

6 March 2019

Rachel Reeves MP
Chair, Business, Energy and Industrial Strategy Select Committee
House of Commons
Westminster
London
SW1A 0AA

Dear Ms Reeves,

Future of audit inquiry: additional responses

Thank you for your letter of 13 February 2019 clarifying the additional points on which you are seeking input as part of your Committee's inquiry into the future of audit.

Ethics and culture go to the heart of our business. We are committed to adhering to professional standards, implementing strong controls and compliance and instilling values and behaviours in our people to meet our obligations in respect of objectivity, independence, rigour and serving the public interest.

Alongside this, audit quality is of critical importance to our firm. We invest considerably in ensuring that we have the right people, processes, technology and global consistency in place to support this.

Hopefully this is reflected in the responses to your questions below. These are areas where we continually set high standards but also strive to continuously improve.

Yours sincerely



David Sproul
Deloitte LLP

- 1. For each of the last five years, what percentage of your FTSE 350 audits cost significantly more (>10%) than originally budgeted. Of those that did cost more:**
 - **How many did you take up with the audit committee?**
 - **Of these, how many did you successfully renegotiate the fees for?**

For the purpose of this exercise, an overrun has been defined as an increase in work required that could not have been known about at the planning phase. As such, it will include scope increases caused by accounting or auditing issues identified during the audit and overruns due to, for example, delays in the provision of information by the company.

The figures (which have been collated manually and retrospectively on a sample of our FTSE350 audits) showed that:

- 50% of audits had overruns of more than 10% of the original budget
- Of the 50% that did cost more, 80% resulted in an additional payment (24% receiving payment for the overrun in full and 56% receiving payment in part). 20% of audits did not result in an additional payment.
- We do not have data on whether overruns were specifically raised with the audit committee or not.

- 2. How much did you spend overall on FTSE350 client hospitality and entertainment provided to audit clients and how many such events were held, in each of the last five financial years?**

There are rigorous regulatory standards in relation to hospitality spending and we have stringent internal controls, especially for companies we audit. Across Deloitte as a whole, there has been a significant reduction in overall spend on hospitality since 2016, with the total falling by nearly 50%.

The Financial Reporting Council's (FRC) Revised Ethical Standard 2016¹ restricts the offer or receipt of gifts or entertainment to and from 'restricted entities,' which includes companies where we provide audit and public interest assurance.

In line with these requirements, we impose a limit of £150 (including VAT) on entertainment to or from a restricted entity, or an individual connected to a restricted entity. This is a limit per head for any one instance of entertainment (for example, a dinner). We would note that hospitality spending typically includes the costs of providing refreshments during meetings.

If there is more than one instance of entertainment during a year, audit partners are required to consider the frequency and value of entertainment and whether this may be perceived to impair independence. Entertainment spending is also required to be documented in audit work papers.

Where key decision makers are present, we prohibit all offering or receiving of entertainment and hospitality during formal or informal bidding processes, contract renewals or fee negotiations.

All requests are also assessed by the Financial Crime and Ethics Team and the relevant audit engagement partner, who is responsible for considering the frequency of entertainment and whether this may create, or be perceived to create, close personal relationships with a third party.

Across the firm, all partners and staff are required to obtain pre-approval from our Financial Crime and Ethics team before offering or accepting any non-trivial gifts, entertainment or hospitality to or from any third party of the firm. We define non-trivial as exceeding £50.

Compliance with our entertainment and hospitality policies is monitored, the firm's Ethics Partner regularly reviews these to ensure they reflect best practice and breaches are logged in line with our independence guidelines.

As discussed with the Committee, we can provide data for both 2017 and 2018.

Our records show that in 2017 an average of £1,352 was spent on hospitality for each FTSE 350 company that we audited (a total of £120,321), and an average of £1,106 spent in 2018 (a total of £96,179).

Our systems record each individual entertainment expenditure rather than the number of events where hospitality spending was incurred, so it is not possible to provide an overview of the total number of hospitality events.

