Report on

2013 Inspection of Deloitte & Touche LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

May 6, 2014

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

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Deloitte & Touche LLP ("the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

Inspections are designed and performed to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. For a description of the procedures the Board's inspectors may perform to fulfill this responsibility, see Part I.C of this report (which also contains additional information concerning the PCAOB inspections generally). Overall, the inspection process included reviews of portions of selected issuer audits completed by the Firm. These reviews were intended to identify whether deficiencies existed in those portions of the inspected audits, and whether such deficiencies indicated defects or potential 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.

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, portions of Appendix C, and Appendix D. Appendix C includes the Firm's comments, if any, on a draft of the report. If the nonpublic portions of the report discuss criticisms of or potential defects in the firm's system of quality control, those discussions also could eventually be made public, but only to the extent the firm fails to address the criticisms to the Board’s satisfaction within 12 months of the issuance of the report.
PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures1/ for the inspection from April 2013 through January 2014. The inspection team performed field work at the Firm's National Office and at 30 of its approximately 66 U.S. practice offices.

A. Review of Audit Engagements

The 2013 inspection of the Firm included reviews of portions of 52 audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed.

The descriptions of the deficiencies in Part I.A of this report include, at the end of the description of each deficiency, references to specific paragraphs of the auditing standards that relate to those deficiencies. The text of those paragraphs is set forth in Appendix D to this report. The references in this sub-Part include only standards that primarily relate to the deficiencies; they do not present a comprehensive list of every auditing standard that applies to the deficiencies. Further, certain broadly applicable aspects of the auditing standards that may be relevant to a deficiency, such as provisions requiring due professional care, including the exercise of professional skepticism; the accumulation of sufficient appropriate audit evidence; and the performance of procedures that address risks, are not included in the references to the auditing standards in this sub-Part, unless the lack of compliance with these standards

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1/ For this purpose, the time span for "primary procedures" includes field work, other review of audit work papers, and the evaluation of the Firm's quality control policies and procedures through review of documentation and interviews of Firm personnel. The time span does not include inspection planning, which may commence months before the primary procedures, and inspection follow-up procedures, wrap-up, analysis of results, and the preparation of the inspection report, which generally extend beyond the primary procedures.
is the primary reason for the deficiency. These broadly applicable provisions are described in Part I.B of this report.

Certain of 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 appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable financial reporting framework and/or its opinion about whether the issuer had maintained, in all material respects, effective internal control over financial reporting ("ICFR"). In other words, in these audits, the auditor issued an opinion without satisfying its fundamental obligation to obtain reasonable assurance about whether the financial statements were free of material misstatement and/or the issuer maintained effective ICFR.

The fact that one or more deficiencies in an audit reach this level of significance does not necessarily indicate that the financial statements are misstated or that there are undisclosed material weaknesses in ICFR. It is often not possible for the inspection team, based only on the information available from the auditor, to reach a conclusion on those points.

Whether or not associated with a disclosed financial reporting misstatement, an auditor's failure to obtain the reasonable assurance that the auditor is required to obtain is a serious matter. It is a failure to accomplish the essential purpose of the audit, and it means that, based on the audit work performed, the audit opinion should not have been issued.  

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2/ Inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Depending upon the circumstances, compliance with PCAOB 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 its previously expressed audit opinions. The Board expects that firms will comply with these standards, and the inspections staff may include in its procedures monitoring or assessing a firm's compliance.
The audit deficiencies that reached this level of significance are described below.

A.1. Issuer A

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 on the effectiveness of ICFR –

- The Firm’s procedures to test controls over revenue were insufficient. Specifically –
  - For one category of revenue, the Firm's testing of the control it selected over the accuracy of billing rates consisted of observing evidence that the control occurred, without evaluating whether the control addressed whether these rates were consistent with customer orders and relevant regulatory requirements. (AS No. 5, paragraph 42)
  - For this category of revenue, the Firm also failed to identify and test any controls over changes to billing rates that were made using the method the issuer most frequently used to effect billing rate changes. (AS No. 5, paragraph 39)
  - The Firm failed to identify and test any controls over whether, for a significant sub-category of revenue, the customers had agreed to purchase services from the issuer. (AS No. 5, paragraph 39)
  - For another category of revenue, the Firm limited its testing of two controls, involving the review and approval of billing rates and changes to billing rates, to inquiring of issuer personnel, inspecting an invoice, and obtaining evidence that certain rates or changes to certain rates had been approved. The Firm's procedures, however, failed to include evaluating the effectiveness of the review and approval process. (AS No. 5, paragraphs 42 and 44)

- The Firm’s substantive procedures to test revenue were insufficient. Specifically –
The Firm designed its substantive procedures – including sample sizes and, in the performance of substantive analytical procedures, thresholds for investigation of differences from expectations – to test certain revenue based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the Firm's sample sizes were too small to provide sufficient evidence, and certain of the thresholds for further investigation were too high. (AS No. 13, paragraphs 16, 18, and 37; AU 329, paragraph .20; AU 350, paragraphs .19 and .23)

For many of the items selected for testing revenue, the Firm's procedures were insufficient, as it failed to test whether the following criteria for recognizing revenue had been met: that there was persuasive evidence of an arrangement, that collectibility was reasonably assured, and/or that services had been rendered at the time revenue was recognized. In addition, for certain of the items selected for testing, the Firm failed to test the accuracy and completeness of data that it used in its testing. (AS No. 14, paragraph 30; AS No. 15, paragraph 10)

The Firm's procedures to test controls over the valuation and existence of certain categories of long-lived assets were insufficient. Specifically –

Regarding additions to one category of long-lived assets, the Firm's testing of two review controls over the capitalization of certain costs was limited to inquiry and procedures designed to verify that the reviews had occurred, without evaluating whether the reviews effectively assessed the appropriateness of recording these costs as additions to assets. The Firm also failed to test controls over the accuracy and completeness of reports used in the performance of a third control over the capitalization of these costs. (AS No. 5, paragraphs 39, 42, and 44)

The Firm failed to identify and test any controls over the accounting for additions to another category of long-lived assets. (AS No. 5, paragraph 39)
The Firm designed its substantive procedures – including sample sizes – to test the valuation and existence of certain categories of long-lived assets based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes the Firm used to test these assets were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19 and .23)

A.2. Issuer B

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 on the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test the effectiveness of controls over the issuer's rights to, and valuation of, certain purchased loans. Specifically –
  - The Firm's testing of a control it selected, which addressed the accuracy of data related to purchased loans, was not sufficient. The issuer used the data subject to this control to estimate the fair value of purchased loans. The Firm's procedures to test this control were limited to inquiring of issuer personnel, reading an issuer-prepared narrative, and obtaining evidence that certain aspects of the control occurred, without testing the effectiveness of the procedures performed in connection with the control. (AS No. 5, paragraphs 42 and 44)
  - The Firm failed to obtain sufficient evidence regarding the issuer's controls over the monitoring and resolution of exceptions in the documentation related to purchased loans. Specifically, the Firm's procedures with respect to the only control it tested in this area were limited to inquiring of issuer personnel and obtaining evidence that the control had occurred, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements related to the issuer's rights to, and valuation of, these loans. (AS No. 5, paragraphs 42 and 44)
The Firm’s procedures to test the valuation of certain of the issuer's purchased loans, which were carried at their estimated fair value, were not sufficient. When testing the issuer's estimate of the value of these loans, the Firm selected a sample of loan pools and evaluated the reasonableness of the significant assumptions related to the fair values of these loan pools. The Firm’s procedures related to two of these assumptions focused on (a) comparing the issuer's assumptions to amounts for those assumptions that the Firm had developed; and (b) investigating certain differences between the issuer's assumptions and the Firm's amounts for those assumptions. These procedures, however, were insufficient, as follows –

