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Report on

2011 Inspection of Deloitte & Touche LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

November 28, 2012

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

PCAOB RELEASE NO. 104-2012-271

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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 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 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 financial statement misstatements, including failures to comply with 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 apparent misstatements 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 whether an issuer's financial statements are misstated or fail to comply with Commission disclosure requirements, rests with the Commission. Any description, in this report, of financial statement misstatements or failures to comply with 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.

2011 INSPECTION OF DELOITTE & TOUCHE LLP

Preface

In 2011, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Deloitte & Touche LLP ("Deloitte" or "the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is issuing this report in accordance with the requirements of the Act.[1/] The Board is releasing to the public Part I of the report, Appendix C, and portions of Appendix D. Appendix C provides an overview of the inspection process for annually inspected firms.[2/] Appendix D includes the Firm's comments, if any, on a draft of the report.[3/] A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system) is nonpublic, unless the firm fails to make sufficient progress in addressing those criticisms.

1/ In its Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions.

2/ The Act requires the Board to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers.

3/ 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.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm performs audit work.[4/] To achieve that goal, Board inspections include reviews of certain aspects of selected audit work performed by the firm and reviews of certain aspects of the firm's quality control system. It is not the purpose of an inspection, however, to review all of a firm's audit work or to identify every respect in which reviewed audit work is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audit work, or the relevant issuers' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

If the Board inspection team identifies deficiencies that exceed a certain significance threshold in the audit work it reviews, those deficiencies are summarized in the public portion of the Board's inspection report.[5/] The Board cautions, however, against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout the Firm's practice. Audit work is selected for inspection largely on the basis of an analysis of factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

4/ This focus on weaknesses and deficiencies 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.

5/ Inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. 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 deficiencies to the firm's present ability to support its previously expressed 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. The inspection team may review, either in the same inspection or in subsequent inspections, the adequacy of the firm's compliance with these requirements. Failure by a firm to take appropriate actions, or a firm's misrepresentations, in responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from October 2010 through March 2012. The inspection team performed field work at the Firm's National Office and at 32 of its approximately 65 U.S. assurance practice offices.

A. Review of Audit Engagements

The 2011 inspection of the Firm included reviews of aspects of 52 audits performed by the Firm and reviews of the Firm's audit work on one issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team selected the audits and aspects to review, and the Firm was not allowed an opportunity to limit or influence the selections.

The inspection team identified matters that it considered to be deficiencies in the performance of the audit work it reviewed. Those deficiencies included failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[6/] as well as 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 was based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claimed to have performed the procedure.[7/]

[6/] When it comes to the Board's attention 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 applicable accounting principles, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

[7/] PCAOB Auditing Standard No. 3, *Audit Documentation* 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.

Two of the deficiencies described below relate to auditing aspects of the issuers' financial statements that the issuers restated after the primary inspection procedures.[8/]

The inspection team considered certain of the deficiencies that it observed to be audit failures. Specifically, certain of the identified deficiencies were of such significance that it appeared that the Firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting ("ICFR"). In addition, one of the identified deficiencies, which occurred in an audit in which the Firm played a role but was not the principal auditor, was of such significance that it appeared to the inspection team that the Firm had not obtained sufficient appropriate audit evidence to fulfill the objectives of its role in the audit. The audit deficiencies that reached these levels of significance are described below.[9/]

1. Issuer A

In this audit, the Firm failed to identify a departure from generally accepted accounting principles ("GAAP") that it should have identified and addressed before issuing its audit opinion. Specifically, the issuer inappropriately allocated to goodwill, rather than to a definite-lived intangible asset, a portion of the purchase price of a group of assets.

In addition, the Firm failed to perform sufficient procedures to test the valuation of goodwill for one of the issuer's segments. The issuer used revenue and earnings projections in its evaluation of the possible impairment of goodwill and, for this segment, the projected growth rates were significantly higher than the issuer's recent historical results and projections for the issuer's industry, which were included in the Firm's work papers. The Firm failed to sufficiently test the projected growth rates for this segment. Specifically, the Firm relied on controls related to the issuer's budget without testing the effectiveness of controls over the development of the assumptions used in the budget process, and the Firm failed to evaluate, beyond inquiry of management, the reasonableness of the issuer's revenue and earnings projections.

[8/] The Board inspection process did not include review of any additional audit work related to the restatements and adjustments.

[9/] 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.

