



AUDIT INSPECTION UNIT

PUBLIC REPORT ON THE 2008/9 INSPECTION OF DELOITTE LLP

7 DECEMBER 2009

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.

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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 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 2009 (“the 2008/9 inspection”). Our inspection visit was conducted primarily in the period from June 2008 to March 2009 (referred to as “the time of our inspection”). This is the second year the AIU has reported publicly on individual firms.

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 2008/9 inspection was the AIU’s fifth inspection of the firm. The ARC considers whether audit registration should be continued for the firm following each inspection undertaken. The AIU’s 2008/9 report to the ARC, which was finalised in October 2009, recommended that the firm’s registration to conduct audit work should be continued.

The AIU exercises judgment in determining those findings which it is appropriate to include in its public report on each inspection, 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 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

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.

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 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 2008/9 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 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 place emphasis on the appropriateness of significant audit judgments exercised in reaching the audit opinion, as well as the sufficiency and appropriateness of the audit evidence.

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 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.

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 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 11 individual audit engagements undertaken by the firm in our 2008/9 inspection. These related to FTSE 100, FTSE 250 and other major public interest entities with financial year ends between June 2007 and June 2008. Our reviews covered 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 which 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. All matters raised in this report are based solely on work carried out by the AIU.

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.

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 has established policies and procedures, including an audit methodology and an audit support system, for use by member firms.

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 2008, the firm’s turnover was £2,010 million, of which £619 million related to the Audit service line⁴. At 31 May 2008, the firm had 10,680 members of staff and 677 partners. The firm had a total of 216 persons authorised to sign audit reports, of whom 203 were partners and 13 were employees (audit directors)⁵.

The AIU estimates that the firm had 380 audit clients within the scope of independent inspection by the AIU as at the 2008/9 reference date of 28 February 2008. Of these audit clients, AIU records show that 226 had a full listing or were listed on the AIM market of the London Stock Exchange⁶, including 21 FTSE 100 audit clients and 74 FTSE 250 audit clients.

1.4 Reporting on AIU reviews of individual audit engagements

The AIU introduced new reporting arrangements in respect of its reviews of individual audit engagements commencing from 2008, with the objective of increasing transparency and meeting the increased expectations of stakeholders. This involved issuing new letter style reports on audits reviewed by the AIU. Although addressed to the relevant audit engagement partner or director, the Oversight Board expects firms to provide copies of these reports to the directors of the relevant clients.

⁴ As disclosed in the firm’s annual report for the year ended 31 May 2008. 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 2008.

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

2 Findings

2.1 Overview

Our review of Deloitte's strategy and key internal and external communications relevant to audit work demonstrated the importance the firm attaches to technical competence and high quality audit work.

In our view, the firm has appropriate policies and procedures in place for its size and the nature of its client base in the relevant areas which are subject to our review. Of particular note are the scope of the pre-issuance reviews undertaken by the firm's Professional Standards Review department (Section 2.2.5) and the 'Partner Dashboard' (a form of balanced scorecard) introduced during the year to strengthen the linkage between audit quality and partner remuneration and to increase transparency (Section 2.2.2). In our view, these processes are likely to make a positive contribution to audit quality. We identified certain areas requiring improvement, including some matters relating to the Practice Review programme, as set out in Sections 2.2 to 2.4 of this report.

In relation to reviews of individual audits, we have generally reported our findings on the basis of significant matters arising on one or more audits. Where appropriate, we have commented on themes arising or issues of a similar nature identified across a number of audits.

We were generally satisfied, subject to our comments below and in Sections 2.4.3 and 2.4.5, with the basis on which significant audit judgments were made on the 11 audits reviewed by us. In our view, audit procedures were generally performed to a good or acceptable standard and, in relation to one listed 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 one of the audits we reviewed, relating to a listed entity, we had significant concerns regarding the appropriateness of the basis of the firm's judgment as to whether a material uncertainty existed relating to the entity's going concern status.