- The first assumption related to loan losses and was derived from the output of the issuer's valuation model. The Firm used generic market information for the loan product type and age to develop amounts for comparison to this assumption, without tailoring its procedures based on the specific performance-related characteristics of the issuer's loan pools. In addition, the Firm failed to establish that its investigation threshold was precise enough to identify potential material misstatements in the valuation of these loans. (AU 328, paragraphs .26, .28, .36, and .38)

- The second assumption was the discount rate used to determine the value of the loan pools. For certain loan pools with differences that met its threshold for investigation, the Firm concluded that the issuer's discount rate was acceptable based upon its determination that the issuer's loan pools had higher rates of certain types of delinquencies than the loans underlying the amounts the Firm had developed. The Firm, however, failed to consider whether the amounts it had developed were appropriate for the remaining loan pools that it had selected for testing and for which there was not a significant difference in the discount rate assumption, given that certain of these loan pools also had higher rates of these types of delinquencies. (AU 328, paragraphs .26, .28, .36, and .38)

During the year, the issuer recorded gains related to mortgage servicing rights ("MSRs") that it acquired when it sold mortgage loans; the gains
were based on the fair value of the acquired MSRs. At year end, the issuer recorded the value of its MSRs using the lower of the amortized cost or the fair value, which the issuer assessed based on categories of the MSRs defined by certain characteristics. The Firm's procedures to test the valuation of these MSRs and the recorded gains were insufficient, as follows –

- The Firm tested the issuer's fair values at acquisition and at year end by comparing them to fair value measurements the Firm obtained from an external source. The Firm, however, failed to obtain an understanding of the specific methods and assumptions the external source used. In addition, for the fair values for the categories of MSRs at year end, the Firm failed to evaluate the appropriateness of using the external source's values given that they were determined based on categories of MSRs that did not correspond to the categories of MSRs that the issuer used to assess the lower of amortized cost or fair value. (AU 328, paragraph .40)

- To test the fair values at year end, the Firm also considered the issuer's assumptions. The Firm's evaluation of the assumptions was insufficient, however, as it performed its testing at the level of the issuer's entire portfolio, without evaluating the specific assumptions that the issuer used to determine the fair values of the MSR categories. (AU 328, paragraphs .26, .28, and .36)

A.3. Issuer C

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 on the effectiveness of ICFR –

- The Firm selected a control over certain revenue that involved (a) the identification of contracts with unusual terms that could affect revenue recognition and (b) reviews of the identified contracts by designated issuer personnel. The Firm's testing of this control was insufficient. Specifically, the Firm limited its procedures to obtaining schedules of contracts identified through the operation of this control, comparing certain terms
included on the schedules to the underlying contracts, and verifying that
the reviews occurred on a timely basis. The Firm's procedures did not
include testing the specific steps used to identify contracts nor did it
include evaluating whether the review aspect of the control operated at a
level of precision that would prevent or detect material misstatements. (AS
No. 5, paragraphs 42 and 44)

- The Firm failed to sufficiently test the one control, the review of significant
  accounting issues and non-routine transactions, that it had identified to
  address the valuation and presentation of notes receivable that the issuer
  received as part of the consideration from the sale of a business during
  the year. Specifically, the Firm's procedures were limited to an evaluation
  of the qualifications of the individuals performing the review, inquiries of
  various issuer personnel, and review of issuer-prepared documents,
  without evaluating whether the control operated at a level of precision that
  would prevent or detect material misstatements related to the notes
  receivable. (AS No. 5, paragraphs 42 and 44)

  The Firm failed to perform sufficient procedures to test the valuation of the
  notes receivable described above. The issuer's earnings forecast for the
  sold business was a significant input to the issuer's estimate of the fair
  value of these notes receivable. The Firm limited its testing of a significant
  input to this earnings forecast to inquiry and a comparison of certain
  forecasted amounts to prior-period amounts, without (a) obtaining an
  understanding of the assumptions the issuer used to develop the
  forecasted amounts, (b) evaluating the relevance of the prior-period
  amounts, beyond identifying a factor that affected the comparability of
  certain of the prior-period amounts, and (c) otherwise testing the
  assumptions underlying this input. In addition, the Firm failed to take into
  account evidence in the work papers that appeared to be inconsistent with
  the issuer's earnings forecast for the sold business. (AS No. 14, paragraph
  3; AU 328, paragraphs .26, .28, .31, .36, and .47)

A.4. Issuer D

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
on the effectiveness of ICFR –
The Firm identified and tested two controls over the determination of the fair value estimates that the issuer used (a) to measure the impairment of certain loans and (b) to determine the carrying value of certain real estate assets. The Firm's testing of these controls was insufficient. Specifically, the Firm's procedures were limited to inquiring of issuer personnel, inspecting issuer-prepared documents, comparing information from certain documents provided by the issuer to information in other issuer-provided documents, and determining that reviews of the fair value determinations occurred. The Firm's procedures did not include evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

The Firm's procedures to test the valuation of impaired loans and real estate assets were insufficient, as follows –

- The Firm designed its substantive procedures – including sample sizes – based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, the sample sizes the Firm used to test impaired loans and real estate assets were too small to provide sufficient evidence. (AS No. 13, paragraphs 16, 18, and 37; AU 350, paragraphs .19 and .23)

- For the majority of the impaired loans and real estate assets that it selected for testing, the Firm failed to obtain evidence regarding whether certain significant valuation assumptions underlying the issuer's determination of fair value were reasonable and reflected, or were not inconsistent with, assumptions that market participants would use. (AU 328, paragraphs .26, .28, and .36)

The Firm failed to perform sufficient procedures to test the general component of the allowance for loan losses ("ALL"), a significant component of the ALL. A significant assumption used in the issuer's determination of substantially all of the general component of the ALL was an estimate of the timing of future loan charge-offs. This estimate was based on two significant factors. The Firm's testing of each of these factors was insufficient, as follows:
The issuer determined the value of one factor based upon an analysis of the timing of its actual loss experience, adjusted to exclude certain losses. This adjusted analysis indicated a lower value for this factor, and a lower amount for the ALL, than the unadjusted analysis would indicate. The Firm identified the nature of the adjustments made in the analysis, but failed to evaluate whether (a) the adjustments were appropriate or (b) the value for this factor that the issuer calculated was reasonable in light of the recent trend in the timing of the issuer's loss experience. (AU 342, paragraphs .09 and .11)

The Firm failed to perform any procedures to evaluate the reasonableness of the other factor. (AU 342, paragraph .11)

A.5. Issuer E

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 on the effectiveness of ICFR –

- The Firm failed to perform sufficient procedures to test the valuation of certain environmental liabilities that the issuer recorded as a result of an acquisition during the year. Specifically, the Firm failed to obtain an understanding, and evaluate the reasonableness, of the significant assumptions that the issuer used to estimate the fair value of these environmental liabilities. (AU 328, paragraphs .12, .26, .28, and .36)

- The Firm's procedures to test controls over the valuation of the inventory at certain significant locations were insufficient in the following respects –

  - The Firm failed to sufficiently test whether a review control that the Firm had selected over the inventory cost calculation operated at a level of precision that would prevent or detect material misstatements. Specifically, the Firm failed to evaluate the criteria used to perform the review. (AS No. 5, paragraphs 42 and 44)
The Firm selected for testing a control over standard cost amounts, but the Firm's testing of this control at three significant locations was insufficient. Specifically –

- For one location, the issuer described the control as preventing unauthorized changes to standard costs. At this location, the Firm's testing did not include procedures to determine whether the control was designed to prevent such unauthorized changes.

