercised and the sufficiency and appropriateness of the audit evidence obtained.

Our inspections include, but are not restricted to, an assessment of compliance with the requirements of relevant standards and other aspects of the regulatory framework for auditing. These comprise the auditing standards and ethical and quality control standards for auditors issued by the FRC's Auditing Practices Board (APB)² and other relevant requirements under the ICAEW's Audit Regulations³. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken. (The APB issued revised Ethical Standards in April 2008 which are effective for audits of financial statements for periods commencing on or after 6 April 2008.)

We seek to identify areas in which improvements are, in our view, required to safeguard audit quality, including matters relating to compliance with regulatory requirements, and to agree an action plan with the firm designed to achieve these improvements. We also assess the extent to which the firm has addressed the findings and recommendations arising from its last AIU inspection.

While the AIU's public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. Our inspections are not designed to, nor would it be possible to, identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected by us for review and cannot be relied upon for this purpose.

We reviewed the quality of fourteen individual audit engagements undertaken by the firm. These related to FTSE 100, FTSE 250, other listed and other major public interest entities, with financial year ends between July 2006 and April 2007. Our reviews covered

² International Standards on Auditing (UK and Ireland), APB Ethical Standards and International Standard on Quality Control (UK and Ireland) 1.

³ The Audit Regulations are issued jointly by The Institute of Chartered Accountants in England and Wales, The Institute of Chartered Accountants of Scotland and the Institute of Chartered Accountants in Ireland.

selected aspects of the audit only. In addition, we undertook one follow up review to assess the extent to which our prior year findings had been addressed in the following year's audit.

The monitoring units of the professional accountancy bodies in the UK who register firms to conduct audit work are responsible for monitoring the quality of audit engagements falling outside the scope of independent inspection by the AIU but within the scope of audit regulation in the UK. Their work, which is overseen by the Oversight Board, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange ("a full listing") and whose financial condition is not otherwise considered to be of major public interest.

Deloitte is also registered with the US Public Company Accounting Oversight Board ("the PCAOB") in relation to audits of entities with a listing in the United States or significant subsidiaries thereof. By agreement with the firm, staff from the PCAOB participated in certain aspects of the 2007/8 inspection.

All matters raised in this report are based solely on work carried out by the AIU.

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC, the Oversight Board, the AIU and their employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

1.3 Background information on the firm

Deloitte is a UK limited liability partnership and is the UK member firm of Deloitte Touche Tohmatsu ("DTT") which establishes policies and procedures, including an audit methodology and an audit support system, for member firms to apply in quality assurance processes that comply with local requirements.

Deloitte operates from 23 offices in the UK through four service lines, being Audit, Tax, Consulting and Corporate Finance. All statutory audit work is conducted through the Audit service line which comprises eleven geographic and industry groups.

For the year ended 31 May 2007, the firm's turnover was £1,802 million, of which £557 million related to the Audit service line⁴. At 31 October 2007, the firm had 10,011 members of staff and 681 partners. The firm had a total of 210 persons authorised to sign audit reports, of whom 202 were partners and 8 audit directors (employees)⁵.

The AIU estimates that the firm had 492 audit clients within the scope of independent inspection by the AIU as at the 2007/8 reference date of 27 February 2007. Of these audit clients AIU records show that 211 had a full listing or were listed on the AIM market of the London Stock Exchange⁶, including 20 FTSE 100 audit clients and 66 FTSE 250 audit clients.

⁴ As disclosed in the firm's annual report for the year ended 31 May 2007. An analysis of fee income between audit and non-audit fees is not publicly available.

⁵ As disclosed in the annual return to the ICAEW as at 31 October 2007.

⁶ The firm also had other AIM listed audit clients below the threshold for inclusion within scope.

2 Findings

2.1 Overview

On the basis of our inspection, we consider that Deloitte's strategy, communications, policies and procedures evidence its commitment to quality and continuous improvement in the conduct of its statutory audit work. This is further evidenced by the open and candid manner in which the firm has consistently dealt with us.

