PCAOB
Public Company Accounting Oversight Board

1666 K Street NW
Washington, DC 20006
Office: (202) 207-9100
Fax: (202) 862-8430
www.pcaobus.org

ORDER INSTITUTING DISCIPLINARY PROCEEDINGS, MAKING FINDINGS AND IMPOSING SANCTIONS

In the Matter of Deloitte & Touche LLP,

Respondent.

PCAOB Release No. 105-2018-008

May 23, 2018

By this Order, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") is censuring Deloitte & Touche LLP ("Deloitte" or "Respondent" or "Firm"), a registered public accounting firm, and imposing on Deloitte a civil money penalty in the amount of $500,000. The Board is imposing these sanctions on the basis of its findings that Deloitte violated PCAOB rules and standards in connection with its integrated audits of Jack Henry & Associates, Inc. ("Jack Henry" or "Company") for the fiscal years ("FY") ended June 30, 2014, 2013, and 2012.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted against Respondent pursuant to Section 105(c) of the Sarbanes-Oxley Act of 2002, as amended (the "Act"), and PCAOB Rule 5200(a)(1).

II.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent has submitted an Offer of Settlement ("Offer") that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to entry of this Order Instituting Disciplinary Proceedings, Making Findings and Imposing Sanctions ("Order") as set forth below.[1]

[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other persons or entities in this or any other proceeding.

ORDER

III.

On the basis of Respondent's Offer, the Board finds that:

A. Respondent

1. Deloitte & Touche LLP, a Delaware limited liability partnership with headquarters in New York, New York, registered with the Board on October 20, 2003. The Firm is licensed to practice public accounting in multiple jurisdictions, including Missouri (License No. C1071F). Deloitte served as Jack Henry's independent auditor from May 1997 to December 2015. Originally based in the Firm's St. Louis, Missouri office, the Jack Henry engagement was transferred to Deloitte's Kansas City, Missouri office in 2010.

B. Issuer

2. Jack Henry & Associates, Inc. is a Delaware corporation with headquarters in Monett, Missouri. Jack Henry provides integrated computer systems, software, transaction processing, business process automation, and other products and services for banks, credit unions, and other financial institutions. The Company's common stock is registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 and is listed on NASDAQ under the symbol "JKHY." Jack Henry is an issuer within the meaning of Section 2(a)(7) of the Act and PCAOB Rule 1001(i)(iii).

C. Summary

3. This case is about Deloitte's failures in auditing Jack Henry's recognition of software license revenue from multiple-element software arrangements. In each of the FY14, FY13, and FY12 audits, Deloitte's engagement teams specifically identified risks of material misstatement (including fraud risks) concerning software license revenue. Due to its high gross profit margins, software license revenue could have had a material impact on Jack Henry's reported net income and earnings per share, even though it represented about five percent of the Company's total revenue.

4. Deloitte's engagement teams planned and performed audit procedures intended to address the significant risks associated with software license revenue. As executed, however, those procedures did not adequately address certain of the identified and assessed risks of material misstatement. As a result, the engagement teams failed to, among other things, obtain sufficient appropriate evidence to support the Firm's unqualified opinions on Jack Henry's financial statements and management's assessments of the effectiveness of internal control over financial reporting ("ICFR") in

the FY14, FY13, and FY12 audits. The engagement teams also failed to exercise the requisite due professional care and professional skepticism in those audits.

5. The audit deficiencies described in this Order came to light after Deloitte received notice from the PCAOB that the Jack Henry FY14 audit would be reviewed during the Board's 2015 annual inspection of the Firm. After getting the notice, the then engagement partner asked another Deloitte partner, who had more auditing experience in the software industry, to review certain FY14 revenue work papers to help anticipate questions that might be asked during the PCAOB inspection. That partner's review raised questions about the Company's accounting for software license revenue, which led Deloitte to examine the Company's accounting and the audit more closely. As a result, the Firm identified a number of audit and accounting issues concerning Jack Henry's recognition of software license revenue. Deloitte promptly reported those issues (which are the subjects of paragraphs 29-37 below) to the PCAOB inspection team before the inspection field work began.