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

The firm had addressed the overall findings arising from our prior year inspection in a satisfactory manner. However, there were recurring issues relating to assessing and responding to risk and the safeguarding of the firm's objectivity and independence when

providing non-audit services. We believe that these should remain areas of focus for the firm 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

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

The firm's stated 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'.

We reviewed the firm's strategy and key internal and external communications relevant to audit 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 and assess the importance the firm places on audit quality. We concluded that the firm attaches importance to technical competence and high quality audit work.

Transparency report

The largest audit firms agreed to publish transparency reports in response to the recommendations of the "post-Enron" group set up by Government. The firm published its

first standalone transparency report in August 2008 in advance of a statutory requirement under regulations made by the Oversight Board taking effect.

The report covered the firm's legal structure, leadership, governance, systems for quality control, independence practices and other matters. It placed a particular emphasis on the firm's commitment to audit quality. We reviewed the report with no issues arising.

2.2.2 Performance evaluation, promotions and remuneration

Performance evaluation

The performance of audit partners is evaluated on an annual basis against seven performance and contribution criteria, the first of which is quality. Each partner prepares a self-appraisal and his/her performance is evaluated by a more senior partner who considers evidence of performance on a range of matters, including findings arising from pre-issuance technical reviews (Section 2.2.5), the Practice Review (Section 2.2.6) and, if applicable, from individual audits reviewed by the AIU. These and other measures, such as attendance at mandatory training, are monitored throughout the year by the Partner in charge of Audit Quality and Risk Management by means of the 'Partner Dashboard', a form of balanced scorecard, which was introduced during the year.

We reviewed the appraisals for a sample of audit partners and found that they were completed in accordance with the firm's policy and gave appropriate weight to audit quality considerations.

We also reviewed the appraisals for a sample of audit directors and managers. The majority of the appraisals we reviewed were completed in accordance with the firm's policies. However, in a minority of the appraisals we reviewed, we identified that, contrary to the firm's policies and Ethical Standards, audit directors and managers referred to cross-selling non-audit services to their audit clients.

Promotions

The firm's partner promotion process starts with a short-listing process managed by service line. Candidates' suitability and competence are assessed against the same seven performance and contribution criteria used in partners' annual performance evaluations.

We reviewed the partner promotion process and the portfolios of evidence for each partner candidate put forward by the Audit service line. In our view, the process was thorough and well executed and the portfolios of evidence gave appropriate consideration to audit quality matters.

Remuneration

The firm's recently revised partner appraisal and remuneration arrangements are now well embedded. The purpose of the new arrangements is to ensure changes in partner roles are reflected promptly, to strengthen the link between audit quality and partner remuneration and to increase transparency. The appraisals we reviewed demonstrated that there was close linkage between audit quality and partner remuneration. In our view, the steps taken by the firm to strengthen the linkage between audit quality and partner remuneration and to improve transparency are likely to make a positive contribution to audit quality.

2.2.3 Other human resource matters

Audit training and technical updates

The firm has a well resourced technical department which 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. The department conveys strong messages to audit partners and staff about the importance of audit quality, compliance, consultation, independence and ethics. Weekly newsletters, periodic Audit Alerts and the firm's annual audit update course reinforce such matters. All audit technical material is accessible to professional staff through the firm's technical databases.

The firm was prompt in including the findings from its Practice Review and the AIU's prior year inspection in its audit training. We were informed that, taking additional sessions into account, all audit partners and staff attended the firm's mandatory training courses.

We met certain partners and staff from the technical department and reviewed some of the firm's audit training material and concluded that it was satisfactory.

Communications and other actions relating to the economic downturn

The firm provided extensive and timely information to audit personnel during the year concerning the audit risks associated with the economic downturn. In addition, it issued specific guidance regarding aspects of going concern, valuations, corporate governance, accounting considerations and industry sector considerations, all of which were available to professional staff through the firm's technical databases.

The firm continued to make a panel of partners available to engagement partners for consultation. In addition, representatives from the firm's audit groups and technical

department held fortnightly meetings to ensure the firm was taking an appropriate and consistent approach to emerging issues.