2. Issuer B

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The Firm failed to perform sufficient procedures to test the valuation of certain long-lived assets, in that it failed to sufficiently evaluate the reasonableness of the three significant assumptions that the issuer used to calculate the depreciation of these assets. Specifically, for one assumption, related to plant capacity, the Firm limited its testing to comparing the assumption to statements made in an issuer-prepared memorandum. For the second assumption, related to the salvage value of the assets, the Firm limited its testing to noting the trends in market prices for one component of the assets. For the third assumption, related to current-year production, the Firm's testing relied on a manually prepared report that the Firm had tested only by inquiry.

- The Firm failed to perform sufficient procedures to test the issuer's revenue and cost of sales (and certain related balance sheet accounts) for transactions accounted for under the percentage-of-completion method. The Firm designed its procedures based on a level of reliance on internal control, but the Firm's testing of important controls on which it relied was insufficient. Specifically, the Firm –

  - Failed to sufficiently test the operating effectiveness of a review control related to revenue, consisting of meetings in which the estimated costs to complete were reviewed, in that it limited its procedures to inquiry regarding whether such information was reviewed in one meeting;

  - Relied on another control related to revenue for the entire year even though that control was not implemented until the last month of the year;

  - Failed to sufficiently test a review control related to cost of sales, as it limited its procedures to inquiry and the observation of a signature by the control owner, without considering the reasonableness of the decisions made, and the resolution of the issues identified, during the operation of this control;

  - Selected a sample for testing a control over the occurrence of cost of sales, which required two signatures before certain costs of sales could be recorded, from a population of signed documents rather than from recorded costs of sales, and performed procedures to confirm the presence of only one of the two signatures; and

- o Failed to sufficiently test the operating effectiveness of another control designed to verify that materials were used before they were included in cost of sales, as its procedures were limited to inquiry and tests of a sample that it selected from the population of costs that had been approved through the operation of the control rather than from the costs that the issuer had recorded.

3. <u>Issuer C</u>

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The issuer recognizes revenue using the percentage-of-completion method of accounting. Changes in the estimates of costs resulted in a significant increase in operating income during the year under audit. The Firm failed to perform procedures to evaluate the quantitative and qualitative considerations related to whether the issuer's failure to disclose this change in estimate represented a departure from GAAP. In addition, the Firm failed to assess whether the issuer's asserted inability to quantify and disclose the aggregate effects of the changes in the estimates of costs for all of its contracts constituted a control deficiency that individually, or in combination with other control deficiencies, represented a material weakness.

- For one operating segment, the Firm failed to perform sufficient substantive procedures to test the completeness, existence, and valuation of contract revenue and costs. The Firm failed to sufficiently test the operating effectiveness of important controls related to contract revenue and costs, because it failed to test the completeness and accuracy of data used in the operation of these controls; the Firm designed its substantive procedures based on a level of reliance on internal control that was excessive due to this deficiency. In addition, the Firm failed to sufficiently test the operating income from this segment's contracts, in that it failed to test the accuracy of the adjustments made to the estimated contract costs in the year under audit, and failed to evaluate whether the adjustments were recorded in the appropriate period.

- At another operating segment, the Firm failed to perform sufficient procedures to test the valuation of contract revenue and costs, as it failed to perform procedures beyond inquiry to evaluate the changes in certain contract reserves.

4. Issuer D

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements –

- The Firm failed to perform sufficient procedures to evaluate the issuer's analysis of the possible impairment of certain long-lived assets, as it failed to sufficiently evaluate the reasonableness of certain significant assumptions that the issuer used in its analysis. Specifically, to evaluate the issuer's estimates of future prices for certain of the issuer's products, the engagement team used the Firm's internal specialist to develop an independent expectation of those prices. The Firm attributed the significant differences between the two sets of estimates primarily to an adjustment factor that the issuer applied to estimated future prices, but the Firm failed to sufficiently evaluate this adjustment factor. The adjustment factor was predicated on the future passage of legislation, and the Firm failed to test the issuer's assumptions regarding the content and timing of that legislation. Further, the Firm failed to evaluate the reasonableness of the issuer's exclusion from the analysis of certain discounts that the issuer had historically provided to its customers.

- The Firm failed to perform sufficient procedures to test the valuation of pension plan assets. Specifically, the Firm failed to sufficiently test the design of an important review control over the valuation of the pension plan assets, in that it failed to assess whether the control operated at a level of precision that would detect a material misstatement. In addition, the Firm failed to test the accuracy of certain inputs used in the operation of this control. The Firm designed its substantive procedures based on a level of reliance on internal control that was excessive due to these deficiencies.

- The Firm failed to sufficiently evaluate the appropriateness of the issuer's use of hedge accounting for certain derivatives. Specifically, the Firm did not address the fact that the issuer's documentation that the Firm obtained (a) did not identify the method to be used to measure hedge ineffectiveness and (b) did not describe the hedged item with the specificity required by GAAP.

