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Report on

2006 Inspection of Deloitte & Touche LLP

Issued by the

Public Company Accounting Oversight Board

June 14, 2007

THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT

**PORTIONS OF THE COMPLETE REPORT ARE OMITTED
FROM THIS DOCUMENT IN ORDER TO COMPLY WITH
SECTIONS 104(g)(2) AND 105(b)(5)(A)
OF THE SARBANES-OXLEY ACT OF 2002**

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Preface to Reports Concerning Annually Inspected Firms

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements and of internal control over financial reporting. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in



that year. Such weaknesses may emerge in varying degrees at different firms in different years.

During 2006, the Board's inspection process focused on how efficiently the annually inspected U.S. firms performed audits in the second year of implementation of Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* ("AS No. 2"). As described in Appendix B to this report, the inspection process occurred at three levels: (1) meetings with senior firm leadership, (2) national office inspection procedures, and (3) inspection procedures for audits of accelerated filers. In general, the Board's inspection teams observed that the firms achieved increased efficiencies as compared to the first year of implementation of AS No. 2. Nonetheless, the Board's inspection teams believed that, in many of these engagements, there were additional opportunities for the auditors to achieve efficiencies in the implementation of AS No. 2. Those observations have been discussed with the firms, and the Board expects that those discussions are contributing to changes to methodology, additional firm training and guidance, and more rigorous discussions with issuers about ways in which firms and issuers can work together to make audits more efficient.



Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



2006 INSPECTION OF DELOITTE & TOUCHE LLP

In 2006, the Board conducted an inspection of Deloitte & Touche LLP ("Deloitte" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report, Appendix B, and portions of Appendix C. Appendix B provides an overview of the inspection process. Appendix C includes the Firm's comments, if any, on a draft of the report.^{1/}

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.^{2/} A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

^{1/} The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

^{2/} See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") performed an inspection of the Firm from May 2006 through November 2006. The inspection team performed field work at the Firm's National Office and at 20 of its approximately 74 U.S. practice offices.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.^{3/} To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system. Appendix B to this report provides a description of the steps the inspection team took with respect to the review of audits of financial statements and of internal control over financial reporting and the review of eight functional areas related to quality control.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.^{4/} It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

^{3/} This focus necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

^{4/} When the Board becomes aware that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits of financial statements and of internal control over financial reporting performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process. The review of the audit of an accelerated filer included a review of aspects of both the Firm's audit of financial statements and its audit of internal control over financial reporting ("ICFR").

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies.^{5/} Those deficiencies included failures by the Firm to identify or appropriately address errors in the issuer's application of GAAP, including, in some cases, errors that appeared likely to be material to the issuer's financial statements. In addition, the deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. PCAOB Auditing Standard No. 3, *Audit Documentation* ("AS No. 3") provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.^{6/} For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the

^{5/} The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

^{6/} See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28.

deficiencies to the firm's present ability to support its previously expressed opinions,^{7/} and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers, and in some instances, follow-up between the Firm and the issuer led to a change in the issuer's accounting or disclosure practices or led to representations related to prospective changes.^{8/}

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis.

Issuer A

The issuer incorrectly determined the fair value of warrants issued to purchase common stock because it used a block sale discount in doing so. The Firm should have identified and addressed this departure from GAAP before issuing its audit report.^{9/}

Issuer B

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

^{7/} See AU 390, *Consideration of Omitted Procedures After the Report Date*, and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T), and PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* ("AS No. 2"), ¶ 197.

^{8/} The Board inspection process generally did not include review of such additional procedures or documentation, or of such revised accounting, although future Board inspections of the Firm may, as appropriate, include further review of any of these matters.

^{9/} The issuer has restated its financial statements related to the matter discussed here.