We reviewed the firm's policies and procedures and, in our view, they were appropriate to the size of the firm and the nature of its client base. Of particular note is the firm's Professional Standards Review department which carries out pre-issuance reviews of the draft financial statements and draft auditor's reports of all the firm's audit clients. For listed clients and other major public interest entities, the pre-issuance review generally also includes a review of the audit files and draft reports to Audit Committees. The firm requires engagement partners to summarise the significant audit judgments and the audit evidence on which they are based prior to the pre-issuance review. In our view, this positively influences appropriate consideration of the basis on which significant audit judgments are made. We identified the need for improvement in certain other areas, such as ensuring attendance at mandatory training courses, details of which are set out in Section 2.2 on Quality Control and Section 2.3 on Independence and Ethics.

In relation to our reviews of individual audits, we have generally reported our findings on the basis of themes arising or issues of a similar nature identified across a number of audits. We believe that the number of individual audits we reviewed makes it appropriate to report on this basis.

We were generally satisfied, subject to our comments in Section 2.4.3, with the basis on which significant audit judgments were made on the fourteen audits reviewed by us. In our view, audit work was generally performed to a good or acceptable standard and, in relation to one FTSE 100 entity, to a very good standard. The overall findings arising from our review of individual audits are set out in Section 2.4; these include areas where improvements are, in our view, needed in order to enhance audit quality. In our view, two of the audits we reviewed, relating to entities which were not listed on a regulated market⁷, required significant improvements in certain areas.

The follow up review we conducted showed that the issues we raised in the previous year had been addressed on that audit.

⁷ Within the meaning of Part VI of the Financial Services and Markets Act 2000.

The firm has implemented the recommendations we made following our inspection last year by providing the required training and taking other steps as appropriate. We noted that a few issues continued to recur although some of the audits we reviewed were undertaken prior to the relevant training taking place. We believe these issues should remain the subject of audit training until the required improvements are achieved.

The principal findings arising from our review of the firm's policies and procedures supporting audit quality and the quality of the individual audits selected by us for review are set out below under three broad headings: Quality Control (Section 2.2); Independence and Ethics (Section 2.3); and Audit Performance (Section 2.4).

2.2 Quality control

This section covers our review of the following aspects of the firm's system of quality control for audit engagements:

- 2.2.1 Leadership, strategy and communications
- 2.2.2 Performance evaluation, promotions and remuneration
- 2.2.3 Other human resource matters
- 2.2.4 Client risk assessment and acceptance/continuance
- 2.2.5 Consultation and review
- 2.2.6 Audit quality monitoring

2.2.1 Leadership, strategy and communications

Deloitte's overall strategic ambition is: 'To be recognised as the pre-eminent and most trusted professional services firm, famous for the quality of our people and renowned for the exceptional quality of our work'.

The firm is managed by an Executive Group appointed by the Senior Partner and Chief Executive and a Board which approves strategy, business plans, partner appointments and has specific oversight of risk.

We reviewed the minutes of the Executive Group and of the Board and noted that they demonstrated the importance the firm places on compliance with professional standards, risk management and quality.

We met certain members of the Executive Group and of the Board, including the Senior Partner and Chief Executive, the Managing Director UK Audit and the Partner in charge

of Audit Quality and Risk Management, to consider the firm's strategy for audit services. We reviewed certain key communications to audit personnel concerning audit quality which were delivered on a regular basis throughout the year by means of partner and staff meetings, e-learning, training courses, Audit Alerts and newsletters. It was clear from these that the firm attaches appropriate importance to technical competence and audit quality.

2.2.2 Performance evaluation, promotions and remuneration

Performance evaluation

The performance of audit partners and staff is evaluated on an annual basis against seven performance and contribution criteria, the first of which is quality. Each partner and member of staff is appraised by a more senior partner or manager who reviews evidence of performance on a range of matters, including findings arising from pre-issuance technical reviews (see Section 2.2.5), the Practice Review (see Section 2.2.6) and, if applicable, from individual audits reviewed by the AIU.

