
2018 Inspection KPMG LLP

(Headquartered in New York, New York)

April 28, 2020

PCAOB

Public Company Accounting Oversight Board

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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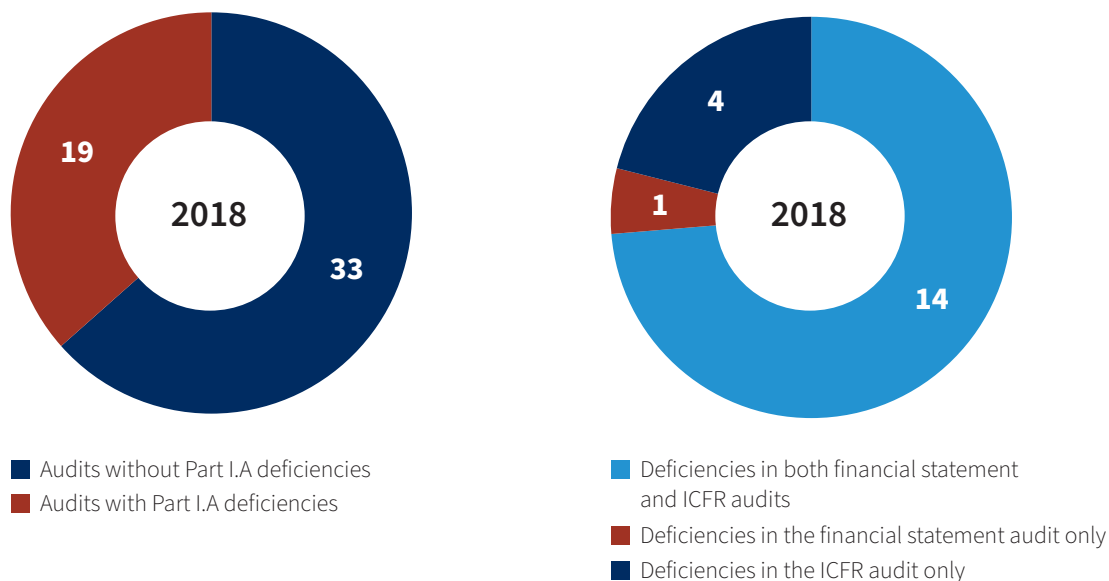
Executive Summary

Our 2018 inspection report on KPMG LLP provides information on our inspection to assess the firm’s compliance with Public Company Accounting Oversight Board (“PCAOB”) standards and rules and other applicable regulatory and professional requirements. This executive summary offers a high-level overview of: (1) Part I.A of the report, which discusses deficiencies (“Part I.A deficiencies”) in certain issuer audits that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer’s financial statements and/or internal control over financial reporting (“ICFR”), and (2) Part I.B of the report, which discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.

The fact that we have included a deficiency in this report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer’s financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. If a deficiency is included in Part I.A or Part I.B of this report, it does not necessarily mean that the firm has not addressed the deficiency.

Overview of the 2018 Deficiencies Included in Part I

Nineteen of the 52 issuer audits we reviewed in 2018 are included in Part I.A of this report due to the significance of the deficiencies identified. The identified deficiencies primarily related to the firm’s testing of controls over and/or substantive testing of revenue and related accounts, inventory, and business combinations.



The most common Part I.A deficiencies in 2018 related to testing controls over the accuracy and completeness of data or reports, testing the design or operating effectiveness of controls selected for testing, identifying controls related to a significant account or relevant assertion, and the overreliance on controls when performing substantive testing due to certain of these deficiencies.

Other deficiencies identified during the 2018 inspection that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s), which appear in Part I.B, related to retention of audit documentation, audit committee communications, and Form AP.

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2018 Inspection

During the PCAOB's 2018 inspection of KPMG LLP, we assessed the firm's compliance with laws, rules, and professional standards applicable to the audits of public companies.

We selected for review 52 audits of issuers with fiscal years generally ending in 2017. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

What's Included in this Inspection Report

This report includes the following sections:

- **Overview of the 2018 Inspection and Historical Data by Inspection Year:** Information on our inspection, historical data, and common deficiencies.
- **Part I – Inspection Observations:**
 - **Part I.A:** Deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR.
 - **Part I.B:** Deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.
- **Part II – Observations Related to Quality Control:** Criticisms of, or potential defects in, the firm's system of quality control. Section 104(g)(2) of the Sarbanes-Oxley Act ("the Act") restricts us from publicly disclosing Part II deficiencies unless the firm does not address the criticisms or potential defects to the Board's satisfaction no later than 12 months after the issuance of this report.
- **Appendix A – Firm's Response to the Draft Inspection Report:** The firm's response to a draft of this report, excluding any portion granted confidential treatment.

2018 Inspection Approach

In selecting issuer audits for review, we use both risk-based and random methods of selection. We make most selections based on (1) our internal evaluation of audits we believe have a heightened risk of material misstatement, including those with challenging audit areas, and (2) other risk-based characteristics, including issuer and firm considerations. We select the remaining audits randomly to provide an element of unpredictability.

When we review an audit, we do not review every aspect of the audit. Rather, we generally focus our attention on audit areas we believe to be of greater complexity, areas of greater significance or with a heightened risk of material misstatement to the issuer's financial statements, and areas of recurring deficiencies. We may also select some audit areas for review in a manner designed to incorporate unpredictability.

Our selection of audits for review does not constitute a representative sample of the firm's total population of issuer audits. Additionally, our inspection findings are specific to the particular portions of the issuer audits reviewed. They are not an assessment of all of the firm's audit work nor of all of the audit procedures performed for the audits reviewed.

View the details on the [scope of our inspections and our inspections procedures](#).

Overview of the 2018 Inspection and Historical Data by Inspection Year

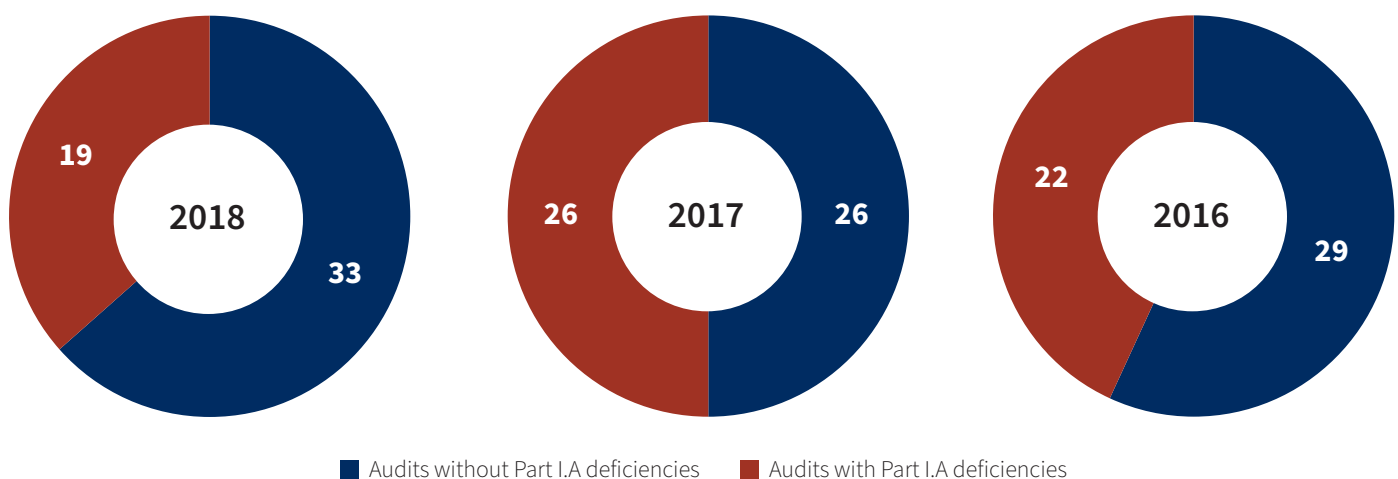
The following information provides an overview of our inspections in 2018 of the firm's issuer audits as well as data from the previous two inspections. We use a combination of risk-based and random methods to select audits for review and to identify areas on which we focus our inspection. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and focus areas from year to year and firm to firm. As a result of this variation, we caution that our inspection results are not necessarily comparable over time or among firms.