5. Issuer E

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements. Specifically –

- The Firm failed to perform sufficient procedures to evaluate the issuer's assertion that no triggering events had occurred during the year that indicated that the carrying value of the issuer's development project, which the issuer had suspended a few years ago, might not be recoverable. Specifically, the Firm failed to evaluate the effect that restrictions added to the issuer's existing credit agreements, which included limitations on additional borrowings and future capital expenditures, had on the issuer's ability to obtain financing to resume construction. In addition, the Firm failed to sufficiently evaluate whether significant assumptions underlying the revenue and earnings projections that the issuer had used in the previous year's impairment analysis for the development project were reasonable in light of recent events. Specifically, with respect to this project, the Firm –

    - Failed to take into account the effect that the continued economic slowdown, which the issuer disclosed was depressing demand for its product, had on the reasonableness of the assumptions underlying those projections;

    - Failed to take into account the facts that certain of the underlying assumptions were more optimistic than historical results for the issuer's peers and that all of the issuer's reporting units had failed to achieve the revenue and earnings that the issuer had projected for the year; and

    - Failed to perform procedures to test certain of the underlying assumptions.

- The Firm failed to perform sufficient procedures to test the valuation of goodwill and other indefinite-lived intangible assets. Specifically, the Firm –

    - Failed to perform sufficient procedures to test controls over the issuer's budgeting process, on which the Firm relied, as the Firm's procedures were limited to inquiry;

    - Failed to sufficiently evaluate the reasonableness of certain assumptions used in the issuer's interim analysis of goodwill and other indefinite-lived intangible assets, as it failed to take into account certain contradictory information, consisting of the issuer's failure to attain previously projected results and the fact that forecasts for revenue growth in the issuer's industry (which were included in the work papers) were generally not as optimistic as the issuer's projections; and

    - Failed to evaluate whether a shortfall of actual results for the year as compared to projections constituted a triggering event requiring an additional impairment test to be performed at year end.

6. Issuer F

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test important controls and to evaluate the severity of identified control deficiencies. Specifically –
    - The Firm failed to sufficiently test the design effectiveness of certain controls over the accounting for certain long-lived assets and related accounts payable, in that the Firm failed to evaluate the review and approval process within the controls and/or failed to determine whether the controls achieved the related control objectives.
    - The Firm identified control deficiencies related to certain misstatements it had noted during its substantive testing. The Firm failed to sufficiently evaluate the severity of these deficiencies, in that it failed to evaluate the magnitude of the potential misstatements resulting from these deficiencies.
- The Firm failed to perform sufficient substantive procedures to test certain long-lived assets and related accounts payable, as it designed its procedures based on a level of reliance on internal control that was excessive due to the deficiencies in the Firm's testing of controls that are discussed above.
- The Firm failed to sufficiently test the issuer's impairment analysis related to certain of the long-lived assets mentioned above, in that it failed to test the completeness and accuracy of certain data used in the analysis and it failed to evaluate the reasonableness of certain key assumptions used in the analysis, beyond inquiring of management and recalculating certain percentages based on data provided by the issuer.
- The Firm failed to perform sufficient procedures to conclude whether the issuer appropriately accounted for certain derivatives as hedges. Specifically –
    - The Firm failed to sufficiently test the issuer's control over the assessment of hedge effectiveness for certain derivatives. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had evaluated the design of that control as it related to the assessment of hedge effectiveness.

  - o The Firm failed to sufficiently evaluate the appropriateness of the issuer's use of hedge accounting for certain derivatives. Specifically, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had assessed whether the issuer's hedge documentation identified the hedged item with the specificity required by GAAP.

  - o The Firm failed to sufficiently evaluate the adequacy of the issuer's assessment of hedge effectiveness for certain derivatives, in that it failed to consider the effect of certain factors related to the design of the hedge relationships, including (a) timing differences between the cash flows of certain of these derivatives and the related hedge items and (b) the fair value of certain other of these derivatives at their re-designation date.

  - o The Firm failed to test the issuer's quantitative assessment of the hedge effectiveness of certain other derivatives.