We reviewed the appraisals for a sample of audit partners, audit directors and senior managers responsible for audit engagements that were reviewed in the previous year, either by the firm in its Practice Review or by the AIU. In our view, the appraisal process for audit partners and staff was conducted to a good standard in all the cases we reviewed apart from one case in which there was no evidence of input from the appraising partner.

Promotions

During the year the firm revised the partner promotion process by introducing a more formalised short-listing process managed by service line. Candidates' suitability and competence are assessed against the same seven performance and contribution criteria as are used in the annual appraisals.

We reviewed the partner promotion process and the portfolios of evidence in respect of the audit partner candidates at December 2007 and, in our view, the process was thorough and appropriate.

Remuneration

Deloitte introduced revised partner appraisal and remuneration arrangements in December 2006 to ensure changes in partner roles were reflected more promptly and to

increase transparency. The appraisals we reviewed demonstrated that there was close linkage between audit quality and remuneration.

2.2.3 Other human resource matters

Audit training and communications

The firm's technical department develops procedures and documentation for use by audit engagement teams and is responsible for an electronic audit support system that allows updates to standard work papers to be introduced usually within 24 hours. It also reviews and responds to technical and regulatory developments, provides a monthly technical seminar for partners and, within a week of the partner seminars, aims to present broadly the same material to qualified staff. Periodic Audit Alerts and weekly newsletters reinforce such training. The department conveys strong messages to audit partners and staff about the importance of quality, including compliance, consultation, independence and ethics. We met with certain partners and staff from the technical department and reviewed some of the firm's audit training material and the credit crunch communications noted below.

The firm was prompt in including in its audit training the findings from its Practice Review and the AIU's prior year inspection and ensured that all audit partners and staff who were required to attend such training did so. However, we noted that not all partners and staff who were required to attend the firm's mandatory IFRS Technical Excellence training did so.

Credit crunch communications

Following the turmoil in financial markets which began in late summer 2007, the firm provided extensive and timely information to audit partners and staff. The firm recognised the credit crunch as a global issue and its IFRS centre of excellence played a leading role in developing DTT's response for member firms, the aim of which was to heighten awareness, rather than change established procedures.

The firm established a panel of specialist partners for consultation and added significant material concerning the credit crunch to its technical reference databases. Material was also distributed to audit partners and staff in the form of Special Audit Alerts which were reinforced by communications from both the Managing Director, UK Audit and the Senior Partner and Chief Executive.

2.2.4 Client risk assessment and acceptance and continuance

Firms are required to have policies and procedures in place to provide them with assurance that client integrity, compliance with ethical requirements and their competence, capabilities and resources are considered before they decide whether to accept or continue an audit engagement⁸.

At least once a year, the Partner in charge of Audit Quality and Risk Management meets with each audit partner to agree client portfolios, the allocation of audit clients to one of three risk bands and the suitability of senior members of audit engagement teams. The purpose of such risk banding is to ensure that increased levels of review and sign-off are carried out for those clients that are deemed to pose higher audit risk to the firm. Audit partners may increase the risk banding of clients at any time, but it may be reduced only with the prior approval of the Partner in charge of Audit Quality and Risk Management.

The acceptance of new audit clients is managed by means of an intranet based tool which gathers data in five key areas. In addition, the tool requires conflicts, independence and anti-money laundering procedures to be undertaken and must be fully completed before audit work may commence. The continuance of audit clients is managed by individual audit engagement partners.

We reviewed the acceptance procedures and related documentation in respect of a sample of new audit clients won during the year and found they were completed properly in all material respects.

2.2.5 Consultation and review

Engagement quality control review

Firms are required to have policies and procedures in place requiring an engagement quality control review to be undertaken for all audits of financial statements of listed entities and other audits meeting specified criteria.⁹ For each such client, Deloitte adopts a two tier review comprising an engagement quality control review and a pre-issuance technical review as described below.