- The issuer performed its annual impairment test of goodwill as of an interim date and, during 2005, elected to carry forward the fair values of all but one of its reporting units that it had used in its 2004 impairment test, as permitted under certain conditions by Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets* ("SFAS No. 142"). The issuer asserted that the conditions for doing so were satisfied, including the condition that the likelihood that the fair values of its business units had declined below their book values was remote. The Firm failed to test that assertion sufficiently (limiting its procedures to obtaining memoranda from management and making inquiries of management), despite the following factors: (1) a decline in the issuer's market capitalization by over 25 percent between the annual goodwill impairment tests; (2) the shut down of certain operating assets and the resulting impairment charges at one business unit; (3) the sales of certain long-lived assets during 2005; and (4) the reduction in the issuer's debt rating during 2005. In addition, despite the fact that the issuer was exploring options to sell or spin off certain business units, the Firm failed to evaluate sufficiently (limiting its procedures to obtaining memoranda from management and making inquiries of management) whether the issuer's determination of the fair values of those business units appropriately took into account whether all or any portion of those business units was more likely than not to be sold or disposed of.
- The issuer's standard practice was to evaluate its long-lived assets for impairment at the business-unit level. One of the issuer's business units that was classified as held for use during 2005 permanently idled certain operating assets at three of its locations. The issuer evaluated one of these locations for impairment and recorded an impairment charge. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the recoverability of the other two locations or of the business unit as a whole. In addition, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the appropriateness of the issuer's change in evaluating its long-lived assets from the business-unit level to a lower level, which was inconsistent with its evaluation of impairment at other business units.
- As discussed above, during 2005, the issuer was exploring options to sell or spin off several business units. At year end, the issuer determined that these business units did not meet the criteria for classification as held for sale.

Thus, it classified them as held for use and evaluated them for impairment. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed procedures to test the issuer's estimated fair value for two of the business units other than obtaining management's representations and tracing the estimated fair values to management's strategic plan. In addition, the Firm failed to evaluate the effect of the issuer's failure to include in its calculation of the estimated fair values an assessment of the likelihood of possible outcomes, including sale of the business units, as required by SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS No. 144").

- The issuer previously had recorded a liability for certain income tax contingencies. The issuer had evidence prior to filing its Form 10-Q that raised questions regarding the amount of the liability and the likelihood of loss; the Firm was aware of this evidence. There was no evidence in the Firm's documentation, and no persuasive other evidence, that the Firm had evaluated the need to perform additional procedures to determine whether adjustment to the accrual or disclosure in the quarterly financial statements was required.

Issuer C

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- The Firm used negative confirmations to test the existence of accounts receivable even though the combined level of inherent and control risk was not assessed as low. PCAOB standards permit the use of negative confirmations to reduce audit risk to an acceptable level, but only when certain conditions are present, one of which is that the combined assessed level of inherent and control risk is low. The Firm also failed to perform appropriate procedures on confirmations that were returned from customers. It reviewed the issuer's resolution of only ten percent of the returned confirmations, and, in its review of those returned confirmations, it failed to review source documentation. The Firm did not perform other substantive procedures to supplement the use of negative confirmations to test the existence of accounts receivable.

- The issuer had a working capital deficit, two consecutive years of net losses, negative cash flows from operations, and declining gross margins. In addition, the issuer had drawn down the maximum amount available on its line of credit. There was no evidence in the audit documentation, and no persuasive other evidence, that, other than through inquiry of the issuer, the Firm, in its evaluation of the issuer's ability to continue as a going concern, had tested significant elements of management's plans for dealing with these conditions, including the forecasted cash flows for 2006.
- The issuer disclosed that it had completed an acquisition during 2005. According to its disclosure, the issuer had purchased all of the stock of a company and had assigned the entire amount of the purchase price to an intangible asset. There was no evidence in the audit documentation, and no persuasive other evidence, that, in evaluating the issuer's purchase accounting, the Firm had tested the fair value of the acquired asset or had evaluated whether the recorded intangible asset was properly recognized as a capitalizable asset rather than being expensed as in-process research and development at the acquisition date.

Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient competent evidential matter to support its audit opinion –

- During the year, the issuer informed the Firm that one of the issuer's trademarked brands would be discontinued, and the issuer also asserted that its trademarks were not impaired. The Firm accepted that assertion on the basis of an analysis by the Firm comparing the carrying value of the trademarks, in the aggregate, against the market value of the issuer's outstanding stock, rather than evaluating the trademarks for impairment individually, based on fair value, in accordance with SFAS No. 142.
- The Firm performed certain procedures to evaluate the issuer's estimated promotional allowance, including comparing the allowance to actual subsequent activity. This comparison identified a significant difference between the subsequent activity and the amount recorded by the issuer. There was no evidence in the audit documentation, and no persuasive other

evidence, that the Firm had performed procedures to ascertain the reasons for the difference.