- For another location, the Firm's procedures were limited to inquiry of issuer personnel, inspecting issuer-prepared documents, comparing information from certain documents provided by the issuer to information in other issuer-provided documents, and determining that reviews of standard costs occurred. The Firm's procedures did not include evaluating whether the control was designed to operate at a level of precision that would prevent or detect material misstatements.

- For the third location, the Firm failed to perform any procedures to test this control. (AS No. 5, paragraphs 42 and 44)

- The Firm failed to identify and test any controls over the accuracy and completeness of certain reports used in the performance of the controls noted above. (AS No. 5, paragraph 39)

The Firm designed its substantive procedures – including sample sizes and, in the performance of substantive analytical procedures for one location, thresholds for investigation of differences from expectations – to test the valuation of certain inventory based on a level of control reliance that was not supported due to the deficiencies in the Firm's testing of controls that are discussed above. As a result, certain of the sample sizes the Firm used to test the valuation of this inventory were too small to provide sufficient evidence, and certain of the thresholds for further investigation were too high. (AS No. 13, paragraphs 16, 18, and 37; AU 329, paragraph .20; AU 350, paragraphs .19 and .23)
A.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 on the effectiveness of ICFR –

- The Firm selected for testing a review control over certain revenue, but its testing of this control was not sufficient. The control consisted of management’s review of monthly financial statement amounts, and its investigation of differences from prior-month amounts above an established threshold. The Firm’s procedures to test this control were limited to determining whether there were explanations for all variances over the established threshold, and whether management had reviewed and approved the analysis. These procedures did not include evaluating whether the control operated at a level of precision that would prevent or detect material misstatements related to revenue. (AS No. 5, paragraphs 42 and 44)

- The Firm designed its substantive procedures – including sample sizes and, in the performance of substantive analytical procedures, thresholds for investigation of differences from expectations – to test certain revenue based on a level of control reliance that was not supported due to the deficiencies in the Firm’s testing of the control that are discussed above. As a result, for certain categories of revenue, the Firm’s sample sizes were too small to provide sufficient evidence, and for certain other categories of revenue the thresholds for further investigation were too high. (AS No. 13, paragraphs 16, 18, and 37; AU 329, paragraph .20; AU 350, paragraphs .19 and .23)

A.7. Issuer G

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 –

- One of the issuer’s subsidiaries had a practice of entering into oral arrangements with some of its customers. The Firm identified a fraud risk related to revenue recognition at this subsidiary. The Firm, however, failed
to perform sufficient procedures to test whether the issuer's recognition of a significant category of the revenue for this subsidiary was appropriate. Specifically, for the Firm's sample of revenue transactions for this category of revenue, the Firm limited its testing to obtaining issuer-prepared invoices and verifying that (a) the invoices had been paid, (b) the invoices that related to rental transactions had corresponding prior-month invoices that had been paid, and/or (c) the related products had been shipped. The Firm's procedures, however, failed to evaluate whether the issuer had met the following criteria for recognizing revenue: that there was persuasive evidence of an arrangement and that the price was fixed or determinable. (AS No. 13, paragraph 13; AS No. 14, paragraph 30)

- For another of the issuer's subsidiaries, the Firm failed to perform sufficient procedures to test the existence and valuation of accounts receivable. A significant input to the issuer's estimate of the value of these accounts receivable was based on data reflecting historical cash receipts. In addition, when testing the existence of these accounts receivable, the Firm used the cash-receipts data to cover the period between the time of its interim substantive procedures and year end. The Firm, however, did not have a sufficient basis to rely on the cash-receipts data that it used in its procedures, as it limited its testing of cash receipts to those that it had used in its interim substantive testing of the existence of accounts receivable. (AS No. 13, paragraph 45; AS No. 15, paragraph 27; AU 342, paragraph .11)

A.8. Issuer H

In this audit, the Firm failed in the following respects to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm identified fraud risks and other significant risks related to the issuer's liquidity forecasts, and identified and tested controls over the preparation of the issuer's long-range plan, which was a significant input that the issuer used to develop its liquidity disclosure in the financial statements. The Firm's procedures to test these controls, however, were not sufficient. Specifically, the Firm's procedures were limited to evaluating the competence of the control owners, obtaining evidence that certain of the reviews that constituted most of the controls had occurred, and attending certain meetings at which management discussed the long-range plan, without evaluating
whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraphs 42 and 44)

A.9. Issuer I

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing controls that included reviews of the calculation of a significant portion of the issuer's insurance liability and the inputs to that calculation. The Firm limited its testing of the operating effectiveness of these controls to inquiring of issuer personnel, obtaining certain documents used in the performance of the reviews, and inspecting evidence that such reviews had occurred, without evaluating whether the controls operated at a level of precision that would prevent or detect material misstatements. (AS No. 5, paragraph 44)

A.10. Issuer J

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing a control involving the analysis and review of the accounting for certain joint ventures and variable interest entities, but its testing of this control was insufficient. Specifically, the Firm's procedures were limited to inquiring of the preparer of the analysis, comparing information used in the performance of the review to supporting documents, and inspecting evidence that such reviews had occurred, without evaluating whether the control operated at a level of precision that would prevent or detect material misstatements. In addition, the Firm failed to test any controls over the accuracy and completeness of certain data that the issuer used in connection with the operation of the control. (AS No. 5, paragraphs 39, 42, and 44)

A.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 on the effectiveness of ICFR –

• The Firm’s testing of a control it selected over certain inventory was not sufficient. Specifically, the Firm used the work of the issuer’s internal auditors to test the operating effectiveness of this control, which consisted
of physical inventory counts conducted by plant personnel. The Firm's procedures were limited to obtaining the internal auditors' plan for testing the physical inventory counts, and determining that the number of locations the internal auditors planned to visit was sufficient without evaluating whether the work the internal auditors actually performed during the year relating to this control achieved the objectives of the testing. (AS No. 5, paragraph 44; AU 322, paragraphs .24 and .25)

- The Firm relied on the testing of the control described above when designing its substantive procedures to test this inventory; the Firm's reliance on this control, however, was not supported due to the deficiency in the Firm's testing of the control that is discussed above. As a result, the Firm's substantive procedures did not provide sufficient evidence. Specifically, for certain plant locations that reported inventory that represented a substantial portion of this inventory, the Firm did not observe inventory; the Firm's only procedure to test the existence of the inventory at these locations was to test the reconciliation of the inventory sub-ledger to the general ledger. (AS No. 13, paragraphs 16, 18, and 37)

A.12. Issuer L

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. The Firm selected for testing two automated controls over the issuer's process for recording certain revenue, but its testing of these controls was insufficient. Specifically, the Firm used the work of the issuer's internal auditors as evidence of the effectiveness of these controls. The internal auditors' testing did not address certain important aspects of the controls related to the issuer's process for recording revenue and was limited to reviewing certain journal entries that related to cost of sales and verifying that invoices were generated automatically. The Firm, however, failed to evaluate whether this testing was appropriate to determine whether the controls were designed and operated to accomplish their stated objectives. (AS No. 5, paragraphs 42 and 44; AU 322, paragraphs .24 and .25)
A.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 on the effectiveness of ICFR —