7. <u>Issuer G</u>

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to sufficiently test the operating effectiveness of important controls over accounts receivable and sales. Specifically, the Firm –

  - o Limited its testing of controls to certain operating segments without assessing the risks associated with the other operating segments;

  - o Failed to sufficiently test controls at the operating segments that it selected for testing, in that it determined its sample of items for testing the control processes on an aggregated basis without assessing the risk of material misstatement associated with each segment, even though the operating systems and control processes differed by segment and the segments operated independently;

  - o Failed to test any controls over the recording in accordance with contractual terms of long-term sales agreements and consignment inventory, and over the completeness and accuracy of adjustments to revenue and accounts receivable; and

  - o Failed to sufficiently test an important entity-level control over the valuation of accounts receivable that it had selected for testing, as it failed to test the completeness and accuracy of key inputs and evaluate the reasonableness of the decisions made, and the resolution of the issues identified, during the operation of this control.

- The Firm failed to perform sufficient substantive procedures to test accounts receivable and sales, as it designed its procedures based on a level of reliance on internal control that was excessive due to the deficiencies discussed above.

- The Firm failed to perform sufficient procedures to evaluate the issuer's analysis of the possible impairment of goodwill for three reporting units. Specifically, the Firm failed to sufficiently test certain key assumptions used in the issuer's discounted cash flow analyses, as it did not obtain an understanding of management's reasons for, and specific plans related to, the majority of the projected revenue growth. The Firm's testing was limited to inquiry of management, a comparison of certain revenue projections to external analysts' forecasts, and a retrospective review of actual results as compared to previously forecasted results, which, for two units, revealed numerous differences exceeding the Firm's established thresholds, including some that the Firm could not explain as having resulted from unexpected events. For the third unit, the comparison involved only one year's worth of actual results.

- The Firm failed to perform sufficient procedures to test the valuation of an environmental liability. Specifically, the Firm failed to sufficiently evaluate the reasonableness of certain key assumptions, and test the completeness and accuracy of the data, used in the issuer's analysis, in that its procedures were limited to reperforming the calculation of the liability, inquiring of management, and comparing certain prices on only one invoice to certain cost estimates used in the issuer's analysis.

- The Firm failed to perform sufficient procedures to evaluate whether the issuer's recording of a significant contingent liability was consistent with GAAP, in that it failed to evaluate the likelihood of an unfavorable outcome and whether management had a sufficient basis for concluding that it could reasonably estimate the amount of the contingency.

8. Issuer H

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR. Specifically –

- Regarding certain investment securities –

    - The Firm failed to sufficiently test the design effectiveness of controls related to the valuation and existence of the securities. Specifically, for two important controls the Firm had selected for testing, the Firm failed to evaluate the precision of the control procedures and whether they achieved the related control objectives. In addition, the Firm failed to identify and test any controls over the activities of a service organization that provided the issuer with values for the investment securities and/or obtain evidence about the controls at the service organization.

    - The Firm failed to perform sufficient substantive procedures to test the valuation of the securities and their classification within the fair value hierarchy set forth in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurements and Disclosures*, as it designed its procedures based on a level of reliance on internal control that was excessive due to the deficiencies discussed above, and it excluded certain investments from the population from which it selected its sample for testing.

    - The Firm failed to perform appropriate substantive procedures to test the existence of investments, in that the Firm's procedures consisted of confirming the investments with the issuer's investment manager, who was not the custodian of the investments.

- In its analysis of the possible impairment of the long-lived assets of a reporting unit, which had not generated revenue from certain key revenue categories, the issuer developed a cash flow analysis using various assumptions based on the results of certain companies in the industry that were generating these revenues. The cash flow analysis was sensitive to changes in the projected revenue growth rates. The Firm failed to perform sufficient substantive procedures to evaluate the issuer's analysis, as the Firm failed to take into account information in its work papers that indicated that projected revenue growth rates for the industry were significantly lower than those used in the analysis. In addition, the Firm failed to evaluate whether the companies that the issuer used to determine the revenue growth rates were comparable to the issuer's reporting unit.

- Regarding revenue –

    - The Firm failed to sufficiently test controls over the existence and valuation of revenue. Specifically, the Firm –

- Failed to sufficiently test the design effectiveness of a control that it selected for testing for one category of revenue, because it failed to evaluate whether the control addressed (a) all the relevant aspects of the issuer's process for accruing this category of revenue, and (b) whether the revenue was recorded in the appropriate period;

- Failed to sufficiently test the operating effectiveness of two important review controls over certain other categories of revenue, because its procedures were limited to observing signatures on certain documents and comparing certain information in the documents reviewed to information in the issuer's systems, without assessing the effectiveness of the review; and

- Failed to identify and test any controls for one category of revenue.

o The Firm failed to perform sufficient substantive procedures to test the existence and valuation of revenue, as it designed its procedures based on a level of reliance on internal control that was excessive due to the deficiencies discussed above.