Issuer E

The issuer recognized revenue for certain transactions when the products were placed at the disposal of the buyer at the issuer's premises. The work papers included a sales contract for one of these transactions that required the issuer to retain the risk of loss for the products stored at the issuer's location. The Firm did not identify this matter and address the effect of this provision on revenue recognition. Further, the Firm did not test whether there were other contracts that, like this one, deviated from what the Firm represented to be the issuer's standard contract language.

Issuer F

During 2005, the issuer completed a significant acquisition of another company and allocated a portion of the purchase price to various intangible assets. The issuer engaged a valuation specialist to estimate the fair values of the acquired intangible assets. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested any of the data or assumptions, including revenue growth rates, attrition rates, and margins, that the issuer had provided to the specialist.

Issuer G

Except for a notation that the Firm had reviewed an issuer-prepared analysis, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed audit procedures to test the issuer's assertion that it qualified as a pass-through entity for tax purposes.

Issuer H

In this audit, the Firm failed to detect significant errors in the issuer's disclosure of certain components of the deferred income tax provision and the deferred income tax assets in the notes to the consolidated financial statements. Although the issuer had recorded a valuation allowance for the entire amount of the deferred tax assets, the errors caused the amount of the potential tax benefits to be significantly overstated.^{10/}

^{10/} In the subsequent year's consolidated financial statements, the issuer changed its disclosures of the matters discussed above.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following eight functional areas: (1) tone at the top; (2) practices for partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances, and arrangements; personal financial interests; and commissions and contingent fees; (4) practices for client acceptance and retention; (5) practices for consultations on accounting, auditing, and SEC matters; (6) the Firm's internal inspection program; (7) practices for establishment and communication of audit policies, procedures, and methodologies, including training; and (8) the supervision by U.S. audit engagement teams of the work performed by foreign affiliates on foreign operations of U.S. issuer audit clients. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

PART II, PART III, APPENDIX A, AND PORTIONS OF APPENDIX C OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX B

THE INSPECTION PROCESS

The inspection process was designed and performed to provide a basis for assessing the degree of compliance of the Firm with applicable requirements and standards related to auditing issuers. This process included reviews of components of selected issuer audit engagements completed by the Firm. These reviews were intended both to identify deficiencies, if any, in the conduct of those audits and to determine whether the results of those audits indicated deficiencies in the design or operation of the Firm's system of quality control over audits. In addition, the inspection included reviews of the design of, and in some cases the application of, policies and procedures related to certain functional areas of the Firm that could be expected to influence audit quality.

1. Review of Selected Audit Engagements

The inspection team reviewed aspects of selected audits performed by the Firm. The inspection team chose the engagements according to the Board's criteria. The Firm was not allowed an opportunity to limit or influence the engagement selection process or any other aspect of the review.

For each audit engagement selected, the inspection team reviewed the issuer's financial statements and certain SEC filings. The inspection team selected certain higher-risk areas for review and, at the practice offices, inspected the engagement team's work papers and interviewed engagement personnel regarding those areas. The areas subject to review included, but were not limited to, revenues, reserves or estimated liabilities, derivatives, income taxes, consideration of fraud, supervision of work performed by foreign affiliates, and assessment of risk by the audit team. The inspection team also analyzed potential adjustments to the issuer's financial statements that had been identified during the audit but not recorded in the financial statements. For certain selected engagements, the inspection team reviewed written communications between the Firm and the issuer's audit committee. With respect to certain engagements, the inspection team also interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other

documentation, the inspection team issued a comment form on the matter and the Firm provided a written response to the comment form. In certain instances, if the inspection team was unable to resolve the issue through these processes, the inspection team requested that the engagement team consult with Deloitte's professional practice personnel, who include local office professional practice directors ("PPDs"), regional professional practice directors ("RPPDs"), and members of the National Office professional practice group. In many cases, this process resulted in resolution of the matter, either because the Firm agreed with the position the inspection team had taken and the Firm or the issuer took steps in light of the significance of the error to remedy the exception, or because the Firm was able to provide additional information that effectively addressed the inspection team's concerns.