An engagement quality control review is carried out by an audit partner who is independent of the audit team and whose role, as an independent partner, is to assess the quality of audit planning, the sufficiency and appropriateness of audit evidence, the

⁸ International Standard on Quality Control (UK and Ireland) 1, paragraph 28

⁹ International Standard on Quality Control (UK and Ireland) 1, paragraph 60.

appropriateness of significant audit judgments and the suitability of the proposed audit report. Such partners are also known at Deloitte as independent review partners. The firm requires such partners to be highly experienced and to be independent of the clients for whom they act. Engagement partners involve independent review partners as necessary throughout the audit process.

We reviewed the involvement of the independent review partners in all the individual audit engagements we reviewed and found they evidenced their work in line with the firm's policies and procedures.

Pre-issuance technical reviews

As explained in Section 2.4.3, once the memorandum summarising the significant audit judgments and the audit evidence obtained on which they were based has been approved by the audit engagement partner and the independent review partner, the draft financial statements, the draft auditor's report and the audit files are sent to the firm's Professional Standards Review department for a pre-issuance technical review. No auditor's report may be released without prior clearance by the Professional Standards Review department. For listed clients and other major public interest entities, the pre-issuance review generally includes a review of the audit files and draft reports to Audit Committees.

We met the associate partner in charge of the Professional Standards Review department in London to ensure we had a proper understanding of the scope, depth and effectiveness of the review process. The associate partner reports to the Partner in charge of Audit Quality and Risk Management and the department is staffed by senior managers and managers on secondment from the audit practice, such secondments and the experience they provide being important to career development.

We reviewed the involvement of the Professional Standards Review department in all the individual audit engagements we reviewed and considered the department provided a valuable role in quality assurance.

2.2.6 *Audit quality monitoring*

Firms are required to have monitoring procedures in place, including reviews of a selection of completed audit engagements, to provide them with assurance that their

system of quality control is adequate, operating effectively and complied with in practice. Such monitoring is required to be undertaken at least annually.¹⁰

Deloitte's audit quality monitoring, known as the Practice Review, is prescribed by DTT for all member firms and is an intranet based programme of review that is carried out annually. In the UK, the Practice Review is planned to cover all the audit partners over a three year cycle and consists of two distinct elements. The first concerns the quality of the firm's audit work and comprises a review of a sample of individual audit engagements. The second comprises an assessment of compliance with certain of the firm's policies and procedures in the audit practice.

The 2007 UK Practice Review took place between June and October 2007 and covered six regional offices in the UK and one corporate audit group in London.

- The quality of 100 individual audit engagements was reviewed and graded, on the basis of five grades, from very good quality to unacceptable. This element of the UK Practice Review was overseen by a partner from South Africa.
- The main areas reviewed concerning compliance with the firm's policies and procedures were compliance with the firm's ethical standards and reputation protection and risk management. No matters of significance were noted. These elements of the UK Practice Review were overseen by partners from other DTT member firms.

The overall results of the 2007 UK Practice Review were presented by the partner in charge of Audit Quality and Risk Management to the Senior Partner and Chief Executive, following which the results were communicated to audit partners by the Managing Director, UK Audit and to audit managers via the firm's mandatory audit update training courses.

On the basis of our review of the Practice Review guidance, the work steps themselves, the results arising and the firm's actions in respect of them, we considered the UK Practice Review to have been well planned and executed and that appropriate steps were taken on the basis of the findings.

¹⁰ International Standard on Quality Control (UK and Ireland) 1, paragraph 74 and the ICAEW's Audit Regulations.

2.3 Independence and ethics

2.3.1 *Ethical policies and consultation*

Firms are required to have policies and procedures in place designed to achieve compliance with the Ethical Standards issued by the Auditing Practices Board together with relevant ethical pronouncements issued by the professional body with which the firm is registered.