9. <u>Issuer I</u>

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR —

- The Firm failed to adequately test the operating effectiveness of the controls over the relevant assertions for revenue, accounts receivable, and inventory. The Firm's approach to testing controls over these assertions consisted of relying on its knowledge from the prior year and its review and supervision of the issuer's internal audit department's walkthroughs of the controls. The Firm failed, however, to evaluate whether the risks associated with the controls were such that reducing its testing from the prior year was appropriate. In addition, the tests of only one item that internal audit performed in connection with the walkthroughs were not sufficient to test certain of the controls, including manual controls. Further, internal audit's testing was performed at an interim date, and the Firm failed to perform any procedures to extend its conclusions to year end.

- The Firm failed to perform sufficient substantive procedures to test revenue, accounts receivable, and inventory, as, in designing its substantive procedures, it relied on the internal controls referenced above that it had not adequately tested.

10. Issuer J

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test controls over revenue and inventory. Specifically –

  - The Firm failed to identify and test any controls over the occurrence and completeness of one category of revenue.

  - The Firm failed to sufficiently test the operating effectiveness of an important review control related to revenue, as it failed to test the control beyond observing the reviewers' signatures.

  - The Firm failed to test controls over the completeness and accuracy of reports that were generated from a significant inventory management application and that were used in the operation of certain important controls over revenue and inventory.

- The Firm designed its substantive procedures to test revenue and inventory based on a level of reliance on internal control that was excessive due to the deficiencies described above. In addition, the Firm used reports in its substantive testing of revenue and inventory that were generated from the application mentioned above without testing the completeness and accuracy of those reports.

- The Firm failed to perform sufficient procedures to test the valuation of goodwill. Specifically –

  - The Firm failed to perform sufficient procedures to test controls in this area, in that the Firm did not test an important control over the development of certain key assumptions used in the issuer's impairment analysis.

  - The Firm failed to sufficiently test the issuer's impairment analysis for one reporting unit, as the Firm:

    - Failed to sufficiently evaluate the reasonableness of the issuer's projections showing increases in gross margin that an external specialist used in a discounted cash flow analysis, as the Firm's evaluation was limited to observing that the issuer had a history of higher gross margins in new markets and that the issuer intended to expand into new markets;

- Failed to test the completeness and accuracy of the data that the issuer provided to the external specialist;

- Failed to sufficiently evaluate the reasonableness of the terminal growth rate that was used in the discounted cash flow analysis, as the Firm's evaluation was limited to comparing the rate to the U.S. inflation rate and to projected growth rates for the economy of the relevant region of the world for the next several years; and

- Failed to sufficiently test the carrying value of this reporting unit, as its procedures were limited to comparing amounts to an issuer-prepared schedule.

11. Issuer K

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to sufficiently test an important review control over the completeness and valuation of revenue and deferred revenue, as it failed to determine the precision and timing of the control's operation.

- The Firm determined that a control over the completeness and accuracy of a schedule of unearned revenue was not operating effectively. The Firm, however, failed to evaluate the effect of this deficiency on the operating effectiveness of an important control over revenue that it had selected for testing and that relied on this schedule.

- The Firm failed to sufficiently test an important control related to the valuation of inventory, in that its procedures were limited to inquiry of the control owner.

- The Firm failed to perform sufficient substantive procedures to test revenue, deferred revenue, and inventory as it designed its procedures based on a level of reliance on internal control that was excessive due to the deficiencies discussed above.

12. Issuer L

In this audit, the Firm failed to obtain an understanding of the specific methods and assumptions underlying the fair value measurements that were obtained from pricing services and used in the Firm's testing of the fair value of certain of the issuer's financial instruments without readily determinable fair values ("hard-to-value securities"). In addition, the Firm failed to adequately test the issuer's disclosures of these securities within the fair value hierarchy set forth in FASB ASC Topic 820, *Fair Value Measurements and Disclosures,* as the Firm failed to evaluate whether significant inputs used to value the securities were observable or unobservable.

13. Issuer M

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test the effectiveness of ICFR –
  - The Firm failed to test controls over the completeness and accuracy of reports used in the issuer's controls over the allowance for loan losses ("ALL").
  - The Firm failed to sufficiently test controls over the valuation of certain investments. Specifically, the Firm's procedures to evaluate controls at the issuer's service organization over the pricing of investments were limited to obtaining certain information from the service auditor that covered only the first three months of the year.
- The Firm failed to perform sufficient procedures to test the issuer's ALL. The Firm evaluated the reasonableness of the issuer's ALL by developing an independent estimate. This estimate was not an adequate test of the ALL, however, as it was based entirely on the issuer's previous year's ALL and the amount of loan charge-offs during the year under audit, and, further, it did not take into account information in the work papers that suggested that the issuer's ALL required further analysis.