Audits Reviewed

	2018	2017	2016 ¹
Total audits reviewed	52	52	51
Audits in which the firm was the principal auditor	51	51	50
Audits in which the firm was not the principal auditor	1	1	1
Integrated audits of financial statements and ICFR	51	50	51
Risk-based selections	42	42	41
Random selections	10	10	10

Part I.A Deficiencies in Audits Reviewed

In 2018, 16 of the 19 audits appearing in Part I.A were selected for review using risk-based criteria. In 2017, 23 of the 26 audits appearing in Part I.A were selected for review using risk-based criteria. In 2016, 20 of the 22 audits appearing in Part I.A were selected for review using risk-based criteria.

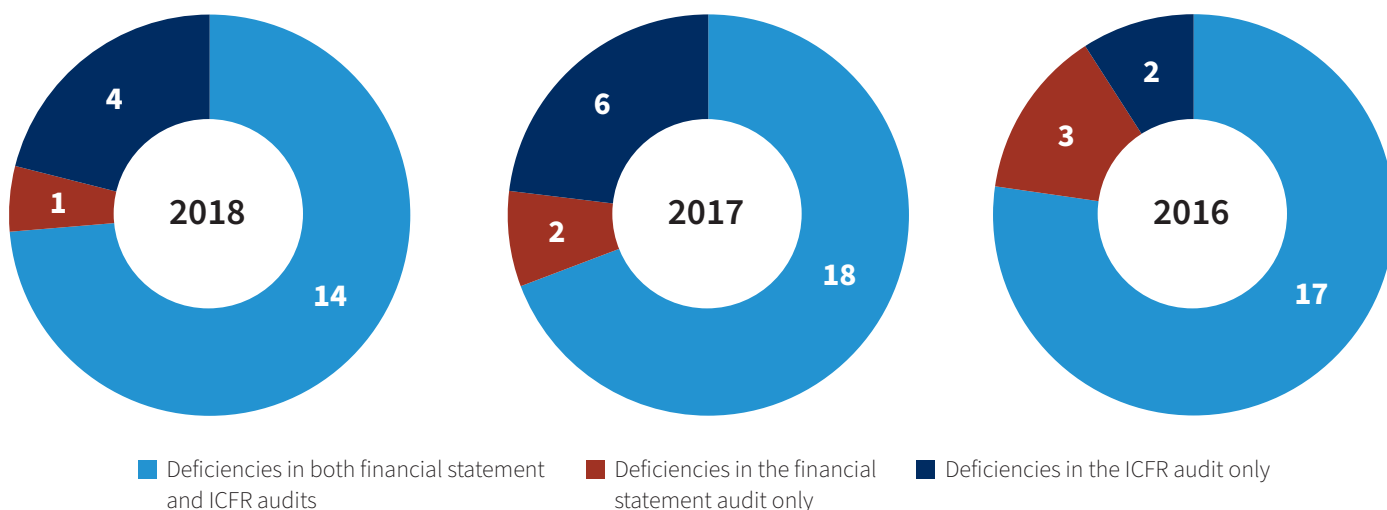


¹ The 51 audits reviewed in 2016 ("51 audits") consisted of 41 non-financial institution issuer audits reviewed pursuant to the inspection team's original inspection plan and 10 additional reviews of financial institution issuer audits that were selected to replace 11 financial institution issuer audits that had been reviewed as part of the inspection team's original inspection plan for which the firm obtained improper advance notice. Information included in this report related to the 2016 inspection of the firm only reflects inspection results for the 51 audits and therefore does not include three audits with identified deficiencies that were part of the 11 originally reviewed financial institution issuer audits as described in Part I.A of the 2016 inspection report. The 10 additional reviews are included in the risk-based selections presented in this table.

If a deficiency is included in Part I.A of our report, it does not necessarily mean that the firm has not addressed the deficiency. In many cases, the firm has performed remedial actions after the issue was identified. Depending on the circumstances, remedial actions may include performing additional audit procedures, informing management of the issuer of the need for changes to the financial statements or reporting on ICFR, or taking steps to prevent reliance on prior audit reports. Our inspection normally includes a review, on a sample basis, of the adequacy of a firm's remedial actions, either with respect to previously identified deficiencies or deficiencies identified during that inspection. If a firm does not take appropriate actions to address deficiencies, we may criticize its system of quality control or pursue a disciplinary action.

The fact that we have included a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — does not necessarily mean that the issuer's financial statements are materially misstated or that undisclosed material weaknesses in ICFR exist. It is often not possible for us to reach a conclusion on those points based on our inspection procedures and related findings because, for example, we have only the information that the auditor retained and the issuer's public disclosures. We do not have direct access to the issuer's management, underlying books and records, and other information.

Audits Affected by the Deficiencies Identified in Part I.A



In connection with our 2016 inspection procedures for one audit, the issuer revised its report on ICFR, and the firm revised its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

The following tables and graphs summarize inspection-related information, by inspection year, for 2018 and the previous two inspections. We caution any comparison of the data provided without reading the descriptions of the underlying deficiencies in each respective inspection report.

Most Frequently Identified Part I.A Deficiencies

Deficiencies in audits of financial statements	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not perform substantive procedures to obtain sufficient evidence as a result of overreliance on controls (due to deficiencies in testing controls)	8	13	8
Did not sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate	5	10	10
Did not perform sufficient testing related to an account or significant portion of an account or to address an identified risk	4	7	9

Deficiencies in ICFR audits	Audits with Part I.A deficiencies		
	2018	2017	2016
Did not identify and/or sufficiently test controls over the accuracy and completeness of data or reports	11	6	8
Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing	9	17	16
Did not identify and test any controls related to a significant account or relevant assertion	7	13	10

Audit Areas Most Frequently Reviewed

This table reflects the five focus areas we have selected most frequently for review in each inspection year (and the related Part I.A deficiencies). For the issuer audits selected for review, we selected these areas because they were generally significant to the issuer's financial statements, may have included complex issues for auditors, and/or involved complex judgments in (1) estimating and auditing the reported value of related accounts and disclosures and (2) implementing and auditing the related controls.

2018			2017			2016		
Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies	Audit area	Audits reviewed	Audits with Part I.A deficiencies
Revenue and related accounts	40	10	Revenue and related accounts	40	11	Revenue and related accounts	40	7
Inventory	20	3	Inventory	19	5	Inventory	18	5
Income taxes	13	1	Business combinations	16	1	Business combinations	12	5
Business combinations	12	3	Long-lived assets	12	2	Goodwill and intangible assets	11	2
Investment securities	12	0	Loans and related accounts	11	5	Income taxes	11	2

Audit Areas with Frequent Part I.A Deficiencies

This table reflects the focus areas with the most frequently identified Part I.A deficiencies in each inspection year with the corresponding results for the other two years presented.

Audit area	2018		2017		2016	
	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed	Audits with Part I.A deficiencies	Audits reviewed
Revenue and related accounts	10	40	11	40	7	40
Inventory	3	20	5	19	5	18
Business combinations	3	12	1	16	5	12
Allowance for loan losses	2	11	5	10	6	10
Loans and related accounts	1	5	5	11	4	10

Revenue and related accounts: The deficiencies in 2018, 2017, and 2016 primarily related to substantive testing of revenue and testing controls over revenue, including controls over the accuracy and completeness of data or reports.