6. After the audit and accounting issues were identified, Deloitte performed remedial audit procedures that ultimately led to Jack Henry restating its FY14, FY13, and FY12 financial statements in June 2015. As the Company disclosed, the restatement corrected historical errors concerning its accounting for multiple-element software arrangements. Due to those errors, Jack Henry had recognized software license revenue before it was allowed to under the then-applicable U.S. generally accepted accounting principles ("GAAP").

7. Various factors contributed to the deficiencies in the FY14, FY13, and FY12 Jack Henry audits, but it was the Firm's actions and inactions—beyond those of its engagement personnel—that make it primarily responsible for the violations of PCAOB standards described in this Order. Deloitte did not include as part of the Jack Henry engagement teams an auditor who possessed sufficient industry-specific experience and knowledge (including of the relevant GAAP) to properly evaluate and audit the Company's accounting for software license revenue. In addition, although this Order concerns Deloitte's FY14, FY13, and FY12 Jack Henry audits, the Firm failed to appropriately act on two earlier opportunities to identify and correct some of the same audit deficiencies described in this Order.

D. <u>Background</u>

Relevant Aspects of Jack Henry's Software Business

8. At all relevant times, Jack Henry disclosed that it was a leading provider of technology solutions and payment processing services for financial institutions. The majority of its revenue was derived from recurring transaction processing fees,

outsourcing fees, and support and service fees. The Company also sold software licenses for several, functionally-distinct core processing systems and more than 100 complementary software products and services to purchasers of its core systems.

9. Jack Henry's customers could opt for in-house installation of the Company's software or they could outsource their transaction and information processing to Jack Henry using Company-hosted systems. The Company's software license revenue came from customers who entered into software license agreements for in-house installations. In-house installation customers licensed Jack Henry's proprietary software based on initial license fees. Many in-house customers also contracted for annual software maintenance and support services (known as "postcontract customer support" or "PCS"). They also often purchased implementation services ("implementation") in connection with their systems. A complete core system implementation typically included detailed planning, project management, data conversion, and testing by Jack Henry personnel.

Recognizing Revenue from Multiple-Element Software Arrangements

10. Jack Henry's software license agreements often included multiple licensed software products whose deliveries were staggered, sometimes over the course of a year or more. In most instances, the Company bundled the software with related implementation and PCS, and delivered the software before other elements. At all relevant times, Jack Henry purported to account for these multiple-element software arrangements in accordance with FASB Accounting Standards Codification ("ASC") 985-605, *Software—Revenue Recognition*, which provided authoritative guidance on the timing and amount of revenue recognized in connection with such arrangements.[2]

11. Under ASC 985-605, Jack Henry was required to allocate the total arrangement fee to all elements based on "vendor-specific objective evidence of fair value"[3] (or "VSOE"), regardless of how those elements were separately priced in

2 ASC 985-605 codified Statement of Position 97-2, *Software Revenue Recognition*, which was released in October 1997. Effective for public company annual reporting periods beginning after December 15, 2017, ASC 985-605 was superseded by ASC 606, *Revenue from Contracts with Customers*.

3 Under ASC 985-605-25-6, vendor-specific objective evidence of fair value was limited to: (a) the price charged when the same element was sold separately, or (b) for an element that was not yet being sold separately, the price established by management, provided it was probable that the price, once established, would not change before the separate introduction of the element into the marketplace.

customer contracts. Subject to certain exceptions, if Jack Henry was unable to establish VSOE for all elements of an arrangement (i.e., all software licenses, implementations, initial PCS terms, and other products and services sold in the arrangement), ASC 985-605 required the Company to defer all revenue from the arrangement until all elements had been delivered.

12. ASC 985-605 provided an exception to revenue deferral when a seller could establish VSOE for all undelivered elements in an arrangement, but could not establish VSOE for one or more delivered elements. Under this exception—known as the residual method—the total arrangement fee was first allocated to the undelivered elements based on those elements' VSOE, and the remainder of the fee, if any, was allocated to the delivered elements for which no VSOE existed.[4] The revenue allocated to the delivered elements was recognized upon delivery (i.e., up-front) while the revenue allocated to the undelivered elements was deferred.

13. At all relevant times, Jack Henry asserted that it had established and maintained (a) VSOE for implementation services based on the pricing used when those services were sold separately, and (b) VSOE for PCS based on stated contractual renewal rates. The Company further asserted that it used the residual method to recognize revenue from software licenses (which lacked VSOE) when the software was delivered to customers in advance of implementation and PCS; revenue from the undelivered implementation and PCS elements was deferred.