¹ [FRC Revised Ethical Standard 2016](#) (p.76)

3. How much did you spend on FTSE 350 client hospitality and entertainment provided to non-audit clients, who subsequently became audit clients, in each of the last five financial years?

Over 2017 and 2018, £120,368 was spent on hospitality involving FTSE 350 companies we were subsequently appointed as auditor to (an average of £2,561 per company).

4. For each new FTSE 350 audit client taken on over the last five years, how many hospitality and entertainment events did you invite them to before they became a client?

As above, our systems record each individual entertainment expenditure rather than the number of events where hospitality spending was incurred, so it is not possible to provide an overview of the total number of hospitality events.

5. What targets are senior audit managers set in order to progress to audit partner level? Can you provide progression letters and appraisals which illustrate the targets used and how they are assessed?

Senior audit managers progress to director and then to partner. We adopt a similar set of principles in assessing progression from senior manager to director as we do from director to partner.

We have a standard partner model to assess all candidates for entry to the partnership. Quality, ethics, integrity and candour are non-negotiables for candidates and all candidates must demonstrate their commitment to these principles and track record in demonstrating them. They are also evaluated on people leadership, collaboration, innovation and market eminence.

Specifically within the audit function of Deloitte, candidates are assessed by colleagues and senior audit leaders on four key factors: audit quality, client portfolio, audit transformation and leadership. This 'scorecard' is then evaluated by an independent partner from outside the candidate's business area. The selling of other services to the companies that we audit is not a factor in promotion decisions.

Following the initial assessment process within the Audit function, successful candidates enter the firm wide partner selection process. This requires the submission of a portfolio of evidence, which is structured around the partner model. Each candidate's case is subject to rigorous due diligence by a member of the Partnership Committee (a group of senior and experienced partners from across the firm) who determine the candidate's case before being presented to the full Committee. Those who are successful are then presented to the Firm's Executive and the NWE Board for approval.

6. Can you tell me how audit staff remuneration and progression is affected by audit quality issues and can you provide examples, such as appraisal forms, of how this is captured for each audit staff group (e.g. audit partners and audit managers)

Audit quality is an integral pillar in our promotion and remuneration decisions and we create an environment where high quality is valued, measured and rewarded.

As set out above the four main pillars against which audit partners and staff are assessed are team leadership, audit quality, audit transformation and business development.

Each audit partner and member of staff at manager level and above receives an annual audit quality dashboard recording audit quality metrics including:

- Results of internal and external audit reviews
- Individuals' contributions to audit quality
- The findings of Corporate Reporting Reviews
- Documentation and audit compliance
- Updating personal independence checks
- Timely archiving of audit engagement files
- Completion of essential professional training

For partners and signing directors, certain metrics, such as the results of quality inspections of their audit engagements, are given an increased weighting in formulating an overall audit quality performance score and graphic, together with an indication of movement from the previous year.

Audit partners and signing directors also receive an audit responsibility rating, reflecting the level of risk, complexity and public scrutiny of their audit engagements.

Partners and staff are not evaluated or remunerated on the selling of other services to the entities they audit.

Both the audit quality dashboard and, where relevant, the audit responsibility rating, are key inputs into the appraisal and remuneration process for all staff at manager level and above. Both are also used by our Audit Quality Remuneration Committee, comprising senior audit partners, in independently challenging the audit quality contribution of each audit partner.

The Committee's recommendations are used by the Audit & Assurance Executive to make final decisions on audit partner reward and promotion, which are then reviewed by the firm's Executive.

As well as recommending rewards for long-term positive contributions to audit quality, the Committee can also penalise partners with quality issues. These include, in the event of a single audit quality issue, one-off financial penalties, monitoring of the partner's work and mandatory learning and improvement activities. In the rare event of persistent quality failings, penalties – in addition to remuneration changes and restriction of the activities the partner is permitted to engage in – can include removal from public interest entity audits, an outright ban on conducting further audits or leaving the firm.