Inventory: The deficiencies in 2018 primarily related to testing controls over the accuracy and completeness of data or reports. The deficiencies in 2017 and 2016 primarily related to substantive testing of the valuation of inventory and testing cycle-count controls.

Business combinations: The deficiencies in 2018 related to substantive testing of data used to value acquired intangible assets and testing controls, including controls over the accuracy and completeness of data. The deficiencies in 2017 related to substantive testing of acquired loans and identifying and testing a control over the purchase price allocation. The deficiencies in 2016 related to substantive testing of assumptions the issuer used to value the assets acquired and liabilities assumed and testing controls over the valuation of acquired intangible assets.

Allowance for loan losses: The deficiencies in 2018 primarily related to substantive testing of the data the issuer used to estimate the allowance for loan losses and testing controls over the completeness and accuracy of data. The deficiencies in 2017 and 2016 primarily related to substantive testing of, and testing controls over, the assumptions or other inputs used by the issuer to estimate the allowance for loan losses.

Loans and related accounts: The deficiencies in 2018 related to substantive testing of loans, including testing related to confirmation requests, and identifying and testing controls over loans. The deficiencies in 2017 and 2016 primarily related to substantive testing and testing controls related to suspense accounts and testing related to confirmation requests.

Auditing Standards Associated with Identified Part I.A Deficiencies

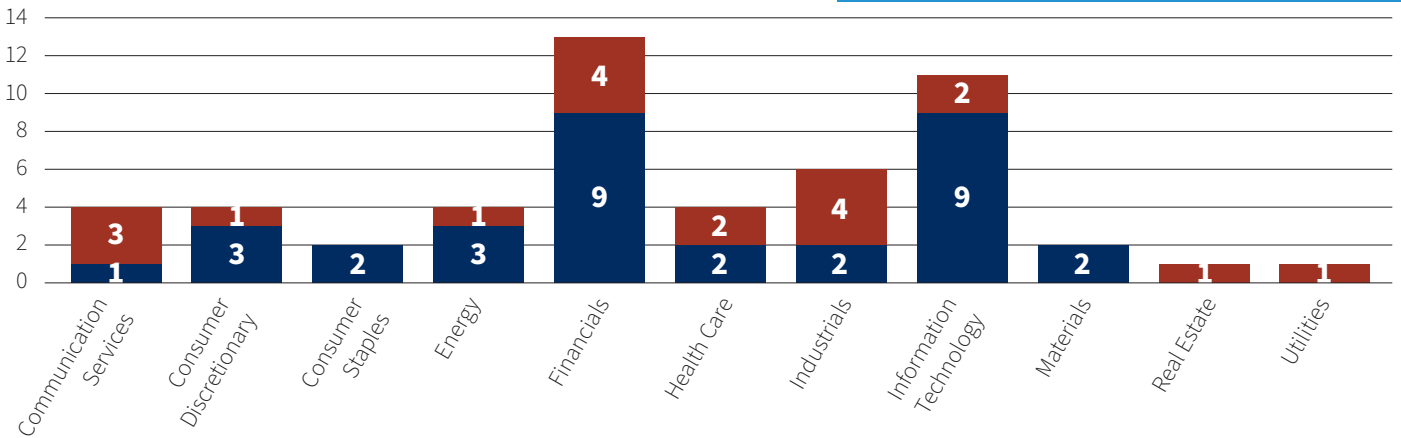
The following lists the auditing standards referenced in Part I.A of the 2018 and the previous two inspection reports and the number of times that the standard is cited in Part I.A.

PCAOB Auditing Standards	2018	2017	2016
<i>AS 1105, Audit Evidence</i>	2	1	0
<i>AS 2101, Audit Planning</i>	0	1	0
<i>AS 2110, Identifying and Assessing Risks of Material Misstatement</i>	0	1	0
<i>AS 2201, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements</i>	46	50	47
<i>AS 2301, The Auditor's Responses to the Risks of Material Misstatement</i>	13	22	17
<i>AS 2305, Substantive Analytical Procedures</i>	1	2	2
<i>AS 2310, The Confirmation Process</i>	2	3	3
<i>AS 2315, Audit Sampling</i>	9	16	11
<i>AS 2401, Consideration of Fraud in a Financial Statement Audit</i>	0	0	1
<i>AS 2415, Consideration of an Entity's Ability to Continue as a Going Concern</i>	0	0	1
<i>AS 2501, Auditing Accounting Estimates</i>	5	8	7
<i>AS 2502, Auditing Fair Value Measurements and Disclosures</i>	5	6	8
<i>AS 2810, Evaluating Audit Results</i>	4	1	2

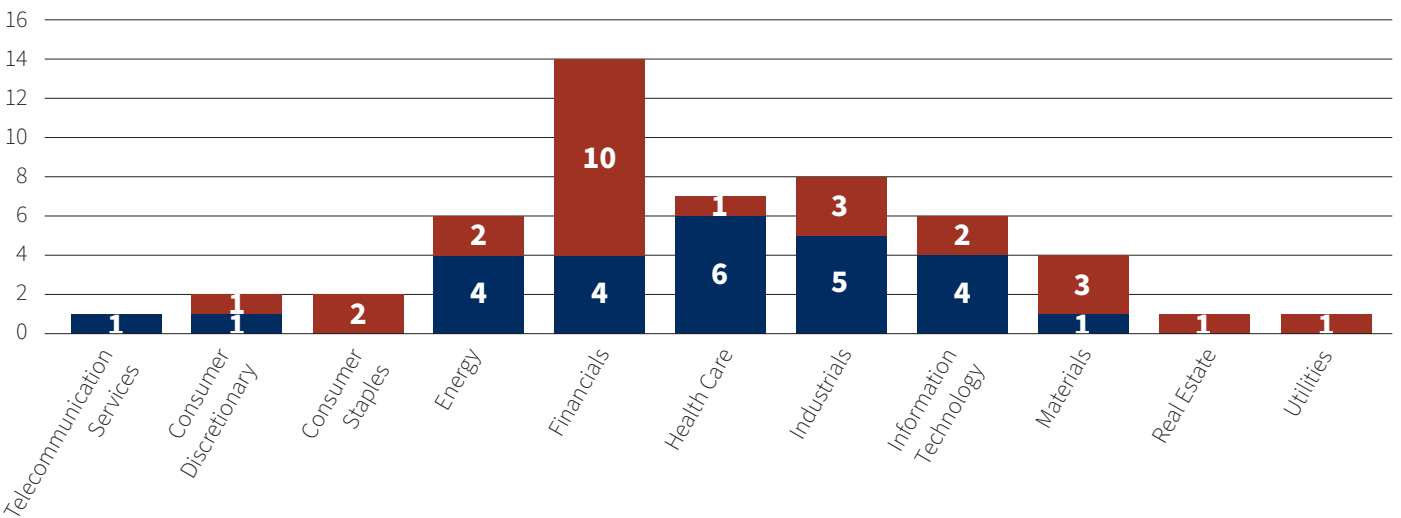
Inspection Results by Issuer Industry Sector

The majority of industry sector data is based on Global Industry Classification Standard ("GICS") data obtained from Standard & Poor's ("S&P"). In instances where GICS data for an issuer is not available from S&P, classifications are assigned based upon North American Industry Classification System data.