14. Issuer N

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR. Specifically, with respect to certain revenue, the Firm –

- Failed to sufficiently test an important review control over that revenue, in that it failed to gain an understanding of the specific control procedures the issuer performed and evaluate the level of precision at which the control operated; and

- Failed to perform sufficient substantive procedures to test that revenue, in that it failed to test the completeness and accuracy of certain reports from business partners that the issuer used to record the revenue.

15. Issuer O

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test controls over the issuer's recognition of a significant portion of revenue. Specifically –

  - The Firm failed to identify that one of the two controls it tested regarding revenue recognition did not apply to a significant portion of the issuer's revenue contracts; and

  - The Firm failed to sufficiently test the operating effectiveness of the other control, as it failed to test the issuer's review and approval process for recording revenue, which was part of this control.

- The Firm failed to perform sufficient procedures to test the valuation and existence of certain inventory and the related controls. Specifically, the controls over inventory valuation that the Firm identified and tested did not apply to approximately 95 percent of the recorded inventory. In addition, the Firm did not perform any substantive procedures to test the valuation of categories of inventory representing approximately 60 percent of the recorded inventory. Further, the Firm failed to sufficiently test the existence of inventory held at locations controlled by others, in that it limited its testing to a single off-site location. As a result, the Firm excluded from testing inventory held at multiple locations controlled by others; the excluded inventory represented approximately five times the Firm's established level of materiality.

- The Firm failed to perform sufficient substantive procedures to test the valuation of certain deferred tax assets, as it failed to sufficiently evaluate the projected revenue growth and other key assumptions management used in its analysis to support the realizability of the tax asset. Specifically, the Firm failed to evaluate the issuer's upward adjustment of certain industry-wide projections that the issuer obtained from external sources for use in projecting revenue growth, failed to test the market share that the issuer used in its analysis, and failed to take into account information in its work papers that suggested that a significant portion of the issuer's business might lag the industry-wide projections.

16. Issuer P

In this audit, the Firm failed to perform sufficient procedures to test the valuation of goodwill and the related controls. Specifically, the Firm failed to sufficiently test important controls related to the development of certain key assumptions used in the issuer's impairment analysis, as it limited its procedures to observing evidence of management's review and evaluating whether the reviewers had the appropriate expertise. In addition, the Firm failed to sufficiently evaluate the reasonableness of management's projections for a significant improvement in pre-tax income as a percentage of revenue for one segment, which was used in the impairment analysis, as its procedures were limited to inquiring of management, comparing recent results to those previously forecast (which showed a shortfall in the results), and noting improved results in gross margin in the most recent two quarters.

17. Issuer Q

In this audit, the Firm failed to perform sufficient procedures to test certain revenue and deferred revenue. Specifically, the Firm –

- Failed to sufficiently test the design effectiveness of important controls it selected for testing, in that it failed to evaluate whether the controls it tested met the issuer's control objectives;

- Failed to perform sufficient substantive procedures, as it designed its procedures based on a level of reliance on internal control that was excessive, due to the deficiency discussed above and, in addition, it determined its sample size for one procedure without considering the significant risk it had identified related to revenue; and

- Failed to perform procedures to determine whether revenue was recognized only when items sold by distributors were delivered to the end user.

18. Issuer R

In this audit, the Firm failed to perform adequate procedures to test the fair value of certain assets that the issuer received from another issuer as part of a settlement agreement. One of the assets that the issuer received was a stock warrant to purchase shares of the other issuer, with the number of shares that could be purchased to be based on the future number of the other issuer's shares outstanding. The Firm failed to adequately test the issuer's assumption regarding the number of shares the other issuer would issue in the future, which was a key assumption in determining the fair value of the warrant. Specifically, the Firm did not evaluate the appropriateness of the issuer's use of the other issuer's share issuances in recent years, which was much lower than the share issuances in the current year. Further, the Firm failed to adequately test the value of two other agreements that were part of this settlement. Specifically, for a research and development contract, the Firm failed to evaluate, other than through inquiry, the issuer's assertion that the rates specified in the contract approximated market rates, and thus that no value for the contract should be recorded. In addition, the Firm failed to perform procedures to test the issuer's assertion that a value for a license it received in connection with the settlement could not be established with sufficient precision to record it.