In our view, the actions taken and communications issued by the firm were appropriate and timely.

2.2.4 Client risk assessment and acceptance/ 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 engagement⁷.

The firm's Partner in charge of Audit Quality and Risk Management is responsible for setting out the framework under which client risk assessments are undertaken. Each year he meets audit partners individually to agree client risk bandings and the suitability of senior members of audit engagement teams. The acceptance and continuance of clients assessed as 'normal' or 'greater than normal risk' is signed off by the engagement partner and the partner in charge of the relevant audit group. The acceptance and continuance of clients assessed as 'much greater than normal risk' must, in addition, be signed off by the London or Regional Head of Audit, as applicable, the Managing Director UK Audit and the Partner in charge of Audit Quality and Risk Management. Audit partners may increase the risk banding of clients at any time, but may reduce it 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. We reviewed the acceptance procedures and related documentation for a sample of new audit clients won during the year and the continuance procedures for the individual audits we reviewed.

We considered the firm's acceptance and continuance policies and procedures to be comprehensive and concluded that, in each case we reviewed, they were completed in accordance with the firm's policies.

⁷ International Standard on Quality Control (UK and Ireland) 1, paragraph 28.

2.2.5 Consultation and review

Engagement quality control reviews

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 criteria⁸.

Engagement quality control reviews are carried out by audit partners who are independent of the audit team. Their role is to assess the quality of audit planning, the sufficiency and appropriateness of audit evidence, the appropriateness of significant audit judgments and the suitability of the proposed audit reports. Such partners are known at Deloitte as 'independent review partners'. We considered the involvement of independent review partners in all the individual audit engagements we reviewed. We considered that they generally performed their reviews in accordance with the firm's policies and procedures. However, in a minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files of their involvement on a timely basis.

Pre-issuance technical reviews

The firm's Professional Standards Review department undertakes pre-issuance technical reviews of memoranda prepared by engagement partners summarising the significant audit judgments made and the audit evidence obtained on which they were based, draft financial statements and draft auditor's reports. For listed clients and other major public interest entities, the pre-issuance review includes a review of draft reports to Audit Committees and, for all new audit clients, it includes a review of the audit files in the first year.

The firm is in the process of establishing an electronic link between the Professional Standards Review department and the firm's Audit Risk Monitoring database to provide a record for monitoring purposes that all engagements have been subject to the firm's system of quality control carried out by the department.

The Professional Standards Review department is headed by an associate partner who reports to the Partner in charge of Audit Quality and Risk Management. The department is staffed by senior managers and managers on secondment from the audit practice, such secondments and the experience they provide being viewed as important to career development.

We met the associate partner in charge and noted the involvement of the Professional Standards Review department, as required, on all the individual audit engagements we

⁸ International Standard on Quality Control (UK and Ireland) 1, paragraph 60.

reviewed. In our view, the scope of the pre-issuance reviews undertaken by the department is a particular strength of the firm's review procedures. However, we were unable to assess the quality of these reviews as the output is not retained on the audit files.

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 annually⁹.

At Deloitte, the annual audit quality monitoring procedure is known as the Practice Review. DTT requires all of its member firms to apply its intranet-based Practice Review programme which focuses on two distinct elements. The first comprises a review of a sample of individual audit engagements and is planned to cover all audit partners over a three year cycle. The second comprises an assessment of compliance at office or business unit level with certain firm-wide procedures relating to audit quality.

The 2008 Practice Review covered four regional offices and three business groups in London. A total of 110 audits were reviewed and graded on the basis of a system comprising five grades. The overall results were communicated to audit partners by the Managing Director, UK Audit and to audit personnel via the mandatory audit update training courses.

We reviewed the instructions for team leaders and reviewers, the work programme used by reviewers, the results by office and by client and the firm's follow-up actions. We consider that the firm has an effective system for monitoring audit quality. However, in our view, additional procedures to demonstrate reviewer independence and additional guidance on grading audit files are required.

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.

⁹ International Standard on Quality Control (UK and Ireland) 1, paragraph 74 and the Audit Regulations.