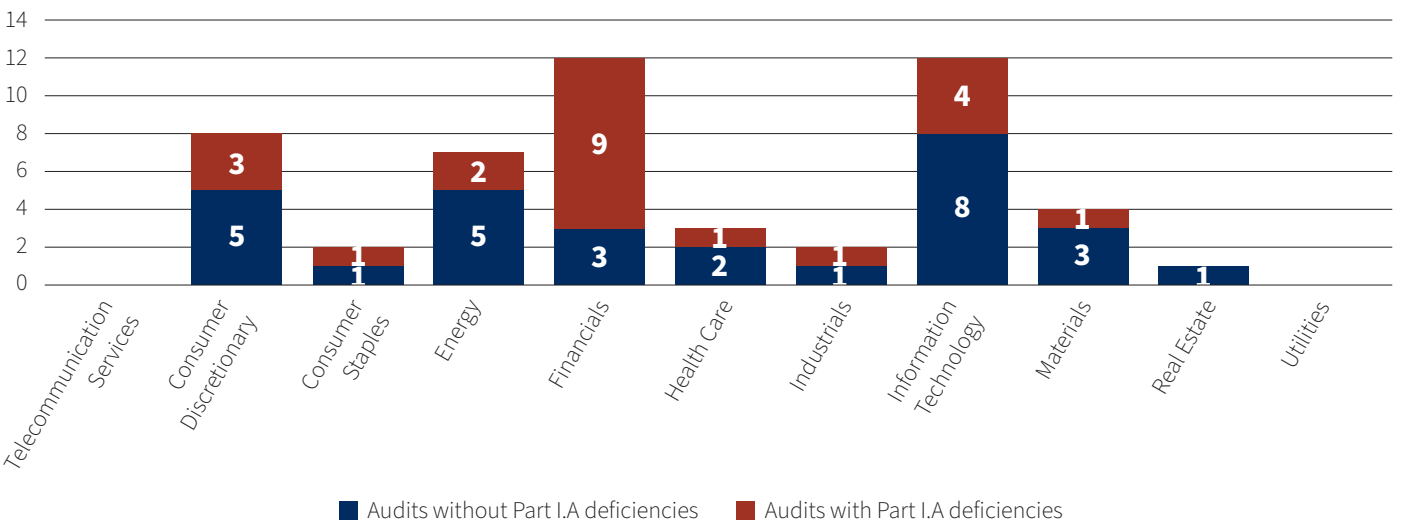
2018



2017



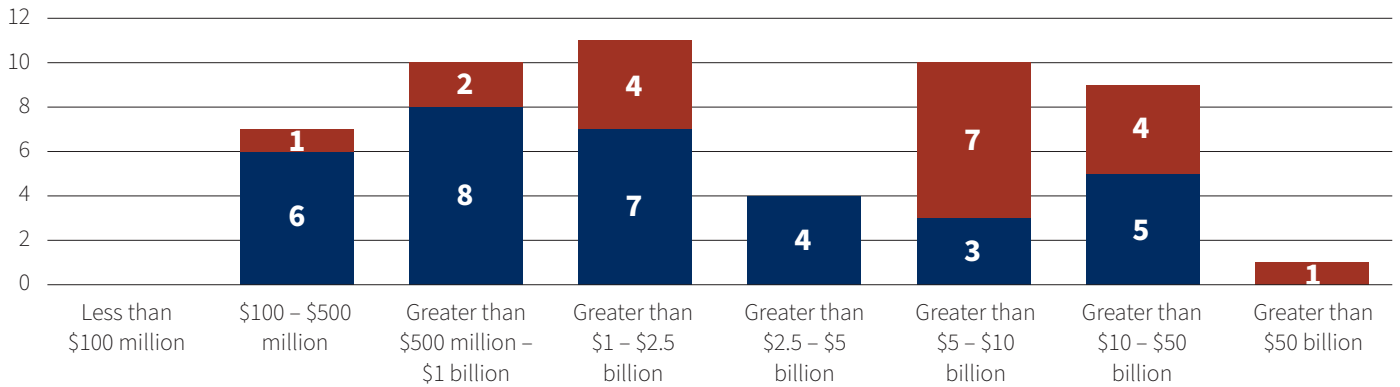
2016



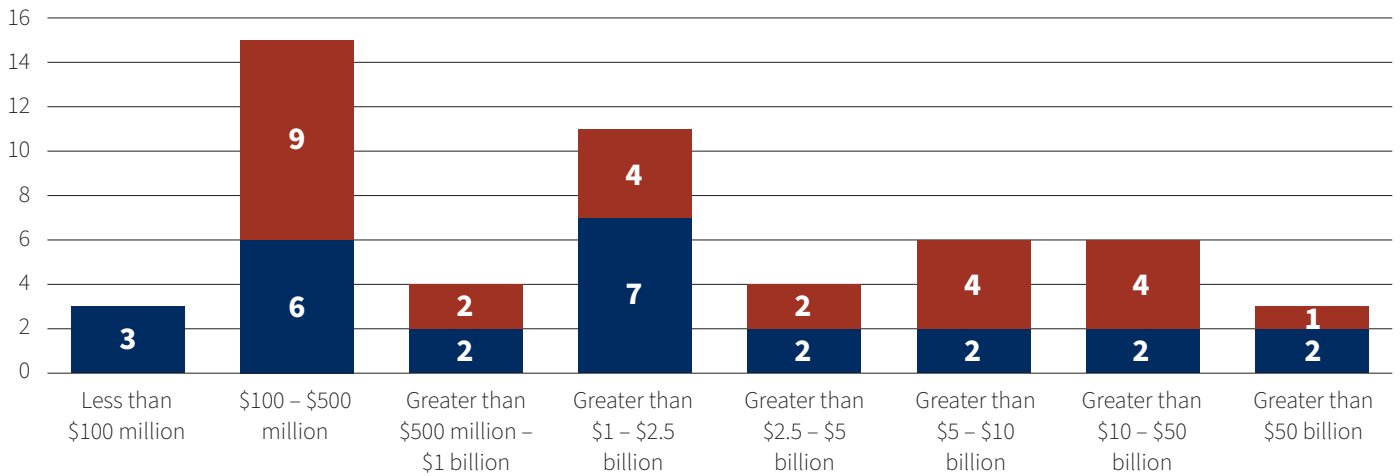
■ Audits without Part I.A deficiencies ■ Audits with Part I.A deficiencies

Inspection Results by Issuer Revenue Range

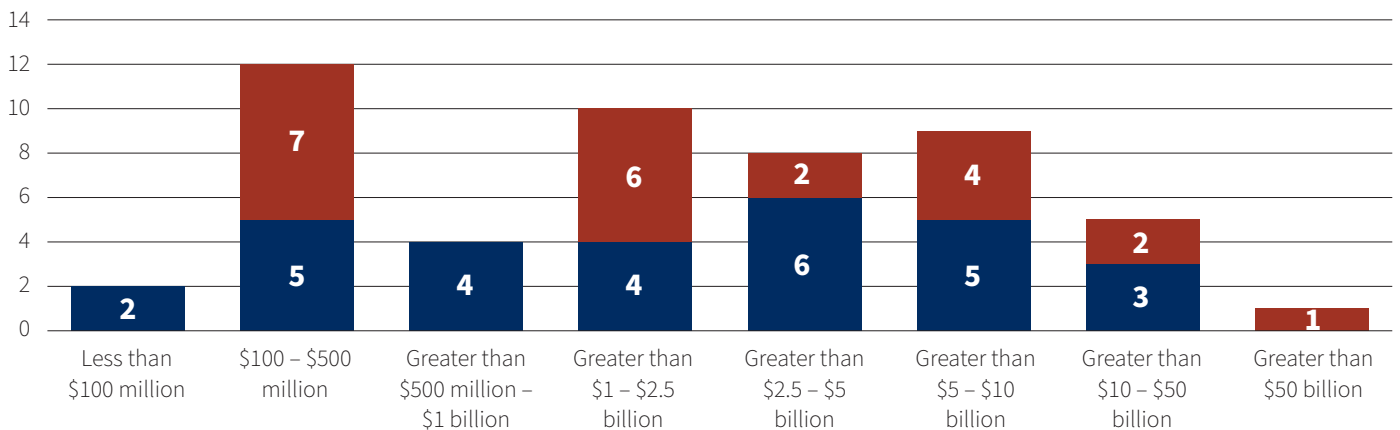
2018



2017



2016



■ Audits without Part I.A deficiencies ■ Audits with Part I.A deficiencies

Classification of Audits with Part I.A Deficiencies

Within Part I.A of this report, we classify each issuer audit in one of the categories discussed below based on the Part I.A deficiency or deficiencies identified in our review.