2. Efficiency of Implementation of AS No. 2

The inspection team reviewed aspects of the Firm's approach to the implementation of AS No. 2 in light of the provisions of that standard and related Board statements.^{11/} Specifically, inspectors evaluated the Firm's approach to (1) integrating the audit of ICFR with the audit of the financial statements; (2) using a top-down approach to the audit; (3) using a risk-based approach; and (4) using the work of others.

The inspection procedures in this area began with the inspection team, along with senior staff in the Board's Division of Registration and Inspections and Office of the Chief Auditor, meeting with members of the Firm's leadership to hear the Firm's perspective on whether and how it had achieved efficiencies in ICFR audits. The inspection team then reviewed the Firm's methodology, tools, and training to determine if those methodology, tools, and training were designed to effectively achieve appropriate efficiencies. This evaluation was followed by a review of aspects of specific ICFR audits. For each audit of an accelerated filer that was the subject of an engagement review, the inspection team assessed the efficiency of the ICFR audit with respect to at least one of the four aspects identified above. The inspection team then met with members of the Firm's leadership to discuss observations from the specific engagement reviews and to provide other feedback relating to the Firm's methodology, tools, and training. The feedback was provided during the course of the inspection field

^{11/} See PCAOB Release No. 2005-009, *Policy Statement Regarding Implementation of [AS No. 2]* (May 16, 2005); PCAOB Release No. 2005-023, *Report on the Initial Implementation of [AS No. 2]* (Nov. 30, 2005); see also Staff Questions and Answers, *Auditing Internal Control Over Financial Reporting* (May 16, 2005).

work to facilitate the Firm's ability to use that feedback in ongoing and future ICFR audits.

3. Review of Eight Functional Areas

The inspection team performed the review of the eight functional areas both to identify possible defects in the Firm's system of quality control and, where applicable, to update the Board's knowledge of the Firm's policies and procedures in the functional areas. A more detailed description of the scope with respect to each of the eight functional areas follows.

a. Review of Partner Evaluation, Compensation, Admission, Assignment of Responsibilities, and Disciplinary Actions

The inspection team reviewed the Firm's policies and procedures related to partner evaluation, partner compensation, nomination and admission of new partners, assignment of responsibilities, disciplinary actions, and termination of partners. The objective of the inspection procedures was to assess whether the design of these processes, as documented and communicated, could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the Firm.

The inspection team interviewed members of the Firm's leadership at its National Office, as well as members of leadership and audit partners in practice offices, regarding these topics. In addition, the inspection team analyzed schedules provided by the Firm that detailed information on each partner, including the partner's office location, recent evaluation history, and compensation history. The inspection team also reviewed a sample of partners' personnel files, including files of newly admitted partners, partners who resigned or took early retirement, and partners who received bonus compensation.

b. Review of Independence Policies

The objectives of the inspection procedures in this area included evaluating the Firm's policies and procedures relating to its compliance with independence requirements with respect to the provision of non-audit services to issuer audit clients; Firm participation in business ventures, alliances, and arrangements; commissions and contingent fee arrangements; personal financial interests and the relationships of Firm professionals with issuer audit clients; and the provision of non-audit services related to

issuer audit clients' compliance with Section 404 of the Act. To accomplish these objectives, the inspection team reviewed the Firm's policies, procedures, guidance, and training materials pertaining to these independence matters. The inspection team also reviewed the Firm's internal inspection program as it relates to monitoring compliance with the Firm's independence policies and procedures; tested the Firm's independence consultation process; and reviewed information concerning the Firm's existing business ventures, alliances, and arrangements, as well as the Firm's process for establishing such enterprises. The inspection team also interviewed numerous National Office and practice office personnel regarding the Firm's independence policies, practices, and procedures.

At the practice offices, the inspection team selected a sample from the engagements it reviewed and, for that sample, reviewed relevant information to identify any non-audit services performed for the issuer, including whether any of the services involved commissions or contingent fee arrangements; to determine whether the fees for the services provided were classified appropriately in the issuer's proxy statement; and to determine whether the Firm was involved in any business ventures, alliances, or arrangements with the issuer. In addition, for the sample, the inspection team read and evaluated the most recent letter pursuant to Independence Standards Board Standard No. 1, *Independence Discussions with Audit Committees*.

