



Enhancing Audit Quality and Transparency

December 2017

kpmg.com





Letter from the Chairman



Quality is fundamental to all of KPMG's work and is the foundation upon which our firm was founded over 120 years ago. It is the essence of our Audit practice. By providing high-quality work, we inspire the confidence of our clients and investors, strengthening the capital markets and economies in which they operate.

The firm, however, has had its challenges over the past year. In April 2017, several members of our Audit leadership team were separated from the firm for violating the firm's Code of Conduct. These individuals either had received improper advance warnings of engagements to be inspected by the Public Company Accounting Oversight Board or were aware that others had received such advance warnings and failed to properly report the situation in a timely manner.

In the wake of this episode, we are taking the necessary actions throughout the firm and the Audit practice to strengthen our culture and ensure the tone set by those at every level of leadership—in word and deed—guarantees nothing but the utmost respect for the regulatory process. We also are reestablishing and reinforcing integrity as the cultural cornerstone of the firm, with the expectation that every individual is personally responsible for the ethical environment of the firm.

We have made leadership changes in our Audit practice, including a new Vice Chair – Audit and a new leader of our Audit Quality and Professional Practice group (AQPP). Both were chosen for their roles, first and foremost, because of their demonstrated track record of impeccable judgment, professionalism, and integrity and their ability to inspire the trust of our people and instill the confidence of our clients.

Our new Audit leaders are fully focused on our path to continually improve our audit quality. We have made important changes to the organizational structure that oversees our audit quality by creating a new position of National Business Leader of AQPP, who will work alongside our Chief Auditor and Chief Accountant with a clear focus on driving execution of audit quality enhancement initiatives. Recognizing the vital importance of auditor training and development supporting our audit

quality priorities, we have moved the audit practice training and development function, which previously reported to Audit operations, into AQPP. And, our Inspections Group, previously part of AQPP, now reports outside our Audit practice to our Vice Chair – Legal, Risk and Regulatory and is focused on carrying out our internal inspections program and interfacing with external inspectors.

Beyond leadership and organizational changes, additional enhancements to our audit quality programs and processes have been made. Among other things, over the past several years, we added approximately 80 professionals to improve our audit processes in the areas of internal inspections, accounting and auditing engagement support, and root cause analysis. In addition, all Audit partners, as part of their yearly performance measurement and compensation process, now receive a specific audit quality rating, which includes factors such as inspection results, training, and independence and licensing compliance, as well as professionalism and leadership. We also have added requirements for Audit professionals to take additional training on auditing standards.

Part of continuously improving our system of audit quality control includes ongoing and productive engagement with our regulators. In addition to complying with the high standards of our United States regulators, KPMG seeks to respond appropriately to the concerns of audit regulators outside of the United States, where certain of the entities we audit have listings. Some of these regulators impose additional requirements on the firm, such as publication of the type of information set forth in this report. This report provides the firm with another opportunity to demonstrate that we take seriously our obligations to stakeholders in all of the countries where the securities of the entities we audit are listed.

Although KPMG has made significant changes in its audit processes in recent months, we are committed to continuously evaluating and enhancing our system of audit quality control, and there is much more to come. We are committed to constantly enhancing our audit quality and take seriously our role in protecting the capital markets.