14. Under ASC 985-605, Jack Henry had to satisfy several preconditions to properly recognize software license revenue up-front using the residual method. Those preconditions required Jack Henry to, among other things: (a) properly define the arrangement; (b) properly identify all deliverables (i.e., elements) in the arrangement; (c) properly establish and maintain VSOE for all undelivered elements (including implementation and PCS); and (d) properly allocate the total arrangement fee to all deliverables based on the VSOE of the undelivered elements.

Jack Henry Restated its FY14, FY13, and FY12 Financial Statements Due to Errors in its Accounting for Multiple-Element Software Arrangements

15. In June 2015, Jack Henry restated its FY14, FY13, and FY12 consolidated financial statements. In connection with the restatement, the Company disclosed that management had "identified historical accounting errors relating to its accounting for

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[4] See ASC 985-605-25-10e.

ORDER

certain software license, maintenance [i.e., PCS] and service agreements."[5] The prior period errors primarily related to the Company's accounting for multiple-element software arrangements.[6]

16. The errors, which caused Jack Henry to prematurely recognize software license revenue, largely concerned the Company's failures to satisfy one or more of the preconditions noted above regarding use of the residual method.[7] For instance, in FY14, FY13, FY12, and earlier years, Jack Henry failed to properly define its multiple-element arrangements and identify all deliverables (i.e., elements) in those arrangements.

17. To use an example, in accounting for a software license agreement that sold four software products (e.g., a core system and three complementary products) delivered at different times, Jack Henry erroneously treated that contract as containing four separate arrangements (each comprised of a software product with related implementation and PCS), and improperly recognized license revenue each time a software product was delivered.[8] Under ASC 985-605, that contract should have been accounted for as a single arrangement containing multiple software licenses and other deliverables. Even if the Company had established VSOE for all other deliverables

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5 See Jack Henry Form 10-K/A (June 25, 2015), at 49.

6 Due to the errors, previously reported revenue for FY14, FY13, and FY12 was overstated by $36.8 million (3 percent), $21.9 million (2 percent), and $9.4 million (1 percent), respectively. Previously reported net income for FY14, FY13, and FY12 was overstated by $14.4 million (7 percent), $9 million (5 percent), and $2.9 million (2 percent), respectively. Total previously reported deferred revenue (current and non-current) was understated by $171.8 million (54 percent), $135 million (44 percent), and $113.1 million (38 percent) as of June 30, 2014, 2013, and 2012, respectively.

7 See *Jack Henry & Associates, Inc.*, SEC Rel. No. 34-79650 (Dec. 21, 2016), at 3-5 (Jack Henry consented, without admitting or denying the findings except as to jurisdiction, to a cease-and-desist order that (1) found that it violated the reporting, books and records, and internal control provisions of the federal securities laws, namely Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Securities Exchange Act of 1934, and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, during FY14, FY13, and FY12; and (2) imposed a civil money penalty of $780,000).

8 See id. at 4.

(which it had not), no revenue should have been recognized on the contract until all licenses, for which no VSOE existed, were delivered.[9]

18. Also in FY14, FY13, FY12, and earlier years, Jack Henry erred in concluding that it had properly established and maintained VSOE for implementation and PCS. Because the Company could not establish VSOE for implementation and PCS, it should have deferred recognition of all revenue from multiple-element software arrangements until every element had been delivered or until the only undelivered element was PCS.[10]

E. Deloitte Violated PCAOB Rules and Standards in its Integrated Audits of Jack Henry for FY 2014, FY 2013, and FY 2012

19. In each of the FY14, FY13, and FY12 integrated audits of Jack Henry (collectively, the "Audits"), Deloitte performed an audit of management's assessment of the effectiveness of ICFR that was integrated with its audit of Jack Henry's financial statements. Deloitte issued audit reports expressing unqualified opinions on Jack Henry's financial statements and ICFR at the end of each Audit.

20. In planning the Audits, Deloitte's engagement teams identified and assessed a number of risks of material misstatement (including fraud risks) regarding Jack Henry's recognition of license revenue from multiple-element software arrangements. In performing the Audits, however, Deloitte violated PCAOB standards when its engagement teams failed to adequately execute their planned responses to those risks.