The APB issued revised Ethical Standards in April 2008. We reviewed the firm's mapping of the revised Standards to the Ethics and Independence section of the Deloitte Policies Manual with no issues arising.

During 2008, the firm updated The Deloitte Code (the 'Code'), a summary statement of the firm's ethical values, consistent with UK Ethical Standards. All Deloitte personnel are required to comply with it. We reviewed the Code and considered it to be a clear summary of the firm's ethical policies.

The firm provides training on its ethical requirements through the monthly technical seminars for audit partners and staff and also by means of specific web-based training. Consultation on ethical matters initially takes place with a designated person in the relevant business unit. If further guidance is required, matters may be referred to the Ethics Partner. We reviewed the firm's systems for recording consultations on ethical matters and considered them to be operating in accordance with the firm's policies.

The Ethical Standards require firms to establish policies and procedures to ensure that the objectives of audit personnel do not include the selling of non-audit services to their audit clients and performance evaluations do not take account of individuals' success in selling such services to their audit clients. As indicated in Section 2.2.2, we identified that, contrary to the firm's policies and Ethical Standards, a number of audit directors and managers referred in their performance evaluations to cross-selling non-audit services to their audit clients.

We considered the firm's independence and ethical policies and procedures to be comprehensive and, subject to the above matter, to have been communicated appropriately.

2.3.2 *Compliance monitoring procedures*

Deloitte requires all audit partners and staff to confirm on an annual basis their personal and financial independence from 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 met the Ethics Partner and members of the Compliance Department and reviewed the procedures for monitoring the completion of the annual compliance confirmations for the year ended 31 May 2008. We also reviewed a sample of completed compliance confirmations. We noted that confirmations had been received from all audit partners by 30 June 2008 and that a small number of confirmations from staff were outstanding at that date.

In our view, the annual compliance confirmation process was comprehensive and carried out on a timely basis.

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, engagement partners and independent review partners are required to rotate after having served for a maximum period of five years and key partners are required to rotate after seven years¹⁰.

The firm updated its policy on the rotation of audit partners and staff and its application guidance on identifying key partners involved in audits of major public interest entities to reflect the revised Ethical Standards. Audit engagement partners are responsible for identifying key partners on their engagements. We reviewed the firm's policy and related guidance and considered them to be consistent with the revised Ethical Standards.

Compliance with partner rotation requirements is managed through a rotation database. The firm informed us that the database was in the process of being enhanced to record details of key partners primarily responsible for the audit of significant overseas affiliates and divisions. Accordingly, audit engagement partners have been instructed to identify such key partners and record relevant details for each engagement. In our view, the firm needs to complete the enhancement of the database as a priority.

Subject to the above matter, we considered the firm's rotation policies and monitoring procedures to be appropriate.

2.3.4 *Other ethical issues*

Non-audit services

Ethical Standards require audit engagement partners to assess threats to the firm's independence and objectivity arising from the provision of non-audit services and the effectiveness of any available safeguards. Engagement partners are required to document the reasoning for their decisions to provide non-audit services and explain the safeguards adopted. In a minority of the audits we reviewed, we considered that audit teams failed to identify threats to the firm's objectivity and independence and apply appropriate safeguards when deciding to provide non-audit services.

¹⁰ APB Ethical Standard 3 (Revised), paragraphs 5,6,12 and 18. "Key partners" are partners other than the 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 its 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 flexibility of the firm's electronic audit support system and related technical databases enables the firm to be responsive to change and to introduce new requirements into audit procedures promptly.

During the year, the firm's technical department amended its guidance on the identification of significant risks and mapped the firm's policies and procedures against the key drivers of audit quality set out in the Audit Quality Framework issued by the FRC in February 2008. It also initiated a number of projects which focused on improving audit quality. However, the firm's methodology and tools did not change significantly during the year.

We believe that the firm's audit methodology and audit support systems address the requirements of Auditing Standards appropriately in most areas. However, we comment in Sections 2.4.2 to 2.4.5 below on its application on individual audits and on certain areas in which we believe some improvement is required.