19. Issuer S

In this audit, the Firm failed to perform sufficient procedures to test certain environmental factors the issuer used in determining the ALL. These environmental factors represented over half of the general component of the ALL, which in turn constituted nearly all of the total ALL. Specifically, the Firm's testing of these environmental factors did not include evaluating the reasonableness of the quantitative measures of the environmental factors, instead focusing on comparing the quantitative measures to those used in prior periods, verifying the consistency of the quantitative measures with the issuer's policy, and comparing certain external data that the issuer used in developing the factors to external sources. In addition, the Firm failed to test the accuracy of certain underlying loan data used in the issuer's analysis and in the Firm's testing, and failed to address certain evidence that it noted that suggested that the issuer should have changed the status of certain loans to impaired.

20. Issuer T

In this audit, the Firm failed to perform sufficient procedures to test the general component of the ALL. The Firm noted that the issuer used the same loss factors to calculate the general component of the ALL that it had used for several years, and identified a significant deficiency related to the issuer's failure to document its methodology for determining the loss factors. The Firm, however, limited its testing of the general component of the ALL to a retrospective review of the issuer's foreclosed loans and various analytical procedures that were not precise enough to identify potential material misstatements in the ALL, as they consisted simply of comparisons of the ALL to those of the issuer's peers and to the issuer's ALL in prior periods. In addition, in evaluating the ALL, the Firm failed to take into account evidence in the work papers that appeared to be inconsistent with certain of management's assumptions.

21. Issuer U

In this audit, the Firm failed to perform sufficient procedures to test a significant portion of the issuer's sales, cost of sales, and inventory. The Firm excluded the issuer's point-of-sale application from its ITGC testing, and its testing of the manual reconciliation and review controls over the data derived from this application was insufficient. Specifically, the Firm's procedures were limited to inquiring of the control owners, observing evidence of review, and confirming that the items selected reconciled to supporting documentation; these procedures did not include obtaining an understanding of, and evaluating the effectiveness of, the specific control procedures that constituted the reconciliation and review. In its substantive testing, the Firm used data and reports derived from this application that it had not tested for completeness and accuracy, and also relied on controls that used those untested data and reports.

22. Issuer V

The Firm audited certain accounts of a subsidiary of the issuer based on instructions from a foreign affiliated firm. The Firm failed to obtain sufficient appropriate audit evidence to fulfill the objectives of its role in the audit, in that the Firm failed to perform sufficient procedures to test the existence and valuation of the issuer's inventory. Specifically –

- For certain inventory, the Firm failed to test the design effectiveness of the issuer's cycle count control on which the Firm relied.

- The Firm intended its primary substantive tests of the year-end inventory balances to be substantive analytical procedures. For certain inventory, the Firm determined its expectation based largely on a fluctuation in certain historical data, but the Firm failed to determine that the fluctuation had a plausible and predictable relationship with the recorded inventory amounts. In addition, the Firm failed to evaluate significant unexpected differences identified through these analytical procedures. For certain other inventory, the Firm compared the average of certain stores' inventory balances at various interim dates to each individual store's balance at year end, notwithstanding that the stores were not homogeneous as to inventory balances and the stores' balances that were used to compute the average were as of different dates. In addition, the thresholds that the Firm used in these latter analytical procedures were not precise enough to identify potential misstatements that could be material.

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 five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control. 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 APPENDIX B OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

APPENDIX C

THE INSPECTION PROCESS FOR ANNUALLY INSPECTED FIRMS

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. This appendix describes the inspection process for those annually inspected firms that have multiple practice offices and a national office structure. While this appendix describes the general inspection process applied in the 2011 inspections of these firms, the process was customized to each firm's inspection, bearing in mind the firm's structure, past inspection observations, observations during the course of the 2011 inspection, and other factors. Accordingly, procedures described in this Appendix, while generally applicable to annual inspections, may not have been applied, or may not have been applied fully, in the inspection of any individual firm, and additional procedures, not described in this appendix, may have been applied in the inspection of an individual firm.

The inspection process included reviews of aspects of selected issuer audits completed by the inspected firm. These reviews were intended both to identify deficiencies, if any, in those aspects of the audits and to determine whether those deficiencies indicated weaknesses or defects in the firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the firm that could be expected to affect audit quality.

1. Review of Selected Audits

Inspections include reviews of aspects of selected audits of financial statements and ICFR. For each audit selected, the inspection team reviewed certain of the issuer's SEC filings. The inspection team selected certain aspects of the audits for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those aspects. The inspection team also analyzed potential adjustments to the issuer's financial statements that were identified during the audit but not corrected. For certain selected engagements, the inspection team reviewed written communications between the firm and the issuer's audit committee and, for some engagements, the inspection team 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 was allowed the opportunity to provide a written response to the comment form.