Lynne Doughtie
Chairman and Chief Executive Officer



Contents

1. Our business, structure, and ownership	2		
2. Tone at the top	3		
2.1 Audit Quality and Professional Practice	3		
2.1.1 <i>Audit Quality and Professional Practice – Chief Auditor and Chief Accountant</i>	3		
2.1.2 <i>Audit Quality and Professional Practice – National Business Leader of Audit Quality and Professional Practice</i>	4		
2.1.3 <i>Audit Quality and Professional Practice – Professional practice partners</i>	4		
2.2 Issue Council	4		
2.3 Inspections Group	5		
3. Engagement performance	6		
3.1 The KPMG LLP Audit	6		
3.2 Supervision, review, and support for the engagement team	6		
3.3 Consultation and differences of opinion	7		
3.4 Quality control review	7		
3.5 Engagement documentation	7		
4. Relevant ethical requirements	8		
4.1 Ethics and integrity	8		
4.2 Independence	8		
4.2.1 <i>Personal independence</i>	8		
4.2.2 <i>Postemployment relationships</i>	9		
4.2.3 <i>Rotation</i>	9		
4.2.4 <i>Approval of audit and non-audit services</i>	9		
4.2.5 <i>Business relationships, suppliers, and financial relationships</i>	10		
4.2.6 <i>Training and reporting</i>	10		
4.2.7 <i>Monitoring</i>	10		
4.3 Objectivity	10		
4.4 Confidentiality	10		
5. Acceptance and continuance reviews of audit entities and specific engagements	11		
5.1 Prospective entity and engagement evaluation processes	11		
5.2 Independence and conflict check system	11		
5.3 Continuance process	11		
6. Personnel management	12		
6.1 Recruitment and hiring	12		
6.2 Assignment of engagement teams	12		
6.3 Professional development	12		
6.4 Performance measurement, advancement, and compensation	13		
7. Monitoring	14		
7.1 Internal inspection processes	14		
7.2 Global Compliance Reviews	15		
7.3 Risk Compliance Program	15		
7.4 Regulatory external reviews	15		
7.5 External peer review	16		
7.6 Complaints and allegations (Ethics and Compliance Hotline)	16		
8. Statement of effectiveness of audit quality controls	18		

1. Our business, structure, and ownership

KPMG LLP (KPMG or the firm) provides Audit, Tax, and Advisory services to a broad range of domestic and international entities. The firm operates from more than 100 offices with more than 35,000 employees and partners throughout the United States. KPMG LLP operates as a Delaware limited liability partnership, meaning it is wholly owned by its more than 2,100 partners and principals (referred to herein collectively as partners).¹ Full details about the services we offer can be found on our Web site at www.kpmg.com/US.

KPMG LLP is the U.S. member firm of KPMG International Cooperative (KPMG International), which is a legal entity formed under Swiss law. KPMG International's member firms have more than 197,000 professionals, including more than 10,100 partners, in 154 countries. More information about KPMG International, including our relationship with it, is set out in Enhancing Audit Quality and Transparency – Supplement: Additional Information Required by Article 13 of EU Regulation 537/2014.



¹ Partners and principals have essentially the same rights under the firm's partnership agreement except that principals are not licensed as certified public accountants under the laws of any of the various states or territories of the United States.

2. Tone at the top

KPMG is absolutely committed to audit quality, and the firm has set enhancing our audit quality as a business imperative.

Our Chairman and Chief Executive Officer (CEO) establishes the strategies and direction of the firm, including its commitment to audit quality, ethical culture, and the promise of professionalism to investors and other participants in the capital markets, regulators, clients, and our partners and employees.

Our Vice Chair – Audit, who reports to the Chairman and CEO and the Deputy Chairman and Chief Operating Officer (COO) of the firm, has responsibility for the firm’s Audit practice, including our system of audit quality control. Our National Managing Partner of Audit Quality and Professional Practice, who reports to the Vice Chair – Audit, is responsible for the day-to-day operation of our system of audit quality control and our processes to continuously improve audit quality. In this role, the National Managing Partner of Audit Quality and Professional Practice has responsibility for the Audit Quality and Professional Practice group (Audit Quality and Professional Practice or AQPP), including the firm’s regional and business unit professional practice partners.

The firm also seeks to demonstrate its commitment to audit quality through its Inspections Group, a dedicated group of highly-skilled professionals who monitor the quality of our Audit professionals’ work and interact with external inspectors and peer reviewers.

2.1. Audit Quality and Professional Practice

AQPP consists of a broad network of partners, managing directors, senior managers, and other professionals who support the firm’s professionals in meeting their responsibilities in the areas of auditing and attestation, accounting and financial reporting, U.S. Securities and Exchange Commission (SEC or Commission) and other regulatory reporting matters, root cause analysis, training, and continuous improvement in audit quality.