- The Firm failed to identify and test controls that sufficiently addressed the risks related to the valuation of postretirement plan liabilities, as the control it selected did not address certain significant assumptions, related to healthcare costs, that the issuer used to estimate these postretirement plan liabilities and did not address the accuracy and completeness of the data that the issuer used to form these assumptions. (AS No. 5, paragraphs 39 and 42)

- The Firm failed to sufficiently test certain of the significant assumptions the issuer used to estimate the postretirement plan liabilities because it failed to test the accuracy and completeness of the data that the issuer used to form these assumptions. (AS No. 15, paragraph 10; AU 342, paragraph .11)

A.14. Issuer N

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as its procedures to test the existence of certain inventory held by a subsidiary that the issuer acquired during the year were insufficient. The Firm chose not to test controls with respect to this inventory. The Firm substantively tested the existence of this inventory at various locations on various interim dates, but failed to perform any procedures to cover the periods from the interim testing dates to year end. (AS No. 13, paragraph 45; AU 331, paragraph .12)

A.15. Issuer O

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements, as it did not perform sufficient procedures to test the existence of a significant portion of accounts receivable. The Firm chose not to rely on controls with respect to these accounts receivable. The Firm tested the existence of these accounts receivable as of the end of the third quarter and
performed analytical procedures to cover the remaining period to year end. The analytical procedures, however, were insufficient. Specifically, one of the key factors the Firm used to develop its expectation of the accounts receivable balance at year-end was based upon the issuer's year-end recorded accounts receivable balance that the analytical procedures were designed to test. (AS No. 13, paragraphs 37 and 45; AU 329, paragraphs .05, .16, and .17)

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which the Firm failed to comply with the requirement to obtain sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable accounting principles, and/or for its opinion concerning whether the issuer maintained, in all material respects, effective ICFR. Each deficiency could relate to several applicable provisions of the standards that govern the conduct of audits, including both the paragraphs of the standards that are cited at the end of each description of the deficiency included in Part I.A of this report and one or more of the specific paragraphs discussed below.

Many audit deficiencies involve a lack of due professional care. AU 230, *Due Professional Care in the Performance of Work* ("AU 230"), paragraphs .02, .05, and .06, requires the independent auditor to plan and perform his or her work with due professional care and set forth aspects of that requirement. AU 230, paragraphs .07 through .09, and Auditing Standard ("AS") No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), paragraph 7, specify that due professional care requires the exercise of professional skepticism. These standards state that professional skepticism is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13, paragraphs 3, 5, and 8, requires the auditor to design and implement audit responses that address the risks of material misstatement. AS No. 15, *Audit Evidence* ("AS No. 15"), paragraph 4, requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of ICFR) and the quality of the audit evidence obtained. The appropriateness of evidence is
measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

The table below lists the specific auditing standards that are referenced for each deficiency included in Part I.A of this report. See the descriptions of the deficiencies in Part I.A for identification of the specific paragraphs, in addition to those noted above, that relate to the individual deficiencies.

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<td>AU Section 342, <em>Auditing Accounting Estimates</em></td>
<td>D, G, and M</td>
</tr>
<tr>
<td>AU Section 350, <em>Audit Sampling</em></td>
<td>A, D, E, and F</td>
</tr>
</tbody>
</table>

C. Information Concerning PCAOB Inspections Generally Applicable to Annually Inspected Firms

Board inspections include reviews of certain portions of selected audit work performed by the inspected firm and reviews of certain aspects of the firm's quality control system. The inspections are designed to identify deficiencies in audits and defects or potential defects in the Firm's system of quality control related to the firm's audits. The focus on deficiencies, defects, and potential defects 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. Further, the inclusion
in an inspection report of certain deficiencies, defects, and potential defects should not
be construed as an indication that the Board has made any determination about other
aspects of the inspected firm's systems, policies, procedures, practices, or conduct not
included within the report.

C.1. Reviews of Audit Work

Inspections include reviews of portions of selected audits of financial statements
and, where applicable, audits of ICFR. For these audits, the inspection team selects
certain portions of the audits for inspection, and it reviews the engagement team's work
papers and interviews engagement personnel regarding those portions. If the inspection
team identifies a potential issue that it is unable to resolve through discussion with the
firm and any review of additional work papers or other documentation, the inspection
team ordinarily provides the firm with a written comment form on the matter and the firm
is allowed the opportunity to provide a written response to the comment form. If the
response does not resolve the inspection team's concerns, the matter is considered a
deficiency and is evaluated for inclusion in the inspection report.

The inspection team selects the audits, and the specific portions of those audits,
that it will review, and the inspected firm is not allowed an opportunity to limit or
influence the selections. Audit deficiencies that the inspection team may identify include
a firm's failure to identify, or to address appropriately, financial statement
misstatements, including failures to comply with disclosure requirements,3/ as well as a
firm's failures to perform, or to perform sufficiently, certain necessary audit procedures.
The inspection does not involve the review of all of a firm's audits, nor is it designed to
identify every deficiency in the reviewed audits. Accordingly, a Board inspection report

3/ 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 Securities
and Exchange Commission ("SEC" or "the Commission"), which has jurisdiction to
determine proper accounting in issuers' financial statements. Any description in this
report of financial statement misstatements or failures to comply with SEC disclosure
requirements should not be understood as an indication that the SEC has considered or
made any determination regarding these issues unless otherwise expressly stated.
should not be understood to provide any assurance that a firm’s audit work, or the relevant issuers' financial statements or reporting on ICFR, are free of any deficiencies not specifically described in an inspection report.

In some cases, the conclusion that a firm did not perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the firm claimed to have performed the procedure. AS 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. In reaching its conclusions, the inspection team considers whether audit documentation or any persuasive other evidence that a firm might provide to the inspection team supports a firm’s contention that it performed a procedure, obtained evidence, or reached an appropriate conclusion. In the case of every matter cited in the public portion of a final inspection report, the inspection team has carefully considered any contention by the firm that it did so but just did not document its work, and the inspection team has concluded that the available evidence does not support the contention that the firm sufficiently performed the necessary work.

Identified deficiencies in the audit work that exceed a significance threshold (which is described in Part I.A of the inspection report) are summarized in the public portion of the inspection report.4

The Board cautions against extrapolating from the results presented in the public portion of a report to broader conclusions about the frequency of deficiencies throughout the firm’s practice. Individual audits and areas of inspection focus are most often selected on a risk-weighted basis and not randomly. Areas of focus vary among

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4/ 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. In addition, 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 for purposes of imposing legal liability.
selected audits, but often involve audit work on the most difficult or inherently uncertain areas of financial statements. Thus, the audit work is generally selected for inspection based on 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.

Inclusion of an audit 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 audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform the issuer of the need for changes to its financial statements or reporting on ICFR, or to take steps to prevent reliance on previously expressed audit opinions.5

C.2. Review of a Firm's Quality Control System

QC 20, System of Quality Control for a CPA Firm's Accounting and Auditing Practice ("QC 20") provides that an auditing firm has a responsibility to ensure that its personnel comply with the applicable professional standards. This standard specifies that a firm's system of quality control should encompass the following elements: (1) independence, integrity, and objectivity; (2) personnel management; (3) acceptance and continuance of issuer audit engagements; (4) engagement performance; and (5) monitoring.