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[9] See id.

[10] If the only undelivered element was PCS, the entire arrangement fee should have been recognized ratably over the remaining initial PCS term. See, e.g., ASC 985-605-25-10a.

ORDER

21. PCAOB rules[11] require that a registered public accounting firm and its associated persons comply with the Board's auditing standards.[12] An auditor may express an unqualified opinion on an issuer's financial statements only when that opinion has been formed on the basis of an audit performed in accordance with PCAOB standards.[13] Among other things, PCAOB standards require auditors to design and implement audit responses that address the risks of material misstatement identified and assessed by the auditors.[14] They must also evaluate the results of the audit to determine whether the audit evidence obtained is sufficient and appropriate to support the opinion to be expressed in the auditor's report.[15] Moreover, PCAOB standards require auditors to exercise due professional care and professional skepticism in planning and performing financial statement and ICFR audits.[16] For the reasons set forth below, Deloitte failed to comply with these and other PCAOB auditing standards in connection with the audit procedures it performed concerning software license revenue and the reports it issued in the Audits.

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[11] All references to PCAOB rules and standards are to the versions of those rules and standards in effect at the time of the relevant audit. As of December 31, 2016, the PCAOB reorganized its auditing standards using a topical structure and a single, integrated numbering system. See *Reorganization of PCAOB Auditing Standards and Related Amendments to PCAOB Standards and Rules*, PCAOB Release No. 2015-002 (Mar. 31, 2015); see also *PCAOB Auditing Standards Reorganized and Pre-Reorganized Numbering* (Jan. 2017). The reorganization did not impose additional requirements on auditors or change substantively the requirements of PCAOB standards.

[12] See PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3200T, *Interim Auditing Standards*.

[13] See AU § 508.07, *Reports on Audited Financial Statements*.

[14] Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS 13"), ¶ 3.

[15] Auditing Standard No. 14, *Evaluating Audit Results*, ¶ 2; see also Auditing Standard No. 15, *Audit Evidence*, ¶ 3.

[16] See AU § 230, *Due Professional Care in the Performance of Work*; Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements* ("AS 5"), ¶ 4.

ORDER

Deloitte's Engagement Teams Identified Fraud Risks and Other Significant Risks of Material Misstatement Relating to Software License Revenue

22. Jack Henry's software license revenue was approximately $53 million in FY14 and $55 million in each of FY13 and FY12. In each of those years, software license revenue represented about five percent of Jack Henry's total revenue. Though relatively small compared to total revenue, Deloitte's engagement teams concluded in each Audit that license revenue was both quantitatively and qualitatively material to Jack Henry's financial statements. The engagement teams also identified software license revenue as a fraud risk based on, among other things, gross profit margins of about ninety percent.

23. Due to its high profitability, an overstatement of license revenue (whether by fraud or error) could have materially inflated the net income and earnings per share ("EPS") reported by Jack Henry. As Deloitte's engagement teams knew, Jack Henry's common stock was covered by multiple securities analysts, resulting in quarterly consensus estimates of the Company's EPS,[17] and management routinely discussed earnings guidance in quarterly calls with analysts.

24. In each Audit, the engagement teams also identified software license revenue as a "significant account," meaning there was "a reasonable possibility that the account…could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements…."[18] As to that account, Deloitte identified the occurrence and accuracy of license revenue as "relevant assertions," meaning those financial statement assertions had "a reasonable possibility of containing a misstatement or misstatements that would cause the financial statements to be materially misstated."[19]

25. Part of identifying significant accounts and their relevant assertions is determining the likely sources of potential misstatements that could cause the financial

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[17] For example, Jack Henry originally reported diluted EPS that met or exceeded consensus estimates for six of the eight quarters in FY14 and FY13. In four of those six quarters, the Company's 2015 restatement reduced diluted EPS below both the originally reported numbers and the consensus estimates.

[18] AS 5 ¶ A10; Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement* ("AS 12"), ¶ 59e.

[19] AS 5 ¶ A9; AS 12 ¶ 59e.

statements to be materially misstated.[20] In each Audit, Deloitte's engagement teams identified several risks of material misstatement ("RoMMs") concerning Jack Henry's use of the residual method to recognize software license revenue.