The firm's ethical policies, which were mapped in a prior year to the requirements of the Ethical Standards, are set out in the Deloitte Policies and Procedures Manual which is available electronically to all partners and staff. The firm provides regular web-based training for partners and staff on ethical requirements covering such matters as independence and ethics awareness, business relationships and compliance with the firm's procedures.

Consultation on ethical matters is made initially with a designated person in the relevant business group. If further guidance is required, matters may be referred to the Ethics Partner.

We reviewed the firm's ethical policies and procedures and considered them to be comprehensive.

Direct assistance by staff from clients' internal audit departments

We noted that the firm's policies allow direct assistance by staff from clients' internal audit departments and understand the firm routinely includes such staff in audit teams dealing with entities in the banking and retail sectors. Direct assistance by internal audit staff is not specifically covered in auditing or ethical standards. In our view, the practice of including staff from clients' internal audit departments in external audit teams may be inconsistent with the underlying principles of the Ethical Standards, because it is not possible for such staff to be independent of their employers. We believe the firm should review the appropriateness of this practice and what safeguards should be applied to deal with such threats to independence.

2.3.2 *Compliance monitoring procedures*

Annual compliance confirmations

Deloitte carries out an annual compliance confirmation at the end of each financial year in which partners and staff confirm their personal and financial independence of the firm's audit clients. The process is managed centrally by the firm's Compliance Department and business group leaders follow up any outstanding confirmations. Those that remain outstanding beyond a certain date are followed up by the Partner in charge of Audit Quality and Risk Management.

We reviewed the firm's procedures in respect of the year ended 31 May 2007 and noted that by 31 July 2007 compliance confirmations had been received from all partners. The firm's own monitoring procedures identified two instances of non-compliance with the requirements of Ethical Standards concerning the holding of investments in restricted entities which have since been disposed of.

Scope of services

The firm's Ethics Partner is responsible for the resolution of independence queries, some of which are reported by partners when they submit their annual compliance confirmations. These queries may arise in connection with certain proposed services and the Ethics Partner is responsible for ensuring their resolution is documented. We noted that this took place only when the queries were resolved so it was not possible to ascertain at any point in time which queries remained unresolved. We understand the firm has now extended its procedures to monitor queries that are in the process of being resolved.

Non-audit services

Ethical Standards require audit engagement partners to demonstrate that proper consideration is given to the possible threats to the firm's independence and objectivity arising from the provision of non-audit services and to ensure appropriate safeguards are put in place. We considered the application of these requirements in all the audits we reviewed and noted that in the large majority of cases these requirements had been applied. However, we considered there was insufficient evidence on file in a small minority of the audits we reviewed to demonstrate that proper consideration had been given to the possible threats to the firm's independence and objectivity arising from the provision of non-audit services and the adequacy of the safeguards that had been put in place.

2.3.3 *Rotation policies and monitoring*

Firms are required to have policies and procedures in place to monitor the length of service of partners and senior staff on individual audit engagements, assess any threats arising to auditor objectivity and implement appropriate safeguards. This reflects the need to avoid auditor independence being compromised by the familiarity threat arising from a long period of service in a senior role. For listed company audits, the engagement partner and engagement quality control reviewer are required to rotate after having served for a maximum period of five years and key audit partners are required to rotate after seven years.¹¹

Rotation monitoring

The firm's compliance with partner rotation requirements is managed by the Partner in charge of Audit Quality and Risk Management through the Audit Risk Management database ("the ARM database") which records details of which partners act for which clients, in what capacities and how long they have acted in those capacities.

We reviewed the operation of the ARM database and, at our request, the firm ran exception reports to ascertain whether any audit engagement partner was shown as having served on listed and unlisted clients designated as public interest for longer than the maximum period allowed. No audit engagement partner was found to have exceeded the maximum period allowed without first having an extension of time properly authorised in accordance with the firm's policies and procedures.

Long association and key audit partners

For each individual audit we reviewed, we considered whether partners and staff had a long association with the client concerned. We discussed one such case with the National Audit Technical Partner following which the firm agreed to make certain changes to its guidance to ensure the ethical requirements are fully met.