The inspection team's assessment of a firm's quality control system is derived both from the results of its procedures specifically focused on the firm's quality control policies and procedures, and also from inferences that can be drawn from deficiencies in the performance of individual audits. Audit deficiencies, whether alone or when

5/ An inspection may include a review of the adequacy of a firm's compliance with these requirements, either with respect to previously identified deficiencies or deficiencies identified during that inspection. 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.
aggregated, may indicate areas where a firm's system has failed to provide reasonable assurance of quality in the performance of audits. Even deficiencies that do not result in an insufficiently supported audit opinion may indicate a defect or potential defect in a firm's quality control system. If identified deficiencies, when accumulated and evaluated, indicate defects or potential defects in the firm's system of quality control, the nonpublic portion of this report would include a discussion of those issues. When evaluating whether identified deficiencies in individual audits indicate a defect or potential defect in a firm's system of quality control, the inspection team considers the nature, significance, and frequency of deficiencies; related firm methodology, guidance, and practices; and possible root causes.

In addition to evaluating the audit work performed on specific audits, inspections include a review of certain of the firm's practices, policies, and processes related to audit quality, which constitute a part of the firm's quality control system. The inspection team customizes the procedures it performs with respect to the firm's practices, policies, and processes related to audit quality, bearing in mind the firm's structure, procedures performed in prior inspections, past and current inspection observations, an assessment of risk related to each area, and other factors. The areas generally considered for review include (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 issuer audit engagements, including the application of the firm's risk-rating system; (4) any other factors.

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6/ Not every audit deficiency suggests a defect or potential defect in a firm's quality control system, and this report does not discuss every audit deficiency the inspection team identified.

7/ An evaluation of the frequency of a type of deficiency may include consideration of how often the inspection team reviewed audit work that presented the opportunity for similar deficiencies to occur. In some cases, even a type of deficiency that is observed infrequently in a particular inspection may, because of some combination of its nature, its significance, and the frequency with which it has been observed in previous inspections of the firm, be cause for concern about a quality control defect or potential defect.
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 audits; 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 defects or potential defects in quality control. A description of the procedures generally applied to these areas is below.

C.2.a. **Review of Management Structure and Processes, Including the Tone at the Top**

Procedures in this area are designed to focus on (a) how 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. To assess this area, the inspection team may interview members of the firm's leadership and review significant management reports and documents, as well as information regarding financial metrics and other processes that the firm uses to plan and evaluate its business.


Procedures in this area are 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 distinct from 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 may interview members of the firm's management and review documentation related to certain of these topics. In addition, the inspection team's evaluation may include the results of interviews of audit partners regarding their responsibilities and allocation of time. In addition, the inspection team may review a sample of partners' personnel files.

The inspection team may consider the firm's documented policies and procedures in this area. In addition, the inspection team may select 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 issuer audit engagements and (b) observe whether the audit procedures were responsive to the risks identified during the process.


The inspection team may review the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the firm's U.S. issuer audits, review available information relating to the most recent foreign affiliated firms' internal inspections, interview members of the firm's leadership, and review 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 may also review certain of the audit work performed by the firm's foreign affiliates on the foreign operations of the firm's U.S. issuer audits.


C.2.e.i. Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area are 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 may interview members of the firm's management and review documents regarding how the firm identifies, evaluates, and
responds to possible indicators of deficiencies in audit performance. In addition, the
inspection team may review documents related to the design, operation, and evaluation
of findings of the firm’s internal inspection program, and may compare the results of its
review of audit work to those from the internal inspection’s review of the same audit
work.

C.2.e.ii. Review of Response to Defects or Potential Defects in
Quality Control

The inspection team may review steps the firm has taken to address possible
quality control deficiencies and assess the design and effectiveness of the related
processes. In addition, the inspection team may inspect audits of issuers whose audits
had been reviewed during previous PCAOB inspections of the firm to ascertain whether
the audit procedures in areas with previous deficiencies have improved.

C.2.e.iii. Review of Certain Other Policies and Procedures Related
to Monitoring Audit Quality

The inspection team may assess policies, procedures, and guidance related to aspects
of independence requirements and the firm’s consultation processes, as well as the
firm’s compliance with these requirements and processes. In addition, the inspection
team may review documents, including certain newly issued policies and procedures,
and interview firm management to consider the firm’s methods for developing audit
policies, procedures, and methodologies, including internal guidance and training
materials.

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

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.8/  

8/ The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In some cases, the result may be that none of a firm's response is made publicly available. 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.
May 2, 2014

Mr. Christopher D. Mandaleris  
Senior Deputy Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, DC  20006


Dear Mr. Mandaleris:

Deloitte & Touche LLP is pleased to submit this response to the draft Report on the 2013 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
APPENDIX D

AUDITING STANDARDS REFERENCED IN PART I

This appendix provides the text of the auditing standard paragraphs that are referenced in Part I.A of this report. Footnotes that are included in this Appendix are from the original auditing standards that are referenced. While this Appendix contains the specific portions of the relevant standards cited with respect to the deficiencies in Part I.A of this report, other portions of the standards (including those described in Part I.B of this report) may provide additional context, descriptions, related requirements, or explanations; the complete standards are available on the PCAOB’s website at http://pcaobus.org/STANDARDS/Pages/default.aspx.
### AS No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements

#### USING A TOP-DOWN APPROACH

<table>
<thead>
<tr>
<th>Selecting Controls to Test</th>
</tr>
</thead>
<tbody>
<tr>
<td>AS No. 5.39</td>
</tr>
<tr>
<td>The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion.</td>
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</table>

#### TESTING CONTROLS

<table>
<thead>
<tr>
<th>Testing Design Effectiveness</th>
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</thead>
<tbody>
<tr>
<td>AS No. 5.42</td>
</tr>
<tr>
<td>The auditor should test the design effectiveness of controls by determining whether the company's controls, if they are operated as prescribed by persons possessing the necessary authority and competence to perform the control effectively, satisfy the company's control objectives and can effectively prevent or detect errors or fraud that could result in material misstatements in the financial statements.</td>
</tr>
<tr>
<td>Note: A smaller, less complex company might achieve its control objectives in a different manner from a larger, more complex organization. For example, a smaller, less complex company might have fewer employees in the accounting function, limiting opportunities to segregate duties and leading the company to implement alternative controls to achieve its control objectives. In such circumstances, the auditor should evaluate whether those alternative controls are effective.</td>
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<table>
<thead>
<tr>
<th>Testing Operating Effectiveness</th>
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</thead>
<tbody>
<tr>
<td>AS No. 5.44</td>
</tr>
<tr>
<td>The auditor should test the operating effectiveness of a control by determining whether the control is operating as designed and whether the person performing the control possesses the necessary authority and competence to perform the control effectively.</td>
</tr>
<tr>
<td>Note: In some situations, particularly in smaller companies, a company might use a third party to provide assistance with certain financial reporting functions. When assessing the competence of personnel responsible for a company's financial reporting and associated controls, the auditor may take into account the combined competence of company personnel and other parties that assist with</td>
</tr>
<tr>
<td>functions related to financial reporting.</td>
</tr>
</tbody>
</table>
# AS No. 13, The Auditor’s Responses to the Risks of Material Misstatement