26. The RoMMs identified by the engagement teams largely related to risks that Jack Henry might fail to satisfy one or more of the preconditions identified in paragraph 14 above regarding use of the residual method. For example, the RoMMs included risks that Jack Henry management (a) might not appropriately define its arrangements and identify all deliverables (i.e., elements) in those arrangements; (b) might fail to establish or maintain VSOE for implementations; (c) might fail to establish or maintain VSOE for PCS; and (d) might fail to properly allocate revenue among the various elements in an arrangement on the basis of VSOE. In numerous cases, the engagement teams assessed these RoMMs as significant risks and/or fraud risks.[21]

Deloitte's Engagement Teams Failed to Respond Appropriately to the Risks of Material Misstatement Regarding Jack Henry's Software License Revenue

27. In designing and implementing appropriate responses to the RoMMs, the auditor's objective is "to address the risks of material misstatement through appropriate overall audit responses and audit procedures."[22] The auditor should design and implement overall responses to address the assessed RoMMs by, among other things, making appropriate assignments of significant engagement responsibilities to persons whose knowledge, skill, and ability are commensurate with the assessed risks of material misstatement.[23] In addition, PCAOB standards provide that "[a]uditors should be assigned to tasks…commensurate with their level of knowledge, skill, and ability so that

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20 See AS 5 ¶ 30; AS 12 ¶ 61.

21 A significant risk is "[a] risk of material misstatement that requires special audit consideration." AS 12 ¶ A5. In determining whether an identified and assessed risk is significant, "the auditor should evaluate whether the risk requires special audit consideration because of the nature of the risk or the likelihood and potential magnitude of misstatement related to the risk." Id. ¶ 70. Identified fraud risks are also significant risks. Id. ¶ 71 & note.

22 AS 13 ¶ 2.

23 See id. ¶ 5a.

they can evaluate the audit evidence they are examining."[24] In connection with the Audits, Deloitte violated these PCAOB standards when it did not include as part of the engagement teams an auditor who possessed sufficient industry-specific experience and knowledge (including of the relevant GAAP) to properly evaluate and audit the Company's accounting for software license revenue.

28. In addition to overall audit responses, auditors "should design and perform audit procedures in a manner that addresses the assessed risks of material misstatement for each relevant assertion of each significant account and disclosure."[25] Moreover, when addressing fraud risks in the audit of the financial statements, "the auditor should perform substantive procedures, including tests of details, that are specifically responsive to the assessed fraud risks."[26] In each Audit, Deloitte's engagement team planned and performed substantive procedures, including tests of details, intended to address the RoMMs they identified and assessed concerning Jack Henry's up-front recognition of software license revenue. For the reasons set forth below, however, those procedures failed to adequately address those risks.[27]

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[24] AU § 230.06*.*

[25] AS 13 ¶ 8.

[26] Id. ¶ 13. Auditors should also perform substantive procedures, including tests of details, that are specifically responsive to significant risks. See id. ¶ 11.

[27] Deloitte also failed to adequately address those risks in auditing management's assessment of the effectiveness of ICFR. The internal controls identified and tested by the engagement teams in FY14, FY13, and FY12 were not designed to adequately address the identified and assessed RoMMs concerning Jack Henry's software license revenue. As a result, Deloitte's engagement teams did not, as required by AS 5, obtain reasonable assurance about whether material weaknesses existed as of the dates of the Company's ICFR assessments. In its 2015 restatement, Jack Henry identified a material weakness based on ICFR deficiencies that included the Company's failure to design and implement appropriate controls concerning multiple-element software arrangements. See Jack Henry Form 10-K/A (June 25, 2015), at 26. Consequently, the Company concluded, and Deloitte revised its ICFR audit report to conclude, that Jack Henry did not maintain effective ICFR as of June 30, 2014.

Insufficient License Revenue Contract Testing

29. In each Audit, Deloitte's engagement team performed a test of details that included reviewing a sample of Jack Henry's software license agreements ("contract testing"). In performing the testing, engagement team members first selected a sample of software license revenue transactions from the Company's general ledger and commission sale logs, and then obtained contracts, invoices, payment support, and other evidence of the transactions. They also discussed each selected transaction with the appropriate implementation manager and others at Jack Henry.