c. Review of Client Acceptance and Retention Policies

The objectives of the inspection procedures in this area were to evaluate whether the Firm's client acceptance and retention policies and procedures reasonably assure that it is not associated with issuers whose management lacks integrity, that it undertakes only engagements within its professional competence, and that it appropriately considers the risks involved in accepting and retaining clients in the particular circumstances. Toward those objectives, the inspection team reviewed the Firm's policies, procedures, and forms related to client acceptance and continuance and evaluated documentation related to new clients and to clients that had recently changed auditors from the Firm. The inspection team also interviewed numerous National Office and practice office personnel regarding the Firm's client acceptance and retention policies, practices, and procedures.

d. Review of Practices for Consultations

The objective of the inspection procedures in this area was to assess the Firm's compliance with professional requirements regarding consultations on accounting,

auditing, and SEC matters. Toward this objective, the inspection team gained an understanding of and evaluated the Firm's policies and procedures relating to its consultation process. The inspection team also reviewed a sample of consultations that occurred during the inspection period to evaluate the effectiveness of the Firm's consultation process, the Firm's compliance with its policies and procedures, whether the conclusions were in accordance with professional standards, and whether the engagement teams acted in accordance with the conclusions.

e. Review of Internal Inspection Program

The objectives of the inspection procedures in this area were to evaluate the effectiveness of the Firm's annual internal inspection program in enhancing audit quality, as well as to assess the Firm's compliance with the quality control standards adopted by the Board. To meet those objectives, the inspection team reviewed policies, procedures, guidance, and forms related to the Firm's internal inspection program, documentation of the results of the current year's inspection program, and steps the Firm took in response to those results. The inspection team also interviewed the Firm's leadership concerning the process and effectiveness of its internal inspection program.

The inspection team reviewed and tested the conduct of the internal inspection program by performing reviews of certain engagements on which the Firm had conducted internal inspections. These procedures included evaluating the qualifications of the Firm's inspectors, reading the inspectors' comments, reviewing the results of the inspectors' review of certain Firm-wide functional areas, and interviewing both area leadership and selected audit personnel concerning the internal inspection program. In addition, for a sample of engagements, the inspection team reviewed documentation of the internal inspectors' review, reviewed certain aspects of the audit work papers, and discussed with the Firm any significant differences in the results of the inspection team's review and those of the Firm's internal inspectors.

f. Review of Practices for Establishment and Communication of Audit Policies, Procedures, and Methodologies, Including Training

The objectives of the inspection procedures in this area were to update the inspection team's understanding of the Firm's processes for establishing and communicating audit policies, procedures, and methodologies, including training; to evaluate whether the design of these processes could be expected to promote audit quality and enhance compliance; and to evaluate changes in audit policies that the Firm had made since the Board's most recent inspection of the Firm.

Toward those objectives, the inspection team reviewed documentation relating to the Firm's method for developing policies and procedures, as well as internal guidance and/or training materials distributed to audit personnel with respect to recent changes in requirements and with respect to selected specific areas. The inspection team also evaluated the effectiveness of the design of the Firm's processes for monitoring developments that could affect the Firm's audit policies, procedures, and methodologies.

g. Review of Policies Related to Foreign Affiliates

The objective of the inspection procedures in this area was to evaluate the processes the Firm uses to ensure that the audit work that its foreign affiliates perform on the foreign operations of U.S. issuers is effective and in accordance with standards established by the Board. The inspection team did not inspect the audit work of foreign affiliates; rather, the inspection procedures in this area were limited to the supervision and control exercised by the U.S. engagement team over such work.

To accomplish this objective, the inspection team reviewed the Firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the foreign operations of U.S. issuer clients; analyzed audit guidance related to planning and administering multi-location engagements; and reviewed available information relating to the most recent foreign affiliated firms' internal inspections. In addition, the inspection team interviewed members of the Firm's leadership with responsibility for oversight of the work performed by foreign affiliates on foreign operations of U.S. issuer clients. Finally, with respect to a sample of the engagements reviewed, the inspection team reviewed the U.S. engagement team's supervision and control procedures concerning the audit work that the Firm's foreign affiliates performed.

h. Review of Tone at the Top

The objective of the review of the Firm's "tone at the top" was to assess whether actions and communications by the Firm's leadership demonstrate a commitment to audit quality and compliance with the Act, the rules of the Board, the rules of the SEC, and PCAOB standards in connection with the Firm's performance of audits, issuance of audit reports, and related matters involving issuers. Toward that end, the inspection team reviewed and analyzed information at the Firm's National Office. Such information included the Firm's code of conduct; documents relating to measuring and monitoring audit quality; descriptions of the duties of, and relationships between and among, the Firm's staff and

leadership; results of surveys of staff and clients; public company audit proposals; internal and external communications from management; and agendas and minutes of the Firm's board of directors. In addition, the inspection team interviewed numerous members of the Firm's leadership team.