We noted that, typically, between three and six key audit partners in the UK were identified for each of the firm's FTSE 100 audit clients. These partners were specialist partners responsible for tax, IT, US GAAP or other complex aspects of the audit. This information is recorded in the ARM database for rotation monitoring purposes.

On the basis of our review, we consider the firm to have effective rotation policies and procedures.

¹¹ APB Ethical Standard 3, paragraphs 5, 6, 12 and 16. "Key audit partners" are partners other than the audit engagement partner responsible for key audit decisions or judgments.

2.4 Audit performance

This section covers findings arising from our review of the firm's audit methodology and our review of individual audits. Our findings are set out under the following headings:

- 2.4.1 Audit methodology
- 2.4.2 Assessing and responding to risk
- 2.4.3 Audit evidence and related judgments
- 2.4.4 Communicating with Audit Committees
- 2.4.5 Audit finalisation

Any findings relating to quality control and independence are covered in Sections 2.2 and 2.3 respectively.

2.4.1 *Audit methodology*

Deloitte's audit methodology was developed by DTT on a global basis for member firms to apply and is based on the requirements of the International Standards on Auditing. The firm's technical department develops the additional material needed to address UK specific requirements.

The firm's audit support system was also developed by DTT and is predominantly electronic. It includes model audit programmes which are driven by planning choices made by audit teams, who may select industry packs that have been tailored to meet UK requirements when dealing with clients in certain specific industries.

The firm's technical department reviews a significant volume of auditing, accounting, legal and regulatory material each year. The flexibility of the firm's electronic audit support system and related technical databases enables the firm to introduce enhancements and new requirements into audit procedures usually within 24 hours. We consider this to be a particular strength.

In response to a matter we raised last year, the firm amended its guidance on the identification of significant risks. Apart from this, the firm's methodology and tools did not change significantly during the year.

In our view, Deloitte's audit methodology addresses the requirements of auditing standards in the UK appropriately and the firm's audit support system enables engagement teams to demonstrate compliance with them.

2.4.2 Assessing and responding to risk

Auditing Standards require the identification and assessment of the risks of financial statements being materially misstated, including which of these risks require special audit consideration (such risks are termed “significant risks”)¹². A proper assessment of the significance of identified risks is important to ensure that audit work planned and undertaken is sufficiently focused on higher risk areas of the audit.

Identification of significant risks

The Deloitte Policies and Procedures Manual provides guidance on the identification and assessment of the risks of financial statements being materially misstated, including which of the risks require special audit consideration. It also provides guidance on the evaluation of the design and implementation of the controls over those risks. In the majority of the audits we reviewed, audit teams had applied the guidance and followed the required procedures. However, in a minority of the audits we reviewed, there was, in our view, room for improvement in the identification of significant risks and the evaluation of the design and implementation of the related controls.

Fraud risks

Auditing Standards require the auditor to make enquiries of management regarding their process for identifying and responding to the risks of fraud. They also require the engagement team to discuss the susceptibility of the entity’s financial statements to material misstatement due to fraud. In the majority of the audits we reviewed, these requirements were applied. However, in a minority of the audits we reviewed, there were weaknesses in the application of the requirements concerning audit teams’ fraud risk discussions and the review of Board oversight of managements’ processes for identifying and responding to the risks of fraud.

Preliminary analytical review

Auditing Standards require the auditor to apply analytical procedures as risk assessment procedures to obtain an understanding of the entity and its environment. In the large majority of the audits we reviewed, the requirements had been applied. However, in a small minority of the audits we reviewed, certain analytical procedures that were carried out as risk assessment procedures did not, in our view, give rise to an increased understanding of the entity or its environment for the purposes of engagement planning.