In December 2018 we also launched a separate bonus scheme, specifically focused on audit quality, to recognise and reward staff at all grades for their contributions to audit quality, including where they uphold professional standards and act in the public interest, develop innovative solutions and build or develop the skills and knowledge of colleagues.

7. Can you confirm that you will be collating and publishing your pay ratios and pay quartiles in respect of gender and BAME next year, and, if you already have this information, can you provide me with this?

Yes.

Deloitte was one of the first companies to publish our gender pay gap in 2015 and reported under the Government's regulations for a second year in September 2018. We have also voluntarily reported our gender 'total earnings gap' to include all equity partner earnings.

We voluntarily reported our ethnicity pay gap in 2017 and have recently reported this again, including an additional ethnicity 'total earnings gap' report. In addition, our Managing Partner for Talent, Emma Codd, has spoken in the media about the importance of mandatory ethnicity pay gap reporting and we contributed to the recent BEIS consultation on this.

We believe that transparency on both the gender and ethnicity pay gaps, as well as the factors driving the divides, are critical to addressing the pay gap. Such reporting shines a light on where organisations stand and what they are doing to change things.

For its 2018 statutory report, Deloitte's mean gender pay gap is 18.1% (18.2% in 2017) and the median pay gap is 16.1% (15.3% in 2017). The firm's median bonus gap is 37.5% (39.1% in 2017) and its mean bonus gap is 52.3% (50.9% in 2017).

Going further than the government regulations, we have also published an equity partner earnings gap and total earnings gap, the latter taking into account earnings for the whole firm (thus, including Equity Partners). The mean total earnings gap has reduced to 41.1% (from 43.2%) and median total earnings gap has reduced to 14.0% (from 15.2%). Further details of our gender pay data are available online [here](#).

In 2018, the median hourly pay gap for Deloitte UK's Black, Asian and Minority Ethnic (BAME) employees stands at 7.9% (it was 6.9% in 2017) and its mean ethnicity pay gap at 12.9% (11.7% in 2017). The firm's median bonus gap for BAME employees is 25% (30.0% in 2017) and its mean ethnicity bonus gap 45% (40.8% in 2017). Further details of the methodology used and contributing factors is available online [here](#).

8. Do your internal reviews of audits change audit outcomes and can you provide examples?

Yes. We have seven principal internal reviews. Appendix A sets out the people and processes involved in each and outlines how they have a positive impact on audit outcomes.

These reviews provide vital challenge and support at various stages of the audit process, ensuring that our audits are executed consistently and of high quality.

9. Please list the technology you share with your network's member firms in other countries.

We have a suite of 24 critical technology services that are central to performing an audit in a consistent and robust manner. These drive quality throughout our audit process, supporting the work performed by our people and guiding them through our global audit methodology.

As a global firm, the majority of our systems are shared between member firms, developed and supported by a central DTTL global team. These enable all member firms to audit our global and international group entities consistently and effectively.

Our global audit business has embarked on a multi-year transformation programme (covering people, process and technology) which will further globalise and standardise our suite of technology.

For reasons of confidentiality we are unable to supply a full list of our technology systems but can broadly say that:

- These include systems to document and archive work, provide technical information, conduct data analysis, analyse financial transactions and financial statements.
- 19 of these are shared across different Deloitte member firms and the intellectual property rights of 14 of these systems are retained by DTTL, with four retained in the UK and one retained in the Netherlands.
- A further five systems are used only in the UK, with the IP rights of these hosted in the UK.

The UK audit business also makes use of technology services shared by the wider UK business. These include platforms for managing restrictions on client work, recording client engagements and take-on procedures, invoicing, HR and marketing. There are eight business-wide suites of systems of this nature (some of which have more than 50 applications within them) and the IP rights of five of these reside in the UK, two reside with DTTL and one is shared between DTTL and the UK.