2.1.1 Audit Quality and Professional Practice – Chief Auditor and Chief Accountant

The Chief Auditor and Chief Accountant, both of whom report to the National Managing Partner of Audit Quality and Professional Practice, provide technical guidance to engagement teams on engagement-related issues and assist in communications with audit committee members and management on those issues, developing and disseminating topic-specific guidance on emerging technical and professional auditing, accounting, and reporting matters, and consulting on and assisting with firm and individual audit engagement matters pertaining to compliance with regulatory and professional standards. Through liaisons with the SEC and Public Company Accounting Oversight Board (PCAOB), as well as active support for the standards-setting processes at the Financial Accounting Standards Board, the Governmental Accounting Standards Board, the Emerging Issues Task Force, the Auditing Standards Board, and other boards and committees of the American Institute of Certified Public Accountants (AICPA), the International Auditing and Assurance Standards Board, and other similar organizations, AQPP professionals develop and present KPMG’s positions on current topics being addressed by regulatory and other standard-setting bodies. In addition, AQPP professionals actively liaise with KPMG International’s International Standards Group (ISG), located in London, on international accounting and auditing standards matters.

The Audit Quality Support Partners program, overseen by the Chief Auditor, comprises select Audit partners, many of whom have recently done a rotation in AQPP and have gone back to their local offices. These professionals provide direct, real-time engagement-level audit quality coaching and support to audit engagement teams. The engagements subject to this support are selected based on an audit quality risk assessment led by our Chief Auditor and professional practice partners. Coaching spans from the planning phase of the audit through to completion and focuses on selected areas that are most subjective and present the highest degree of judgment and audit risk.

2.1.2 Audit Quality and Professional Practice – National Business Leader of Audit Quality and Professional Practice

The firm recently established a new role of National Business Leader of Audit Quality and Professional Practice, who reports to the National Managing Partner of Audit Quality and Professional Practice and is responsible for driving the execution of audit quality enhancement initiatives and ensuring that resources are appropriately placed to ensure prioritization of these actions. The National Business Leader also has responsibility for root cause analysis, the remediation development process, as well as the Audit practice's training and development function.

The Root Cause and Collaboration Group (RCCG) reports to the National Business Leader and is instrumental to our ongoing process to enhance our ability to identify, analyze, and address findings to continually improve our system of audit quality control and audit engagement performance.

The role of the RCCG is to collaborate with other Audit practice groups and other groups in the firm outside of the Audit practice to appropriately respond to audit quality control matters raised through internal and external inspections by (1) gathering information associated with audit quality matters, identifying the root causes of audit deficiencies, and supporting the development of remedial action plans designed to enhance audit engagement performance; and (2) enhancing the firm's processes to build audit quality considerations into operational and business initiatives through ongoing collaboration with other Audit practice groups.

The RCCG analyzes root causes associated with audit quality matters through a process tailored to specific circumstances, which in each case involves defining the problem, understanding the current state, collecting and analyzing the data, and identifying root causes. The RCCG also provides input to the development and implementation of remedial actions designed to address root causes. The selection of remedial actions to be implemented is performed in conjunction with the firm's senior Audit leadership team and other Audit practice groups. The RCCG is responsible for monitoring the implementation, execution, and effectiveness of the selected remedial actions. The group also performs an initial review and assessment of new audit processes, programs, and initiatives to further our objective to continually improve audit quality and develops and maintains an inventory of ongoing projects for prioritization by the firm's senior Audit leadership team.

2.1.3 Audit Quality and Professional Practice – Professional practice partners

The firm's nationally managed Audit practice is supported by two regional leadership teams, each with a designated regional professional practice partner who reports to the National Managing Partner of Audit Quality and Professional Practice. The regional professional practice partners are senior partners who provide professional practice and audit quality leadership and direct adherence to firm policies and professional standards within their respective regions. They are supported in their roles by a network of:

- Senior Audit partners who report to the respective regional practice partners and serve as professional practice partners for their business units
- A complement of professionals, referred to as the professional practice support team (PPS), who assist with elements of our monitoring systems and otherwise support the firm's professionals in meeting their risk management and professional practice responsibilities.

The roles of our professional practice partners are to:

- Support and advise partners, managing directors, and engagement teams on entity-specific audit matters
- Assimilate information pertaining to the professional practice of the firm
- Monitor compliance with firm policies and professional standards
- Review firm policies and processes in an effort to continuously improve audit quality
- Provide performance feedback related to audit quality for Audit partners and managing directors in the business unit.