30. By means of the contract testing in each Audit, Deloitte's engagement teams obtained audit evidence showing, among other things: (a) that Jack Henry's contracts often included multiple software products whose deliveries occurred at different times; (b) that Jack Henry treated such contracts as containing not one, but several, multiple-element arrangements, each comprised of a software product plus implementation and PCS; and (c) that Jack Henry separately recognized license revenue on delivery of each software product. As the Company disclosed in its 2015 restatement, that practice of separating software contracts into multiple arrangements did not comply with ASC 985-605, and caused Jack Henry to prematurely recognize license revenue. During the Audits, the engagement teams failed to recognize that the Company's practice was not compliant with GAAP. As a result, the contract testing failed to address a number of RoMMs, including the risk that the Company might fail to appropriately identify all deliverables in its multiple-element software arrangements.

Insufficient Testing of VSOE for PCS

31. Establishing and maintaining VSOE for PCS was a precondition to Jack Henry's up-front recognition of software license revenue using the residual method. At all relevant times, Jack Henry asserted that it had established VSOE for PCS based on stated renewal rates—i.e., rates that were fixed and stated in the Company's software license contracts.[28] But instead of using fixed and stated rates, the Company's agreements included, for example, renewal rates that were contingent on future events. Jack Henry concluded in its 2015 restatement that those renewal provisions did not provide a proper basis for establishing VSOE of PCS under ASC 985-605. It further

[28] See ASC 985-605-25-67 ("The fair value of the postcontract support shall be determined by reference to the price the customer will be required to pay when it is sold separately (that is, the renewal rate).").

concluded that its pricing for stand-alone sales of PCS was not sufficiently consistent to establish VSOE.[29]

32. The contract testing in each Audit was intended to address, among other things, the RoMM that Jack Henry might fail to properly establish VSOE for PCS by failing to include stated renewal rates in its software agreements. But the testing failed to address that RoMM because the engagement team members who reviewed PCS renewal provisions in the Company's software contracts did not appropriately evaluate whether those provisions qualified as stated renewal rates for purposes of establishing VSOE.

Insufficient Testing of VSOE for Implementations

33. Jack Henry's up-front recognition of software license revenue under the residual method was also preconditioned on its ability to establish and maintain VSOE for implementation services, which the Company asserted was based on pricing used when it sold those services separately. In their risk assessments during the Audits, Deloitte's engagement teams identified a RoMM that Jack Henry might fail to satisfy this precondition.

34. For implementation services sold in multiple-element arrangements, Jack Henry asserted that VSOE was based on the same standard hourly labor rate it used when selling those services on a stand-alone basis (i.e., when it sold implementation separately from software). VSOE for implementation services was an estimate of revenue arrived at by multiplying the standard hourly labor rate by the number of hours management anticipated would be needed to complete the services. The Company deferred the estimated implementation revenue when license revenue was recognized upon delivery of the corresponding software.

35. Jack Henry's estimates of labor hours, which were a key factor in determining VSOE for implementations, necessarily involved subjective factors that made them potentially susceptible to misstatement or bias.[30] For example, such

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[29] See Jack Henry Form 10-K/A (June 25, 2015), at 49.

[30] See, e.g., AU § 342.04, *Auditing Accounting Estimates* ("As estimates are based on subjective as well as objective factors, it may be difficult for management to establish controls over them. Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate

misstatement or bias could occur if management (whether through fraud or error) underestimated the hours to complete implementations. In that case, the deferred revenue allocated to implementations under the residual method would be reduced and the revenue recognized up-front on (much more profitable) software licenses would be inflated.

36. To properly establish VSOE for implementations based on its standard labor rate, Jack Henry had to be able to make reasonable estimates of labor hours to complete implementations. Under PCAOB standards, "[t]he auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole."[31] In evaluating reasonableness, "[t]he auditor should obtain an understanding of how management developed the estimate,"[32] and "normally should consider the historical experience of the entity in making past estimates as well as the auditor's experience in the industry."[33] The auditor also should normally concentrate on "key factors and assumptions" that are, among other things, "[s]ubjective and susceptible to misstatement and bias."[34]

37. In each Audit, Deloitte's engagement teams violated PCAOB standards by failing to sufficiently evaluate the reasonableness of Jack Henry's estimates of hours to complete implementations.[35] The teams failed: (a) to perform procedures sufficient to

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accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors.").