## Responses to Fraud Risks

| AS No. 13.13 | **Addressing Fraud Risks in the Audit of Financial Statements.** In the audit of financial statements, the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks. If the auditor selects certain controls intended to address the assessed fraud risks for testing in accordance with paragraphs 16-17 of this standard, the auditor should perform tests of those controls. | Issuer G |

## TESTING CONTROLS

### Testing Controls in an Audit of Financial Statements

| AS No. 13.16 | **Controls to be Tested.** If the auditor plans to assess control risk at less than the maximum by relying on controls, and the nature, timing, and extent of planned substantive procedures are based on that lower assessment, the auditor must obtain evidence that the controls selected for testing are designed effectively and operated effectively during the entire period of reliance. However, the auditor is not required to assess control risk at less than the maximum for all relevant assertions and, for a variety of reasons, the auditor may choose not to do so. | Issuers A, D, E, F, and K |

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**Footnote to AS No. 13.16**

12/ Reliance on controls that is supported by sufficient and appropriate audit evidence allows the auditor to assess control risk at less than the maximum, which results in a lower assessed risk of material misstatement. In turn, this allows the auditor to modify the nature, timing, and extent of planned substantive procedures.

| AS No. 13.18 | **Evidence about the Effectiveness of Controls in the Audit of Financial Statements.** In designing and performing tests of controls for the audit of financial statements, the evidence necessary to support the auditor's control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. The auditor should obtain more persuasive audit evidence from tests of controls the greater the reliance the auditor places on the effectiveness of a control. The auditor also should obtain more persuasive evidence about the effectiveness of controls for each relevant assertion for which the audit approach consists primarily of tests of controls, including situations in which substantive procedures alone cannot provide sufficient appropriate audit evidence. | Issuers A, D, E, F, and K |
### AS No. 13, *The Auditor's Responses to the Risks of Material Misstatement*

<table>
<thead>
<tr>
<th>SUBSTANTIVE PROCEDURES</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AS No. 13.37</td>
<td>As the assessed risk of material misstatement increases, the evidence from substantive procedures that the auditor should obtain also increases. The evidence provided by the auditor's substantive procedures depends upon the mix of the nature, timing, and extent of those procedures. Further, for an individual assertion, different combinations of the nature, timing, and extent of testing might provide sufficient appropriate evidence to respond to the assessed risk of material misstatement.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Timing of Substantive Procedures</th>
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<tbody>
<tr>
<td>AS No. 13.45</td>
<td>When substantive procedures are performed at an interim date, the auditor should cover the remaining period by performing substantive procedures, or substantive procedures combined with tests of controls, that provide a reasonable basis for extending the audit conclusions from the interim date to the period end. Such procedures should include (a) comparing relevant information about the account balance at the interim date with comparable information at the end of the period to identify amounts that appear unusual and investigating such amounts and (b) performing audit procedures to test the remaining period.</td>
</tr>
<tr>
<td>AS No. 14, Evaluating Audit Results</td>
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<tr>
<td>------------------------------------</td>
<td></td>
</tr>
<tr>
<td><strong>EVALUATING THE RESULTS OF THE AUDIT OF FINANCIAL STATEMENTS</strong></td>
<td></td>
</tr>
<tr>
<td>AS No. 14.3</td>
<td>In forming an opinion on whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework, the auditor should take into account all relevant audit evidence, regardless of whether it appears to corroborate or to contradict the assertions in the financial statements.</td>
</tr>
<tr>
<td><strong>Evaluating the Presentation of the Financial Statements, Including the Disclosures</strong></td>
<td></td>
</tr>
</tbody>
</table>
| AS No. 14.30 | The auditor must evaluate whether the financial statements are presented fairly, in all material respects, in conformity with the applicable financial reporting framework.  
Note: AU sec. 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, establishes requirements for evaluating the presentation of the financial statements. Auditing Standard No. 6, Evaluating Consistency of Financial Statements, establishes requirements regarding evaluating the consistency of the accounting principles used in financial statements.  
Note: The auditor should look to the requirements of the Securities and Exchange Commission for the company under audit with respect to the accounting principles applicable to that company. | Issuers A and G |
### AS No. 15, Audit Evidence

#### SUFFICIENT APPROPRIATE AUDIT EVIDENCE

<table>
<thead>
<tr>
<th>Using Information Produced by the Company</th>
<th></th>
</tr>
</thead>
</table>
| **AS No. 15.10** | When using information produced by the company as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to: 1

- Test the accuracy and completeness of the information, or test the controls over the accuracy and completeness of that information; and
- Evaluate whether the information is sufficiently precise and detailed for purposes of the audit. |

|  | Issuers A and M |

**Footnote to AS No. 15.10**

9/ When using the work of a specialist engaged or employed by management, see AU sec. 336, *Using the Work of a Specialist*. When using information produced by a service organization or a service auditor's report as audit evidence, see AU sec. 324, *Service Organizations*, and for integrated audits, see Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*.

#### SELECTING ITEMS FOR TESTING TO OBTAIN AUDIT EVIDENCE

<table>
<thead>
<tr>
<th>Selecting Specific Items</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AS No. 15.27</strong></td>
<td>The application of audit procedures to items that are selected as described in paragraphs 25-26 of this standard does not constitute audit sampling, and the results of those audit procedures cannot be projected to the entire population. 12/</td>
</tr>
</tbody>
</table>

|  | Issuer G |

**Footnote to AS No. 15.27**

12/ If misstatements are identified in the selected items, see paragraphs 12-13 and paragraphs 17-19 of Auditing Standard No. 14.
**AU 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements**

<table>
<thead>
<tr>
<th>EVALUATING AND TESTING THE EFFECTIVENESS OF INTERNAL AUDITORS’ WORK</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AU 322.24</strong></td>
<td>The auditor should perform procedures to evaluate the quality and effectiveness of the internal auditors' work, as described in paragraphs .12 through .17, that significantly affects the nature, timing, and extent of the auditor's procedures. The nature and extent of the procedures the auditor should perform when making this evaluation are a matter of judgment depending on the extent of the effect of the internal auditors' work on the auditor's procedures for significant account balances or classes of transactions.</td>
</tr>
<tr>
<td><strong>Issuers K and L</strong></td>
<td></td>
</tr>
</tbody>
</table>
| **AU 322.25** | In developing the evaluation procedures, the auditor should consider such factors as whether the internal auditors'—  
  • Scope of work is appropriate to meet the objectives.  
  • Audit programs are adequate.  
  • Working papers adequately document work performed, including evidence of supervision and review.  
  • Conclusions are appropriate in the circumstances.  
  • Reports are consistent with the results of the work performed. |
| **Issuers K and L** |  |
### AU 328, Auditing Fair Value Measurements and Disclosures

<table>
<thead>
<tr>
<th>UNDERSTANDING THE ENTITY'S PROCESS FOR DETERMINING FAIR VALUE MEASUREMENTS AND DISCLOSURES AND THE RELEVANT CONTROLS, AND ASSESSING RISK</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AU 328.12</td>
<td>When obtaining an understanding of the entity's process for determining fair value measurements and disclosures, the auditor considers, for example:</td>
</tr>
</tbody>
</table>

- Controls over the process used to determine fair value measurements, including, for example, controls over data and the segregation of duties between those committing the entity to the underlying transactions and those responsible for undertaking the valuations.

- The expertise and experience of those persons determining the fair value measurements.

- The role that information technology has in the process.