2. Review of Firm Management and Monitoring Processes Related to Audit Quality Control

The inspection team's review of a firm's system of quality control was intended to provide a basis for assessing whether that system was appropriately designed and implemented to achieve the goal of conducting audits that are in compliance with applicable standards. This review included an evaluation of the firm's ability to respond effectively to indications of possible defects in its system of quality control.

a. Review of Management Structure and Processes, Including the Tone at the Top

Procedures in this area were designed to focus on (a) how the firm's management is structured and operates the firm's business, and the implications that the management structure and processes have on audit performance, and (b) whether actions and communications by the firm's leadership – the "tone at the top" – demonstrate a commitment to audit quality. The inspection team interviewed members of the firm's leadership to obtain an understanding of any significant changes in the firm's approach to, and processes for, its management, including the mechanisms, formal or informal, that assess, monitor, or affect audit performance. The inspection team also reviewed significant management reports and documents, as well as information regarding financial metrics and the budget and goal setting processes that the firm uses to plan for, and evaluate the success of, its business.

b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area were designed to focus on (a) whether the firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the firm; (b) the firm's processes for allocating its partner resources; and (c) the accountability and responsibilities of the different levels of firm management with respect to partner management. The inspection team interviewed members of the firm's management and also reviewed documentation related to certain of these topics. In addition, the inspection team's interviews of audit partners included questions regarding their responsibilities and allocation of time and the interviews of firm management included the performance of partners being inspected, the evaluation and compensation process, any disciplinary actions, and any situations where a client requested a change in the lead audit partner. In addition, the inspection team reviewed a sample of partners' personnel files, including files of partners who resigned or took early retirement and partners who had significant negative inspection results from recent internal and PCAOB inspections.

c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Clients, Including the Application of the Firm's Risk-Rating System

The inspection team selected certain issuer audits to (a) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the client and (b) observe whether the audit procedures were responsive to the risks identified during the process.

d. Review of Processes Related to the Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audit Clients

The inspection team reviewed the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the operations of U.S. issuer clients, reviewed available information relating to the most recent foreign affiliated firms' internal inspections, interviewed members of the firm's leadership, and reviewed the U.S. engagement teams' supervision and control procedures concerning the audit work that the firm's foreign affiliates performed on a sample of audits. In some cases, the inspection team also reviewed, on a limited basis, certain of the audit work performed by the firm's foreign affiliates on the foreign operations of U.S. issuer clients.

e. Review of the Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Weaknesses in Quality Control

(i) Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area were designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team interviewed members of the firm's management and reviewed documents regarding how the firm identifies, evaluates, and responds to possible indicators of deficiencies in audit performance, including internal inspection findings, PCAOB inspection observations, restatements, and litigation. In addition, the inspection team reviewed documents related to the design, operation, and evaluation of findings of the firm's internal inspection program. The inspection team also reviewed certain audits that the firm had inspected and compared its results to those from the internal inspection.

(ii) Review of Response to Weaknesses in Quality Control

The inspection team reviewed steps the firm has taken in the past several years to address possible quality control deficiencies. The inspection team then assessed the design and evaluated the effectiveness of the processes identified. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

(iii) Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team assessed policies, procedures, and guidance related to aspects of the firm's independence requirements and its consultation processes and the firm's compliance with them. In addition, the inspection team reviewed documents, including certain newly issued policies and procedures, and interviewed firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

APPENDIX D

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.[10/]

[10/] 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.

Deloitte & Touche LLP
30 Rockefeller Plaza
New York, NY 10112
USA

November 5, 2012

Mr. Christopher D. Mandaleris
Senior Deputy 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 2011 Inspection

Dear Mr. Mandaleris:

Deloitte & Touche LLP is pleased to submit this response to the draft Report on 2011 Inspection of Deloitte & Touche LLP (the Draft Report) of the Public Company Accounting Oversight Board (the PCAOB or the Board). We believe that the PCAOB's inspection process serves an important role in the achievement of our shared objectives of improving audit quality and serving investors and the public interest. We are committed to continuing to work with the PCAOB to further strengthen trust in the integrity of the independent audit.

We have evaluated the matters identified by the Board's inspection team for each of the issuer audits described in Part I of the Draft Report and have taken actions as appropriate in accordance with PCAOB standards to comply with our professional responsibilities under 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.*

Executing high quality audits is our number one priority. We are confident that the investments we have made and are continuing to make in our audit processes, policies, and quality controls are resulting in significant enhancements to our audit quality.

Sincerely,

Joseph J. Echevarria, Jr.
Chief Executive Officer
Deloitte LLP

Gregory G. Weaver
Chairman and CEO
Deloitte & Touche LLP