The sole purpose of this classification system is to group and present issuer audits by the number of Part I.A deficiencies we identified within the audit as well as to highlight audits with an incorrect opinion on the financial statements and/or ICFR.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

This classification includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's financial statements were determined to be materially misstated, and the issuer restated its financial statements. It also includes instances where an audit deficiency was identified in connection with our inspection and, as a result, an issuer's ICFR was determined to be ineffective, or there were additional material weaknesses that the firm did not identify, and the firm withdrew its opinion, or modified its report, on ICFR.

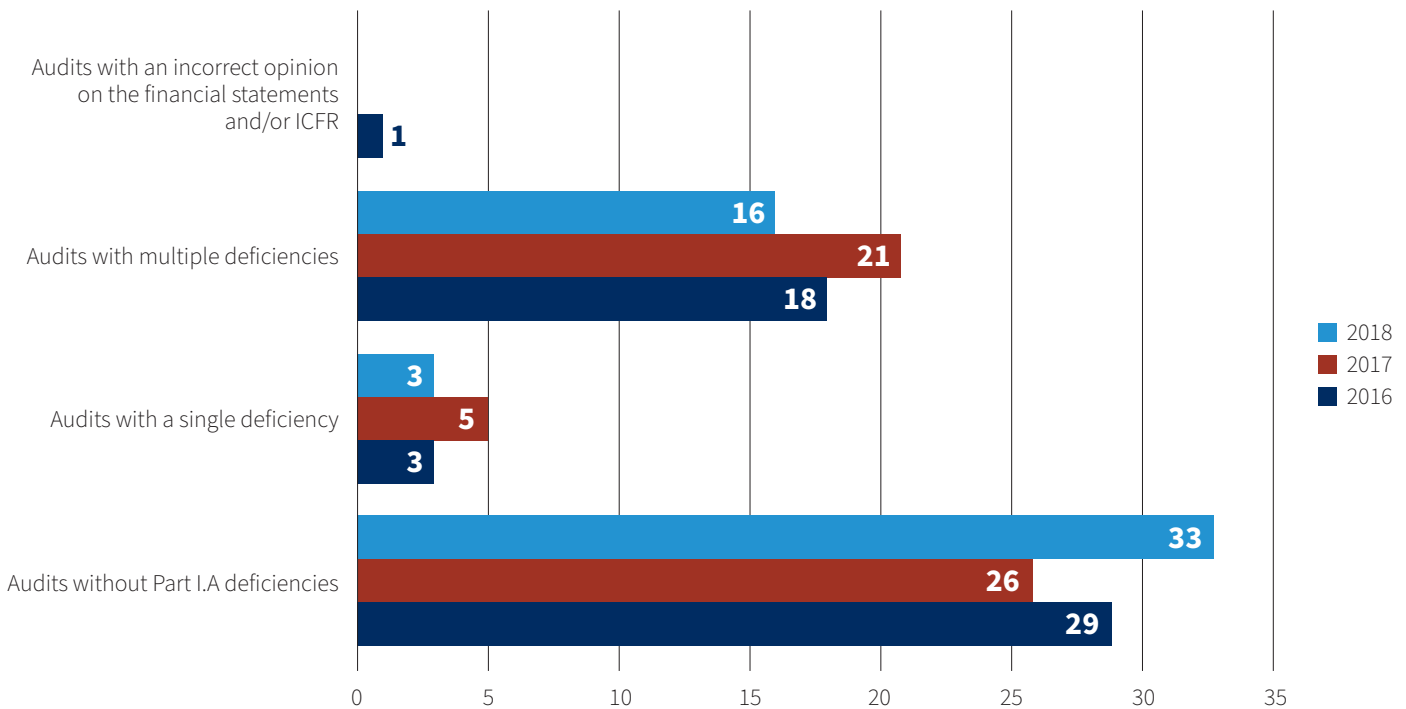
Audits with Multiple Deficiencies

This classification includes instances where multiple deficiencies were identified that related to a combination of one or more financial statement accounts, disclosures, and/or important controls in an ICFR audit.

Audits with a Single Deficiency

This classification includes instances where a single deficiency was identified that related to a financial statement account or disclosure or to an important control in an ICFR audit.

Number of Audits in Each Category



Part I: Inspection Observations

Part I.A of our report discusses deficiencies that were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or ICFR. Part I.B discusses deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. Consistent with the Act, it is the Board's assessment that nothing in Part I of this report deals with a criticism of or potential defect in the firm's quality control system. Any such criticisms or potential defects are discussed in Part II. Further, you should not infer from any Part I deficiency or combination of deficiencies that a quality control finding is identified in Part II.

Part I.A: Audits with Unsupported Opinions

This section of our report discusses the deficiencies identified, by specific issuer audit reviewed, in the audit work supporting the firm's opinion on the issuer's financial statements and/or ICFR.

We identify each issuer by a letter (e.g., Issuer A) and industry sector. Each deficiency could relate to several auditing standards, but we reference the PCAOB standard(s) that most directly relates to the requirement with which the firm did not comply.

Issuer audits are presented below within their respective deficiency classifications (as discussed previously). Within the classifications, we generally present the audits based on our assessment as to the relative significance of the identified deficiencies taking into account the significance of the financial statement accounts and/or disclosures affected, and/or the nature or extent of the deficiencies.

Audits with an Incorrect Opinion on the Financial Statements and/or ICFR

None

Audits with Multiple Deficiencies

Issuer A – Financials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to the **Allowance for Loan Losses ("ALL")**, **Loans Receivable**, **Deposit Liabilities**, and **Derivatives**.

Description of the deficiencies identified

With respect to the **ALL**:

For certain consumer loans, the firm selected for testing a control that consisted of the issuer's quarterly review of its ALL assumptions and adjustments to the ALL, including a review of any exceptions to the issuer's ALL methodology and whether quarterly changes to the ALL were reasonable. The firm did not evaluate certain criteria the control owners used to identify items for follow up related to the review of quarterly changes to the ALL. Further, the firm did not evaluate the review procedures the control owners performed to determine whether certain items identified by the control owners for follow up were appropriately resolved. (AS 2201.42 and .44)

The issuer used loan charge-offs as inputs to the determination of the general reserve component of the ALL. The firm did not identify and test any controls over loan charge-offs for one type of these consumer loans. (AS 2201.39)

As part of the issuer's overall credit risk assessment for corporate loans collectively evaluated for impairment, the issuer determined a loan risk rating for each loan based on loan information for each borrower, including a borrower risk rating. The following deficiencies were identified:

- The firm selected for testing controls that consisted of the independent reviews of the assigned loan risk ratings for corporate loans that met certain criteria. The firm did not identify and test any controls over the accuracy and completeness of the loan information that the control owners used to evaluate the assigned loan risk ratings. (AS 2201.39)
- The firm used this loan information in certain of its substantive procedures to evaluate the appropriateness of the issuer's loan risk ratings for these loans. The firm did not test, or (as discussed above) test controls over, the accuracy and completeness of this information. (AS 2501.11)
- The issuer used various models to determine the borrower risk ratings for certain corporate loans. The firm did not identify and test any controls over the issuer's evaluation of the appropriateness of these models. (AS 2201.39)
- The firm's approach for testing the ALL for these loans was to review and test management's process. The firm did not perform any procedures to test the calculations in these models. (AS 2501.11)

With respect to **Loans Receivable**:

The firm did not identify and test any controls over certain types of loans receivable, including unfunded commitments. (AS 2201.39)

The firm did not perform any substantive procedures to test these loans receivable, including unfunded commitments. (AS 2301.08)