The inspection team conducted interviews at four of the Firm's practice offices to obtain perspectives on communications from the Firm's leadership relating to audit quality and tone at the top. The inspection team interviewed members of the leadership at each of these offices, as well as certain audit partners and senior managers assigned to engagements that were reviewed.

APPENDIX C

RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.^{12/}

^{12/} In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

May 29, 2007

Mr. George Diacont
Director
Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street NW
Washington, DC 20006

Re: Deloitte & Touche LLP – Response to Part I of Draft Report on 2006 Inspection

Dear Mr. Diacont:

Deloitte & Touche LLP (“D&T”) is pleased to submit its response to the Public Company Accounting Oversight Board’s (the “Board”) April 30, 2007 draft of its Report on 2006 Inspection of Deloitte & Touche LLP (the “Draft Report”). We are supportive of the inspection process and believe the Board’s comments and observations enhance the ability to achieve our shared objective of improving audit quality.

D&T is committed to the highest standards of audit quality. We continually monitor the systems and processes for our audit practice, including quality control, and, among other things, make changes to methodologies, policies, and procedures when we identify improvements that could enhance audit quality. As we have done with respect to the Board’s previous inspection reports, we will thoroughly consider the Board’s comments and concerns addressed in the Draft Report, assess whether we have already initiated actions that address those concerns, and consider whether additional actions are necessary.

We have evaluated the matters identified by the Board’s inspection team for each of the eight Issuer audits described in Part I of the Draft Report and have taken appropriate actions. In evaluating the matters identified, we have considered whether it was necessary to perform additional auditing procedures in accordance with AU 390, *Consideration of Omitted Procedures After the Report Date*, and in six instances we performed and documented additional auditing procedures, which did not change our conclusions or affect our reports on the Issuers’ financial statements. With respect to the single material departure from generally accepted accounting principles cited in the Draft Report, the Issuer client and we considered AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report*, and, as noted in the Draft Report, this Issuer has restated its financial statements to correct this accounting error.

We have the following specific disagreements with respect to the comments on two Issuer audits described in Part I of the Draft Report:

- Issuer D. We disagree with the matter cited in the second bullet point. As indicated in our response to the inspection team’s comments, the review of subsequent activity was not intended to be, and is not, the sole test of the year-end balance. The engagement

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team addressed the testing of promotional allowances during the audit, and we believe the procedures performed and conclusions reached were appropriate. No further documentation or procedures are considered necessary. Accordingly, we do not believe this observation warrants inclusion in Part I.

- Issuer H. We believe this disclosure error, which did not affect the Issuer's balance sheet, nor statements of operations or cash flows, is not quantitatively or qualitatively material. Accordingly, we do not believe this observation warrants inclusion in Part I.

We have the following specific comments with respect to Appendix B, Section 2, of the Draft Report, which will be included in the portions of the final report the Board makes public:

Appendix B, Section 2 regarding efficiency of implementation of AS No. 2 indicates "...feedback was provided during the course of the inspection field work to facilitate the Firm's ability to use that feedback in ongoing and future ICFR audits." Feedback was initially provided on September 7, 2006 via conference call, almost two months after the last week of inspection field work at practice offices. Additional feedback was provided in a meeting on October 19, 2006. Given the timing of this feedback, we had only limited opportunity to use the observations noted to impact calendar year-end audits. We suggest that the wording included in the Draft Report with respect to this subject be modified or removed and in the future that feedback be provided on a real-time basis during the course of fieldwork.

* * * * *

We are available to the Board and its staff to discuss our response in further detail. Please contact James V. Schnurr at 203.761.3539, Guy W. Moore at 203.761.3226, or Tracey C. Golden at 203.761.3468 with any questions.

Sincerely,

Deloitte + Touche LLP