- The types of accounts or transactions requiring fair value measurements or disclosures (for example, whether the accounts arise from the recording of routine and recurring transactions or whether they arise from nonroutine or unusual transactions).

- The extent to which the entity's process relies on a service organization to provide fair value measurements or the data that supports the measurement. When an entity uses a service organization, the auditor considers the requirements of section 324, Service Organizations, as amended.

- The extent to which the entity engages or employs specialists in determining fair value measurements and disclosures. |

Issuer E
### AU 328, Auditing Fair Value Measurements and Disclosures

- The significant management assumptions used in determining fair value.
- The documentation supporting management's assumptions.
- The process used to develop and apply management assumptions, including whether management used available market information to develop the assumptions.
- The process used to monitor changes in management's assumptions.
- The integrity of change controls and security procedures for valuation models and relevant information systems, including approval processes.
- The controls over the consistency, timeliness, and reliability of the data used in valuation models.

### TESTING THE ENTITY'S FAIR VALUE MEASUREMENTS AND DISCLOSURES

<table>
<thead>
<tr>
<th>Testing Management's Significant Assumptions, the Valuation Model, and the Underlying Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>AU 328.26</td>
</tr>
<tr>
<td>The auditor's understanding of the reliability of the process used by management to determine fair value is an important element in support of the resulting amounts and therefore affects the nature, timing, and extent of audit procedures. When testing the entity's fair value measurements and disclosures, the auditor evaluates whether:</td>
</tr>
<tr>
<td>(a) Management's assumptions are reasonable and reflect, or are not inconsistent with, market information (see paragraph .06).</td>
</tr>
<tr>
<td>(b) The fair value measurement was determined using an appropriate model, if applicable.</td>
</tr>
<tr>
<td>(c) Management used relevant information that was reasonably available at the time.</td>
</tr>
</tbody>
</table>

Issuers B, C, D, and E

| AU 328.28                                                                                     |
| Where applicable, the auditor should evaluate |

Issuers B, C,
### AU 328, Auditing Fair Value Measurements and Disclosures

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Text</th>
</tr>
</thead>
<tbody>
<tr>
<td>AU 328.31</td>
<td>Assumptions ordinarily are supported by differing types of evidence from internal and external sources that provide objective support for the assumptions used. The auditor evaluates the source and reliability of evidence supporting management’s assumptions, including consideration of the assumptions in light of historical and market information. Issuer C</td>
</tr>
<tr>
<td>AU 328.36</td>
<td>To be reasonable, the assumptions on which the fair value measurements are based (for example, the discount rate used in calculating the present value of future cash flows), individually and taken as a whole, need to be realistic and consistent with:</td>
</tr>
<tr>
<td></td>
<td>a. The general economic environment, the economic environment of the specific industry, and the entity's economic circumstances;</td>
</tr>
<tr>
<td></td>
<td>b. Existing market information;</td>
</tr>
<tr>
<td></td>
<td>c. The plans of the entity, including what management expects will be the outcome of specific objectives and strategies;</td>
</tr>
<tr>
<td></td>
<td>d. Assumptions made in prior periods, if appropriate;</td>
</tr>
<tr>
<td></td>
<td>e. Past experience of, or previous conditions experienced by, the entity to the extent currently applicable;</td>
</tr>
<tr>
<td></td>
<td>f. Other matters relating to the financial statements, for example, assumptions used by management in accounting estimates for financial statement accounts other than those relating to fair value measurements and disclosures; and</td>
</tr>
<tr>
<td></td>
<td>g. The risk associated with cash flows, if applicable, including the potential variability in the amount and timing of the cash flows and the related effect on the discount rate.</td>
</tr>
<tr>
<td></td>
<td>Where assumptions are reflective of management's intent and ability to carry out specific courses of action, the auditor considers whether they are consistent with the entity's plans and past experience. Issuers B, C, D, and E</td>
</tr>
</tbody>
</table>

**Footnote to AU 328.36**
### AU 328, Auditing Fair Value Measurements and Disclosures

The auditor also should consider requirements of GAAP that may influence the selection of assumptions (see FASB Concepts Statement No. 7).

<table>
<thead>
<tr>
<th>AU 328.38</th>
<th>For items valued by the entity using a valuation model, the auditor does not function as an appraiser and is not expected to substitute his or her judgment for that of the entity’s management. Rather, the auditor reviews the model and evaluates whether the assumptions used are reasonable and the model is appropriate considering the entity’s circumstances. For example, it may be inappropriate to use discounted cash flows for valuing an equity investment in a start-up enterprise if there are no current revenues on which to base the forecast of future earnings or cash flows.</th>
<th>Issuer B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing Independent Fair Value Estimates for Corroborative Purposes</td>
<td>The auditor may make an independent estimate of fair value (for example, by using an auditor-developed model) to corroborate the entity’s fair value measurement. When developing an independent estimate using management’s assumptions, the auditor evaluates those assumptions as discussed in paragraphs .28 to .37. Instead of using management’s assumptions, the auditor may develop his or her own assumptions to make a comparison with management’s fair value measurements. In that situation, the auditor nevertheless understands management’s assumptions. The auditor uses that understanding to ensure that his or her independent estimate takes into consideration all significant variables and to evaluate any significant difference from management’s estimate. The auditor also should test the data used to develop the fair value measurements and disclosures as discussed in paragraph .39.</td>
<td>Issuer B</td>
</tr>
</tbody>
</table>

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**Footnote to AU 328.40**

fn6 See section 329, Analytical Procedures.

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### EVALUATING THE RESULTS OF AUDIT PROCEDURES

| AU 328.47 | The auditor should evaluate the sufficiency and competence of the audit evidence obtained from auditing fair value measurements and disclosures as well as the consistency of that evidence with other audit evidence. | Issuer C |
obtained and evaluated during the audit. The auditor's evaluation of whether the fair value measurements and disclosures in the financial statements are in conformity with GAAP is performed in the context of the financial statements taken as a whole (see paragraphs 12 through 18 and 24 through 27 of Auditing Standard No. 14, *Evaluating Audit Results*).
### AU 329, Substantive Analytical Procedures

| AU 329.05 | Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations:
<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Financial information for comparable prior period(s) giving consideration to known changes</td>
</tr>
<tr>
<td>b.</td>
<td>Anticipated results—for example, budgets, or forecasts including extrapolations from interim or annual data</td>
</tr>
<tr>
<td>c.</td>
<td>Relationships among elements of financial information within the period</td>
</tr>
<tr>
<td>d.</td>
<td>Information regarding the industry in which the client operates—for example, gross margin information</td>
</tr>
<tr>
<td>e.</td>
<td>Relationships of financial information with relevant nonfinancial information</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>ANALYTICAL PROCEDURES USED AS SUBSTANTIATIVE TESTS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Availability and Reliability of Data</strong></td>
</tr>
<tr>
<td><strong>AU 329.16</strong> Before using the results obtained from substantive analytical procedures, the auditor should either test the design and operating effectiveness of controls over financial information used in the substantive analytical procedures or perform other procedures to support the completeness and accuracy of the underlying information. The auditor obtains assurance from analytical procedures based upon the consistency of the recorded amounts with expectations developed from data derived from other sources. The reliability of the data used to develop the expectations should be appropriate for the desired level of assurance from the analytical procedure. The auditor should assess the reliability of the data by considering the source of the data and the conditions under which it was gathered, as well as other knowledge the auditor may have about the data. The following factors influence the auditor's consideration of the reliability of data for</td>
</tr>
</tbody>
</table>