For certain other types of loans, including unfunded commitments, the firm sent positive confirmation requests to the issuer's customers for a selection of loans. For confirmations that were not returned, the firm did not perform alternative procedures that provided sufficient evidence that the account balances were accurate as of the confirmation date. Further, for the confirmations that were returned with exceptions, the firm did not evaluate the nature of those exceptions. (AS 2310.31 and .33)

With respect to **Deposit Liabilities**:

The transaction data for certain retail deposit accounts were transmitted from various source systems to the issuer's retail deposit system to record transactions in the general ledger. The firm did not identify and test any controls over the accuracy and completeness of the data maintained in one of these source systems. (AS 2201.39)

The firm sent positive confirmation requests to the issuer's customers for a sample of these retail deposit liabilities. For certain of the items in its sample for which the requested confirmations were not returned, the firm did not perform alternative procedures that provided sufficient evidence that the recorded amounts of the deposit liabilities were accurate as of the confirmation date. (AS 2310.31)

The sample size the firm used in certain of its substantive procedures to test these deposit liabilities was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Derivatives**:

The issuer used various models in the valuation of certain derivatives. The firm selected for testing controls over these models that consisted of (1) the validation of the design and construction of models that met certain criteria and (2) the annual review of the models that were not subject to the first control. The firm did not evaluate the review

procedures the control owners performed, including the criteria the control owners used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44)

The firm selected for testing a control that consisted of the review of the categorization of certain derivatives within the fair value hierarchy as set forth in FASB ASC Topic 820, *Fair Value Measurement*. The firm did not evaluate the specific procedures the control owner performed to assess the reasonableness of the categorization within the fair value hierarchy. (AS 2201.42 and .44)

The firm did not perform any substantive procedures to evaluate the reasonableness of the issuer's categorization of these derivatives within the fair value hierarchy. (AS 2502.43)

Issuer B – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue, Deferred Revenue, and Inventory**.

Description of the deficiencies identified

With respect to **Revenue and Deferred Revenue**:

The issuer entered into revenue arrangements with multiple elements and allocated the total consideration from these arrangements between the sale of products and services using its best estimate of selling price (“BESP”) under the relative-selling-price method. The issuer determined BESP based on contractual prices or factors of list prices. The firm selected for testing a control that consisted of reviews of the issuer's annual analysis of BESP. The firm did not determine whether the control owners' reviews of this analysis considered whether contractual prices or factors of list prices were the most appropriate selection for BESP. (AS 2201.42 and .44)

The firm did not perform any substantive procedures to test the issuer's assertion that contractual prices or factors of list prices were the most appropriate selection for BESP. (AS 2810.30)

The firm selected for testing a control that consisted of the review of all of the issuer's sales transactions, including multiple-element arrangements, for appropriate revenue recognition. The firm did not evaluate whether the control owners assessed whether prices for extended warranty services that were separately stated on customer invoices represented evidence that customers had the option to purchase these services for an expressly stated amount separate from the price of the product, which may have affected the revenue allocation. (AS 2201.42 and .44)

The firm did not perform any substantive procedures to evaluate whether prices for extended warranty services that were separately stated on customer invoices represented evidence that customers had the option to purchase these services for an expressly stated amount separate from the price of the products. (AS 2810.30)

With respect to **Inventory**:

The firm selected for testing an automated control and certain information technology (“IT”) dependent manual controls over inventory that used data or reports that were derived from the issuer's inventory system, for which the firm had identified a significant deficiency that was not remediated until the fourth quarter. The firm did not test any instances of the automated control and the controls over the accuracy and completeness of these data and reports subsequent to the remediation of the significant deficiency. (AS 2201.55 and .56)

The firm selected for testing a control over program changes that consisted of the approval, testing, and monitoring of changes made during the year to the issuer's inventory system. The firm did not identify and test any controls over the completeness of the report that was generated by the inventory system affected by the significant deficiency discussed above and that the firm used to select program changes for testing. (AS 2201.39)

Issuer C – Communication Services

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue, Accounts Receivable, Unbilled Accounts Receivable, Advanced Billings, Deferred Revenue,** and a **Business Combination.**

Description of the deficiencies identified

With respect to **Revenue** and **Accounts Receivable:**

For certain revenue, the firm did not identify and test any controls over the issuer's determination of whether the GAAP requirements that (1) persuasive evidence of an arrangement existed and (2) collectability was reasonably assured were met for transactions recorded as revenue. (AS 2201.39)

The firm selected for testing various controls that consisted of monthly comparisons of this revenue by customer, product, geographic region, and/or business unit to revenue recorded in the prior month. The firm did not evaluate the review procedures that the control owners performed, including whether items identified for follow up were appropriately resolved. (AS 2201.42 and .44)

For certain of this revenue, the firm selected for testing controls that consisted of a monthly comparison of a sample of invoices to the related prior-month invoice and the investigation of differences. In testing these controls, the firm did not inspect the invoices the control owners used in this comparison to determine whether all differences were identified for investigation. (AS 2201.44)

The sample sizes the firm used in certain of its substantive procedures to test revenue and accounts receivable were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Unbilled Accounts Receivable, Advanced Billings,** and **Deferred Revenue:**

The firm tested various controls over certain unbilled accounts receivable, advanced billings, and deferred revenue that used data from the issuer's billing systems but did not identify and test any controls over the accuracy and completeness of these data. (AS 2201.39)

The firm's substantive procedures to test these accounts consisted of analytical procedures. The firm used data from the issuer's billing systems to develop its expectations but did not test, or in the alternative, identify and test controls over, the accuracy and completeness of these data, as discussed above. Further, the firm established its thresholds for investigating differences based on a level of control reliance that was not supported due to the deficiency in the firm's testing of controls. As a result, the thresholds that the firm used did not provide the desired level of assurance that misstatements that could have been material would be identified. (AS 2301.16, .18, and .37; AS 2305.16 and .20)

With respect to a **Business Combination:**

During the year, the issuer acquired a business and determined the fair value of an acquired intangible asset using customer attrition-rate assumptions. The following deficiencies were identified:

- The firm did not identify and test any controls over the accuracy and completeness of historical revenue data that the issuer used to determine the attrition rates. (AS 2201.39)
- The firm's approach for testing the attrition rates was to review and test management's process. The firm did not perform any substantive procedures to test, or in the alternative, identify and test any controls over, the accuracy and completeness of historical revenue data that the issuer used to determine the attrition rates, as discussed above. (AS 2502.39)

Issuer D – Information Technology

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue, Deferred Revenue, and Accounts Receivable**.

Description of the deficiencies identified

The firm selected for testing a control over manually recorded period-end adjustments to reverse certain revenue for shipped products that had not been delivered to the issuer's customers by the end of the period. The firm did not identify and test any controls over the accuracy and completeness of the shipping terms entered into the revenue system that were used to determine whether adjustments were necessary. (AS 2201.39)

The firm did not identify and test any controls that addressed whether all manual sales orders were entered into the revenue system. (AS 2201.39)

The issuer entered into revenue arrangements with multiple elements and allocated consideration to the deliverables using vendor-specific objective evidence ("VSOE") of fair value or its BESP. The following deficiencies were identified:

- The firm identified errors in the issuer's VSOE and BESP analyses and concluded that the issuer's control over the preparation and review of these analyses was not operating effectively as of year end. In determining whether the deficiency represented a material weakness, the firm did not sufficiently evaluate the magnitude of the potential misstatements because it limited its procedures to evaluating the known misstatements. (AS 2201.62 and .63)
- The firm's approach to substantively test the VSOE and BESP analyses was to review and test management's process. The firm did not test the accuracy and completeness of the stand-alone sales transactions the issuer used in these analyses, or in the alternative, test any controls over the accuracy and completeness of these transactions. (AS 2501.11) In addition, the issuer used certain sales order data that it obtained from the revenue system and manually entered into the analyses. The firm did not test, or (as discussed above) sufficiently test controls over, the completeness of the manually entered sales order data used in the analyses. (AS 2501.11)

The sample sizes the firm used in certain of its substantive procedures to test revenue, deferred revenue, and accounts receivable were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Issuer E – Financials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Uncorrected Misstatements** and **Reinsurance Recoverable**.