¹² International Standard on Auditing (UK and Ireland) 315, paragraphs 100 and 108

2.4.3 *Audit evidence and related judgments*

Deloitte's policies and procedures require engagement partners to approve a memorandum, towards the end of an audit engagement, summarising the significant audit judgments and the audit evidence obtained on which they were based. This procedure must be completed and signed by the engagement partner and the independent review partner before the audit file, draft financial statements, draft audit report and draft Audit Committee report may be sent for pre-issuance review. This procedure helps to ensure appropriate consideration is given to the basis on which significant audit judgments are made.

We reviewed a number of significant audit judgments and, following discussion with the relevant audit teams, we were generally satisfied that audit evidence on which they were based was sufficient and the judgments were reasonable. However, there were certain areas in a number of audits we reviewed in which there was, in our view, insufficient evidence on file, as noted below.

Impairment reviews

In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on file to support the judgments concerning the impairment of material balances; or that certain available indicators of impairment had been followed up or that sufficient consideration had been given to changes in market prices.

Provisions and accruals

In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on file to support the judgments concerning certain material provisions and accruals; or to support the continuing appropriateness of certain provisions.

Post-employment benefits

In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on file to support the judgments concerning post-employment benefits and, in particular, concerning the extent of work undertaken to verify the existence and valuation of certain pension scheme assets.

External confirmations

Auditing Standards require that when carrying out external confirmations the auditor should maintain control over the confirmation process and perform alternative procedures where no response is received. In the large majority of the audits we reviewed, these requirements were applied. However, in a small minority of the audits we reviewed, there were weaknesses in the application of these requirements.

Using the work of an expert

Auditing Standards require that when planning to rely on the work of an expert, the auditor should evaluate the professional competence and objectivity of the expert. We reviewed the application of these requirements in all the audits we reviewed and noted that, in the large majority of cases, these requirements were applied. However, in a small minority of the audits we reviewed, there was room for improvement in the evaluation of the professional competence and objectivity of experts on whom the firm relied.

2.4.4 *Communicating with Audit Committees*

Auditing Standards require the auditor to communicate matters of governance interest arising from the audit with those charged with governance of the entity. Such communications will usually take place with an Audit Committee or similar body acting on behalf of the Board¹³. Appropriate communication with the Audit Committee or other relevant governance body contributes to the quality of the audit and assists both parties to discharge their responsibilities effectively.

We reviewed the firm's communications with Audit Committees for all the audits we reviewed. In our view, they were timely and addressed the key issues in a balanced and informative manner. However, in a small minority of the audits we reviewed, we noted that uncorrected misstatements other than those considered 'clearly trivial' had not been reported to Audit Committees as required.

2.4.5 *Audit finalisation*

Audit finalisation procedures include a final analytical review of the financial statements as a whole, a review of events occurring after the end of the financial year that may require adjustment of, or disclosure in, the financial statements ("subsequent events")

¹³ International Standard on Auditing (UK and Ireland) 260, paragraph 11

and consideration of the appropriateness of the going concern assumption in preparing the financial statements.

We reviewed the firm's audit finalisation procedures in all the audits we reviewed and found they were generally performed to a good standard. However, in a minority of the audits we reviewed, there was room for improvement either in the application or in the evidencing of the firm's procedures in relation to one or more of the following: subsequent events, going concern, obtaining representations from those charged with governance or the archiving of completed audit files.

8 December 2008

END OF REPORT

Appendix A – Firm’s response

The firm’s response is on the following page.

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20 November 2008

Our ref: JVN/SDL-SMD

Dear Mr Jones

Public report on the AIU's 2007/8 inspection: Deloitte response

We are pleased to respond to the Audit Inspection Unit's public report on its inspection of Deloitte in respect of the year ended 31 March 2008.

We consider that the AIU's report provides a balanced view of the results of their inspection, and we are therefore pleased to record our agreement with its overall conclusions and findings.

Deloitte's Audit Transparency Report for 2008 provides further, comprehensive information regarding our approach to delivering quality and is available on our website:

<http://annualreport.deloitte.co.uk/audit-transparency-2008/>

Yours sincerely



Vince Niblett
Managing Director, Audit
For Deloitte & Touche LLP

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