### AU 329, Substantive Analytical Procedures

<table>
<thead>
<tr>
<th><strong>purposes of achieving audit objectives:</strong></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Whether the data was obtained from independent sources outside the entity or from sources within the entity</td>
<td></td>
</tr>
<tr>
<td>• Whether sources within the entity were independent of those who are responsible for the amount being audited</td>
<td></td>
</tr>
<tr>
<td>• Whether the data was developed under a reliable system with adequate controls</td>
<td></td>
</tr>
<tr>
<td>• Whether the data was subjected to audit testing in the current or prior year</td>
<td></td>
</tr>
<tr>
<td>• Whether the expectations were developed using data from a variety of sources</td>
<td></td>
</tr>
</tbody>
</table>

### Precision of the Expectation

<table>
<thead>
<tr>
<th>AU 329.17</th>
<th>The expectation should be precise enough to provide the desired level of assurance that differences that may be potential material misstatements, individually or when aggregated with other misstatements, would be identified for the auditor to investigate (see paragraph 20). As expectations become more precise, the range of expected differences becomes narrower and, accordingly, the likelihood increases that significant differences from the expectations are due to misstatements. The precision of the expectation depends on, among other things, the auditor’s identification and consideration of factors that significantly affect the amount being audited and the level of detail of data used to develop the expectation.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuer O</td>
<td></td>
</tr>
</tbody>
</table>

### Investigation and Evaluation of Significant Differences

<table>
<thead>
<tr>
<th>AU 329.20</th>
<th>In planning the analytical procedures as a substantive test, the auditor should consider the amount of difference from the expectation that can be accepted without further investigation. This consideration is influenced primarily by materiality and should be consistent with the level of assurance desired from the procedures. Determination of this amount involves considering the possibility that a combination of misstatements in the specific account balances, or class of transactions, or other balances or classes could aggregate to an unacceptable amount.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuers A, E, and F</td>
<td></td>
</tr>
</tbody>
</table>
## AU 331, Inventories

<table>
<thead>
<tr>
<th>INVENTORIES</th>
<th></th>
<th>Issuer N</th>
</tr>
</thead>
<tbody>
<tr>
<td>AU 331.12</td>
<td>When the independent auditor has not satisfied himself as to inventories in the possession of the client through the procedures described in paragraphs .09 through .11, tests of the accounting records alone will not be sufficient for him to become satisfied as to quantities; it will always be necessary for the auditor to make, or observe, some physical counts of the inventory and apply appropriate tests of intervening transactions. This should be coupled with inspection of the records of any client's counts and procedures relating to the physical inventory on which the balance-sheet inventory is based.</td>
<td></td>
</tr>
</tbody>
</table>

## AU 342, Auditing Accounting Estimates

<table>
<thead>
<tr>
<th>EVALUATING ACCOUNTING ESTIMATES</th>
<th></th>
<th>Issuer D</th>
</tr>
</thead>
<tbody>
<tr>
<td>Evaluating Reasonableness</td>
<td>In evaluating the reasonableness of an estimate, the auditor normally concentrates on key factors and assumptions that are—</td>
<td></td>
</tr>
<tr>
<td>AU 342.09</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a. Significant to the accounting estimate.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. Sensitive to variations.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c. Deviations from historical patterns.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>d. Subjective and susceptible to misstatement and bias.</td>
<td></td>
</tr>
</tbody>
</table>

The auditor normally should consider the historical experience of the entity in making past estimates as well as the auditor's experience in the industry. However, changes in facts, circumstances, or entity's procedures may cause factors different from those considered in the past to become significant to the accounting estimate.
## AU 342, Auditing Accounting Estimates

### Footnote to AU 342.09

In addition to other evidential matter about the estimate, in certain instances, the auditor may wish to obtain written representation from management regarding the key factors and assumptions.

<table>
<thead>
<tr>
<th>AU 342.11</th>
<th>Review and test management’s process. In many situations, the auditor assesses the reasonableness of an accounting estimate by performing procedures to test the process used by management to make the estimate. The following are procedures the auditor may consider performing when using this approach:</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>Identify whether there are controls over the preparation of accounting estimates and supporting data that may be useful in the evaluation.</td>
</tr>
<tr>
<td>b.</td>
<td>Identify the sources of data and factors that management used in forming the assumptions, and consider whether such data and factors are relevant, reliable, and sufficient for the purpose based on information gathered in other audit tests.</td>
</tr>
<tr>
<td>c.</td>
<td>Consider whether there are additional key factors or alternative assumptions about the factors.</td>
</tr>
<tr>
<td>d.</td>
<td>Evaluate whether the assumptions are consistent with each other, the supporting data, relevant historical data, and industry data.</td>
</tr>
<tr>
<td>e.</td>
<td>Analyze historical data used in developing the assumptions to assess whether the data is comparable and consistent with data of the period under audit, and consider whether such data is sufficiently reliable for the purpose.</td>
</tr>
<tr>
<td>f.</td>
<td>Consider whether changes in the business or industry may cause other factors to become significant to the assumptions.</td>
</tr>
<tr>
<td>g.</td>
<td>Review available documentation of the assumptions used in developing the accounting estimates and inquire about any other plans, goals, and objectives of the entity, as well as consider their relationship to the assumptions.</td>
</tr>
<tr>
<td>h.</td>
<td>Consider using the work of a specialist regarding certain assumptions (section 336, Using the Work of a Specialist).</td>
</tr>
<tr>
<td>i.</td>
<td>Test the calculations used by management to translate the assumptions and key factors into the accounting estimate.</td>
</tr>
</tbody>
</table>

| Issuers | D, G, and M |
AU 350, Audit Sampling

**SAMPLING IN SUBSTANTIVE TESTS OF DETAILS**

<table>
<thead>
<tr>
<th>Planning Samples</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>AU 350.19</td>
<td>The second standard of field work states, &quot;A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed.&quot; After assessing and considering the levels of inherent and control risks, the auditor performs substantive tests to restrict detection risk to an acceptable level. As the assessed levels of inherent risk, control risk, and detection risk for other substantive procedures directed toward the same specific audit objective decreases, the auditor's allowable risk of incorrect acceptance for the substantive tests of details increases and, thus, the smaller the required sample size for the substantive tests of details. For example, if inherent and control risks are assessed at the maximum, and no other substantive tests directed toward the same specific audit objectives are performed, the auditor should allow for a low risk of incorrect acceptance for the substantive tests of details. Thus, the auditor would select a larger sample size for the tests of details than if he allowed a higher risk of incorrect acceptance.</td>
</tr>
</tbody>
</table>

Footnote to AU 350.19

Some auditors prefer to think of risk levels in quantitative terms. For example, in the circumstances described, an auditor might think in terms of a 5 percent risk of incorrect acceptance for the substantive test of details. Risk levels used in sampling applications in other fields are not necessarily relevant in determining appropriate levels for applications in auditing because an audit includes many interrelated tests and sources of evidence.

AU 350.23  

To determine the number of items to be selected in a sample for a particular substantive test of details, the auditor should take into account tolerable misstatement for the population; the allowable risk of incorrect acceptance (based on the assessments of inherent risk, control risk, and the detection risk related to the substantive analytical procedures or other relevant substantive tests); and the characteristics of the population, including the expected size and frequency of misstatements. | Issuers A, D, E, and F |