Description of the deficiencies identified

With respect to **Uncorrected Misstatements**:

The issuer prepared a schedule of numerous uncorrected misstatements that it had identified and that affected several financial statement accounts. The firm did not perform any procedures to determine whether the uncorrected misstatements included on this schedule were accurate and whether there were other uncorrected misstatements that the issuer identified that the firm should have evaluated. (AS 1105.10) In addition, the firm did not evaluate the effect of the uncorrected misstatements on the specific accounts and disclosures involved. (AS 2810.17)

With respect to **Reinsurance Recoverable**:

One of the issuer's reinsurance agreements required the reinsurer to maintain for the issuer's benefit certain assets as collateral for the reinsurance recoverable. The firm did not identify and test any controls that addressed whether the assets maintained as collateral were in compliance with the provisions of the reinsurance agreement. (AS 2201.39)

The firm did not test whether the assets maintained as collateral were in compliance with the provisions of the reinsurance agreement. (AS 2301.08)

Issuer F – Energy

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Proved Oil and Gas Reserves**.

Description of the deficiencies identified

The firm selected for testing a control that included the review and approval of changes to the inputs that were used by the issuer to determine its proved oil and gas reserves. The number of changes selected for testing did not provide sufficient appropriate audit evidence in light of the volume of changes subject to the control. (AS 2201.46 and .47)

The sample size the firm used in its substantive procedures to test the appropriateness of certain inputs used to determine the issuer's proved oil and gas reserves was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Issuer G – Health Care

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Inventory**.

Description of the deficiencies identified

The firm did not identify and test any controls over the accuracy and completeness of the actual costs for raw materials, direct labor, and overhead that were used by the issuer's inventory system to calculate manufacturing variances between actual and standard costs for the inventory at one of the issuer's locations. (AS 2201.39)

The sample size the firm used in certain of its substantive procedures to test this inventory was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

The firm did not perform any substantive procedures that addressed the accuracy of the allocation of the direct labor and overhead costs to this inventory. (AS 2301.08)

Issuer H – Financials

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to the **ALL**.

Description of the deficiencies identified

The firm selected for testing a control that consisted of the review of the issuer's risk assessment for graded loans. This review included the determination of which loans would be subject to an independent loan-grade review. The loan

grades were an important factor in estimating the ALL. The firm did not evaluate the specific review procedures that the control owner performed to determine which loans would be subject to an independent loan-grade review. (AS 2201.42 and .44)

The issuer used a model in the valuation of the ALL that used various data, including historical loan-loss data, derived from the issuer's data warehouse systems. The firm did not identify and test any controls over the accuracy of the transfer of these data from the issuer's source systems to the data warehouse systems, or test other controls that would have provided evidence over the accuracy of these data. (AS 2201.39)

The firm's approach for testing the ALL was to review and test management's process. The firm did not perform any substantive procedures to test, or in the alternative, identify and test any controls over, the accuracy of the historical loan-loss data, as discussed above. (AS 2501.11)

Issuer I – Industrials

Type of audit and related area affected

In our review, we identified deficiencies in the ICFR audit related to **Revenue**.

Description of the deficiencies identified

For one category of revenue that comprised six types of revenue arrangements, the firm selected for testing a control that consisted of a monthly comparison, by project type, of certain financial information and the investigation of variances over established thresholds. The firm did not evaluate whether certain thresholds the control owners used were sufficiently precise to detect misstatements that could be material. (AS 2201.42 and .44) In addition, the firm did not identify and test any controls over the accuracy of certain data that the control owners used in the performance of this control. (AS 2201.39)

For four types of these revenue arrangements, the firm selected for testing a control that included the review of invoices. The firm did not test the procedures the control owners performed to determine whether the services were provided for the revenue recorded for three of these types of revenue arrangements. (AS 2201.44) In addition, the firm did not identify and test any controls over the accuracy of certain data that the control owners used in the performance of this control for one of these three types of arrangements. (AS 2201.39)

For the other two types of revenue arrangements, the firm selected for testing controls that consisted of the review and approval of journal entries. The firm did not identify and test any controls over the accuracy of the data that the control owners used in the performance of these controls. (AS 2201.39)

For another category of revenue, the firm selected for testing a control that consisted of the review of revenue transactions greater than an established monetary threshold. The firm did not identify and test any controls over revenue transactions that were less than this established threshold. (AS 2201.39)

Issuer J – Communication Services

Type of audit and related areas affected

In our review, we identified deficiencies in the ICFR audit related to **Revenue** and **Accounts Receivable**.

Description of the deficiencies identified

The firm selected for testing a control over certain revenue and the related accounts receivable that consisted of the review of sales orders the issuer entered into its revenue system. The firm did not identify and test any controls that addressed whether all sales orders were subject to this review. (AS 2201.39)

The firm did not identify and test any controls that addressed whether all approved requests for changes in billing rates were processed in the revenue system. (AS 2201.39)

Issuer K – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue** and **Deferred Revenue**.

Description of the deficiencies identified

In response to ineffective IT general controls over the general ledger and revenue systems for one of its business units, the issuer implemented, and the firm selected for testing, an annual control at year end that consisted of testing a sample of revenue transactions from the revenue system to determine whether revenue had been appropriately recognized. The following deficiencies were identified:

- The firm did not identify that this annual control did not address the accuracy and completeness of the data and reports that were derived from the revenue system throughout the year and used in the operation of certain IT-dependent manual controls that the firm had selected for testing. (AS 2201.68)
- The firm did not sufficiently test the annual control because the firm did not (1) evaluate whether the issuer's selection process resulted in all transactions having an opportunity of being selected and (2) test the control owner's procedures to determine whether revenue or deferred revenue had been appropriately recorded for certain items selected for testing. Further, the firm did not identify and test any controls over the completeness of the reports derived from the revenue system that the control owner used to select transactions for testing. (AS 2201.68)
- The firm did not identify and test any controls over the accuracy and completeness of the data derived from the general ledger system that were used in the operation of certain IT-dependent manual controls that the firm had selected for testing. (AS 2201.68)
- The sample sizes the firm used in certain of its substantive procedures to test this revenue were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiencies in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Issuer L – Utilities

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue**.

Description of the deficiencies identified

The issuer generated certain revenue from its distribution of electricity that its customers purchased from other energy companies. The firm selected for testing a control over the volumes of electricity distributed by the issuer. The firm did not identify and test any controls over the accuracy and completeness of the volumes of electricity that the issuer's customers purchased from other energy companies that were used in this control. (AS 2201.39)

The firm used these volume data in its substantive testing of this revenue but did not perform any procedures to test or, in the alternative, identify and test any controls over, the accuracy and completeness of these data, as discussed above. (AS 1105.10)

Issuer M – Industrials

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue** and **Inventory**.

Description of the deficiencies identified

With respect to **Revenue**:

The firm selected for testing a control over certain revenue that consisted of a comparison, by contract, of actual profit to forecasted amounts. The firm did not identify and test any controls over the data and assumptions used to develop the forecasted profits that were used in the performance of this control. (AS 2201.39)

The sample size the firm used in certain of its substantive procedures to test this revenue was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Inventory**:

The firm selected for testing a control over the existence of certain inventory that included reviews of the issuer's cycle-count results to assess the reliability of the cycle-count process. The issuer used cycle-count data from its inventory systems to manually prepare the cycle-count analyses that were used in the operation of this control. The firm did not identify and test any controls that addressed whether these analyses were accurate and complete. (AS 2201.39)

The sample sizes the firm used in certain of its substantive procedures to test this inventory were too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

Issuer N – Real Estate

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue, Accounts Receivable, Gain on Sale of Assets**, and **Acquired Real Estate Assets**.