Direct assistance by internal audit staff

Following our report last year, the firm's policies and procedures have been clarified to restrict the use of staff from clients' internal audit departments to perform audit procedures directly for audit teams to those areas in which a significant risk has not been identified and which do not require the significant application of judgment.

2.4.2 Assessing and responding to risk

Auditing Standards require the identification and assessment of the risks of the financial statements being materially misstated, including which of these risks require special audit consideration (such risks are termed "significant risks")¹¹. 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.

The Deloitte Policies Manual provides guidance on the identification and assessment of the risks of financial statements being materially misstated, including significant risks. 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, in our view, the application and evidencing of certain aspects of the firm's procedures concerning the evaluation of controls required improvement.

2.4.3 Audit evidence and related judgments

Audit judgments

Deloitte's policies and procedures require the preparation of a memorandum, towards the end of an audit, summarising the significant audit judgments made and the audit evidence obtained on which they were based. This memorandum must be completed by the engagement partner and reviewed by the independent review partner before the Professional Standards Review department is asked to undertake its pre-issuance review.

We reviewed a number of significant audit judgments, including such matters as the rationale for accounting treatments, the reasonableness of assumptions in valuations and estimates and judgments concerning the extent of audit work performed. We were generally satisfied, subject to our comments below and in Section 2.4.5, with the basis on which significant audit judgments were made.

In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files to support the recognition of certain provisions.

¹¹ International Standard on Auditing (UK and Ireland) 315, paragraphs 100 and 108.

In one of the audits we reviewed, there was, in our view, insufficient evidence on the audit file to demonstrate that the client's use of hedge accounting was appropriate.

In one of the audits we reviewed, there was, in our view, insufficient justification on the audit file as to why the audit team did not seek to confirm certain matters relating to compliance with loan covenants.

Litigation and claims

In a small minority of the audits we reviewed, the audit files were, in our view, not sufficiently clear concerning the nature and extent of the audit procedures undertaken in connection with clients' litigation and claims.

Disclosures

In a small minority of the audits we reviewed, there was, in our view, insufficient evidence on the audit files to demonstrate that audit teams had given appropriate consideration to disclosures. In one case, in our view, the audit team did not give sufficient consideration to the need for the disclosure in the financial statements of a related party transaction. In two other cases, there was, in our view, insufficient evidence on the audit files that audit teams had reviewed financial information in a directors' report and a trustees' report for consistency with the financial statements.

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 entity¹². Such communications will usually take place with an Audit Committee, or similar body acting on behalf of the Board. 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 considered the firm's communications with Audit Committees for all of the audits we reviewed. In our view, they were generally timely and addressed the key issues in a balanced and informative manner. However, in a small minority of the audits we reviewed, there was, in our view, insufficient reporting of errors identified or independence threats arising from the provision of non-audit services.

¹² International Standard on Auditing (UK and Ireland) 260, paragraph 11.

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

In one of the audits we reviewed, we had significant concerns regarding the appropriateness of the basis of the firm’s judgment as to whether a material uncertainty existed relating to the entity’s going concern status. The audit team carried out extensive audit procedures to evaluate the group’s ability to continue as a going concern, including direct communication with the group’s bankers. However, in our view, those procedures did not focus sufficiently on the implications of the fact that the group was not achieving its financial forecasts at the time the audit report was issued.

In a small minority of the audits we reviewed, in our view, audit procedures relating to going concern or the evidencing thereof required improvement.

We considered that other audit finalisation procedures were generally performed to a good standard on all the audits we reviewed.

7 December 2009

END OF REPORT

Appendix A – Firm’s response

The firm’s response is on the following page.

Andrew Jones
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12 November 2009

Our ref: JVN/SMD

Dear Mr Jones

Public report on the AIU's 2008/9 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 2009.

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 2009 provides further, comprehensive information regarding our approach to delivering quality and is available on our website:

<http://annualreport.deloitte.co.uk/audit-transparency-2009/AT-report-2009.pdf>

Yours sincerely



Vince Niblett
Managing Director, Audit
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