[31] Id.

[32] AU § 342.10.

[33] AU § 342.09.

[34] Id.

[35] In performing contract testing, engagement team members asked Jack Henry implementation managers about the timing of implementation projects related to their test selections. But those inquiries were insufficient to evaluate the reasonableness of management's estimates of hours to complete implementations. See AU § 333.02, *Management Representations* (management representations "are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit"). In addition, in the FY14 and FY13 audits, the engagement teams tested whether Jack Henry consistently sold stand-alone implementations at its standard hourly labor rate for purposes of supporting

obtain an understanding of how management developed those estimates; (b) to evaluate the reasonableness of the subjective factors and assumptions underlying the estimates; and (c) to adequately consider Jack Henry's historical experience in making past estimates of hours to complete implementations. In its 2015 restatement, Jack Henry disclosed that—in FY14, FY13, FY12, and earlier periods—"its mechanisms for tracking and estimating implementation hours [were] not capable of producing reliable estimates in support of its assertion of VSOE for implementation services…."[36]

F. Prior PCAOB Inspection and Deloitte Internal Inspection

38. Although this Order concerns Deloitte's FY14, FY13, and FY12 Jack Henry audits, the improper software accounting existed in earlier years during which the Firm served as the Company's auditor. During the Board's 2005 inspection of Deloitte, a PCAOB inspection team reviewed the Firm's audit of Jack Henry's financial statements for the year ended June 30, 2004, as to which Deloitte issued an unqualified audit report. The PCAOB inspection found that there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm tested how the Company allocated value to each element of its multiple-element software contracts based on VSOE, and therefore that the Firm had not assessed whether the appropriate amount of revenue was recognized in the proper periods. Following these 2005 inspection findings, Deloitte failed to identify that Jack Henry was unable to properly support its VSOE assertions in subsequent audits.

39. In 2010, Deloitte performed an internal inspection (as part of the Firm's system of quality control) that involved a review of the integrated audit of Jack Henry for the year ended June 30, 2009, as to which the Firm issued unqualified opinions on the financial statements and ICFR. In performing that inspection, the Deloitte reviewers focused on, among other areas, the audit work around software license revenue, including VSOE. But they failed to identify certain audit deficiencies in the software revenue work papers they reviewed, including the absence of substantive testing of VSOE for implementation and evidence that Jack Henry may have improperly separated a material software contract into multiple arrangements.

40. By failing to appropriately address the audit deficiencies identified in the Board's 2005 inspection and to identify the audit deficiencies evidenced in the work

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management's VSOE assertion. But that testing did not address the reasonableness of the Company's estimates of hours to complete implementations.

[36] See Jack Henry Form 10-K/A (June 25, 2015), at 49.

papers reviewed during the 2010 internal inspection, the Firm contributed to the violations of PCAOB standards that occurred during its FY14, FY13, and FY12 audits of Jack Henry.

IV.

41. Deloitte has certified to the Board that prior to entry of this Order, it established and implemented the following changes to its quality control processes and procedures:

a. Deloitte enhanced its process to more effectively assess the match between the industry expertise of its engagement partners/engagement quality reviewers and the issuer audits to which they are assigned. The enhanced process includes identifying issuer audit clients that utilize complex accounting for material revenue streams other than their primary revenue stream, and ensuring that appropriate personnel have been assigned to address any related industry-specific risks.

b. Deloitte enhanced its internal inspection process to more effectively assess the industry experience of inspection reviewers when assigning them to review specific areas of complex accounting for issuer audit engagements. Among other things, the Firm specifically assesses whether the internal inspection team has appropriate industry experience regarding all issuer revenue streams subject to inspection procedures.

V.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), Deloitte & Touche LLP is hereby censured;

B. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $500,000 is imposed upon Deloitte & Touche LLP. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Deloitte & Touche LLP shall pay the civil money penalty within 10 days of the issuance of this Order by (1) wire transfer in accordance with instructions furnished by Board staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Controller, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter, which identifies the payor as a respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006; and

C. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), for a period of three years from the date of this order, Deloitte & Touche LLP shall provide the PCAOB Division of Registration and Inspections with prompt written notice in the event of any decision to rescind the enhancements of the processes specified in Section IV above and the reason(s) therefor.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

May 23, 2018