Description of the deficiencies identified

With respect to **Revenue, Accounts Receivable**, and **Gain on Sale of Assets**:

The firm selected for testing controls over adjustments to one type of revenue and related accounts receivable and the gain on the sale of certain real estate assets. The issuer used system-generated reports in the performance of these controls. To test controls over the accuracy and completeness of these reports, the firm either relied on testing performed in a prior year or tested one instance of the reports as of an interim date. The firm did not identify and evaluate the nature of the changes that were made to the configuration of these reports after the testing dates to update its conclusion to the date of management's assessment. (AS 2201.55 and .56)

The sample size the firm used in its substantive procedures to test adjustments to one type of revenue and related accounts receivable was too small to provide sufficient appropriate audit evidence because these procedures were designed based on a level of control reliance that was not supported due to the deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

With respect to **Acquired Real Estate Assets**:

During the year, the issuer acquired certain real estate assets. The firm selected for testing certain controls, each of which consisted of the review of a significant assumption used to determine the fair value of these acquired assets. The firm did not evaluate whether certain items that the control owners identified for follow up had been appropriately resolved. (AS 2201.42 and .44)

Issuer O – Health Care

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Business Combinations**.

Description of the deficiencies identified

During the year, the issuer acquired numerous businesses. The firm did not identify and test any controls over the valuation of the assets acquired and liabilities assumed in these business combinations. (AS 2201.39)

The firm did not perform any substantive procedures to test the valuation of the assets acquired and liabilities assumed in these business combinations. (AS 2502.15)

Issuer P – Information Technology

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to a **Business Combination**.

Description of the deficiencies identified

During the year, the issuer acquired a business. The firm selected for testing a control that consisted of a review of certain assumptions underlying the cash-flow forecasts that the issuer used to determine the fair value of certain acquired intangible assets. The firm did not evaluate the review procedures performed, including the criteria the control owner used to identify items for follow up and whether those items were appropriately resolved. (AS 2201.42 and .44) In addition, the firm did not test the aspect of this control that addressed the accuracy and completeness of certain data used in the valuation of these intangible assets. (AS 2201.42 and .44)

The firm's approach for testing the fair value of these acquired intangible assets was to review and test management's process. The firm did not sufficiently test the accuracy and completeness of certain data that the issuer used to value these acquired intangible assets because its procedures were limited to comparing certain of these data to schedules the issuer had obtained from the acquired company. (AS 2502.39) In addition, the firm did not sufficiently test certain assumptions underlying the forecasted revenue that the issuer used to value one of these intangible assets beyond inquiring of management and comparing these assumptions to an issuer-prepared schedule. (AS 2502.26 and .28)

Audits with a Single Deficiency

Issuer Q – Consumer Discretionary

Type of audit and related area affected

In our review, we identified a deficiency in the financial statement audit related to **Revenue**.

Description of the deficiency identified

The firm did not identify, and evaluate the significance to the notes related to the financial statements of, the issuer's omission of a required disclosure under FASB ASC Topic 235, *Notes to Financial Statements*, regarding its revenue recognition accounting policy for certain revenue. (AS 2810.30 and .31)

Issuer R – Financials

Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to **Deposit Liabilities**.

Description of the deficiency identified

The issuer placed items in deposit suspense accounts when the items needed further evaluation or processing. The firm selected for testing a control that included a review of the issuer's deposit suspense account reconciliations. The firm did not evaluate the review procedures that the control owner performed, including the assessment of whether items that had been cleared from the suspense accounts had been appropriately resolved. (AS 2201.42 and .44)

Issuer S – Communication Services

Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to **Income Taxes**.

Description of the deficiency identified

The firm selected for testing a control that included a review of the issuer's deferred tax assets and liabilities roll-forward schedule. The control owners used certain supporting schedules in the performance of this control, but the firm did not identify and test any controls over the accuracy and completeness of the supporting schedules. (AS 2201.39)

Part I.B: Other Instances of Non-Compliance with PCAOB Standards or Rules

This section of our report discusses any deficiencies we identified that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. When we review an audit, we do not review every aspect of the audit. As a result, the areas below were not reviewed on every audit inspected.

The deficiencies below are presented in numerical order based on the PCAOB standard or rule with which the firm did not comply. We identified the following deficiencies:

- In four of 52 audits reviewed, the firm did not assemble a complete and final set of audit documentation for retention within 45 days of the report release date. In these instances, the firm was non-compliant with AS 1215, *Audit Documentation*.
- In one of 10 audits reviewed, the firm did not make a required communication to the issuer's audit committee related to the current year's uncorrected misstatements. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.
- In six of 26 audits reviewed, the firm did not make certain required communications to the issuer's audit committee related to the names, locations, and planned responsibilities of other independent public accounting firms that performed audit procedures in the current period audit. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.
- In five of 52 audits reviewed, the firm did not make certain inquiries of the issuer's audit committee related to fraud. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*, and AS 2110, *Identifying and Assessing Risks of Material Misstatement*.
- In two of 26 audits reviewed where one or more other accounting firms participated in the firm's audit, the firm's report on Form AP contained inaccurate information and/or omitted information that was required to be reported. In these instances, the firm was non-compliant with PCAOB Rule 3211, *Auditor Reporting of Certain Audit Participants*.
- In one of 10 audits reviewed, the firm did not document the substance of its discussions with the audit committee about the potential effects of permissible tax services on the independence of the firm. In this instance, the firm was non-compliant with PCAOB Rule 3524, *Audit Committee Pre-approval of Certain Tax Services*.

Part II: Observations Related To Quality Control

Part II of our report discusses criticisms of, and potential defects in, the firm's system of quality control.

Deficiencies are included in Part II if an analysis of the inspection results, including the results of the reviews of individual audits, indicates that the firm's system of quality control does not provide reasonable assurance that firm personnel will comply with applicable professional standards and requirements. Generally, the report's description of quality control criticisms is based on observations from our inspection procedures.

Any changes or improvements to its system of quality control that the firm may have brought to the Board's attention may not be reflected in this report, but are taken into account during the Board's assessment of whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

Criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified, are nonpublic when the reports are issued. If a firm does not address to the Board's satisfaction any criticism of, or potential defect in, the firm's system of quality control within 12 months after the issuance of our report, any such deficiency will be made public.

Appendix A: Firm's Response to the 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, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. 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. 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.



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April 3, 2020

Mr. George Botic
Director - Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Response to Part I of Draft Report on the 2018 Inspection of KPMG LLP

Dear Mr. Botic:

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") DRAFT Report on 2018 Inspection of KPMG LLP, dated March 4, 2020 ("Draft Report").

The PCAOB inspection process provides valuable insights to improve the quality of our audits and is taken very seriously by the firm. We remain committed to full cooperation with the PCAOB, appreciate the professionalism and commitment of the PCAOB staff, and value the important role the PCAOB plays to improve audit quality.

We conducted a thorough evaluation of the matters identified in Part I of the Draft Report and have taken appropriate actions to address the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures.

Our top priority is consistently executing quality audits. We remain dedicated to continuous improvement in our audit engagement performance and our system of audit quality control. We provide transparency to our stakeholders about our overall efforts to improve audit quality, including specific actions we have taken and continue to take, in our 2019 Audit Quality Report. We understand our responsibility to our stakeholders and remain committed to working constructively with the PCAOB in the months and years to come.

Sincerely yours,

KPMG LLP

Lynne M. Doughtie
Chairman and Chief Executive Officer

Frank E. Casal
Vice Chair - Audit

KPMG LLP is a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