2.2 Issue Council

The role of the Issue Council is to provide counsel to the National Managing Partner of Audit Quality and Professional Practice, its chair, on current and emerging auditing, accounting, reporting, and audit quality control matters to achieve our goal of executing consistently high-quality audits. Each of the National Managing Partner's direct reports, as described above, serve on the Issue Council. Other members include the National Managing Partner of Audit Operations, the National Partner in Charge of Risk Management – Audit and Independence, and other members of the firm's senior Audit leadership team. To fulfill its role, the Issue Council considers both internally

and externally generated information associated with audit quality matters and then develops and recommends remedial plans and determines responsibilities for the execution and monitoring of those plans. The final remedial plans and responsibilities for execution and monitoring are approved by the National Managing Partner of Audit Quality and Professional Practice.

2.3 Inspections Group

The Inspections Group executes the firm's annual internal inspection program, the Quality Performance Review (QPR) Program, for the Audit practice, performs preissuance quality inspections, and liaises closely with the RCCG. In addition, the Inspections Group coordinates and is the principal interface for external quality reviews of the firm's Audit practice, including the annual PCAOB inspection of the firm, the AICPA peer review program, and other auditor regulator inspection groups.

To further ensure the objectivity of those who conduct internal reviews and interact with external inspectors and peer reviewers, in 2017, our Inspections Group began reporting to the firm's Vice Chair – Legal, Risk and Regulatory (LRR). The Vice Chair – LRR reports directly to the Chairman and CEO and has no operational responsibilities, thereby further insulating the Inspections Group from business or operational pressures.

The Inspections Group's work is discussed in more detail in Section 7, "Monitoring."



3. Engagement performance

Engagement performance encompasses all aspects of the design and execution of an audit engagement, including the firm's audit methodology and the supervision, consultation, documentation, review, and communication of audit results. Our global audit quality framework assists every KPMG partner and professional in concentrating on the skills and behaviors needed to deliver an appropriate, independent audit. In addition, the firm's training includes programs designed to enhance professionals' ability to apply judgments by incorporating KPMG's judgment framework that addresses how to recognize and overcome biases in making judgments and applying appropriate professional skepticism.

3.1 The KPMG LLP Audit

KPMG International's Global Services Centre consists of professionals who develop and regularly update the methodologies that constitute the global audit process, in cooperation with KPMG International's ISG and the U.S. firm's AQPP.

The KPMG Audit is, where applicable, an integrated audit model, which incorporates both the audit of the financial statements and the audit of internal control over financial reporting. Our integrated audit is enhanced through timely communications throughout the audit process with the audit committee and management of the audited entity.

We use our knowledge and experience to identify and assess risks to determine the nature, timing, and extent of audit procedures to be performed. The higher the risk, the more persuasive the audit evidence needs to be to mitigate such risks. We exercise professional skepticism throughout the audit in gathering and objectively evaluating the sufficiency and appropriateness of audit evidence obtained, which includes evidence that is confirming as well as disconfirming.

The KPMG Audit addresses both manual and automated controls of entities we audit and includes integration of the firm's information technology professionals and other specialists into the core audit engagement team, when appropriate. Our audit also includes procedures aimed at identifying and responding to fraud risks.

Our audit methodology is facilitated through eAuditIT, the firm's electronic audit tool. eAuditIT is an activity-based work flow and electronic audit file that integrates our methodology, guidance, industry knowledge, and tools needed to facilitate the audit process.

The KPMG audit also guides the conduct of audits of financial statements consisting of two or more components (group audits) and clearly delineates responsibilities relative to managing group audits and the involvement of the group audit engagement team in the work performed by the component auditor. Our audit methodology includes policies and guidance related to those matters that merit special consideration in performing group audits, including:

- Performing the group risk assessment
- Identifying significant components
- Identifying significant accounts/disclosures and relevant assertions at the group level
- Evaluating group-wide controls
- Establishing group and component materiality
- Communicating with the component auditors
- Being involved in the risk assessment for significant components
- Evaluating the results and findings of all work performed and considering whether sufficient appropriate audit evidence has been obtained.

3.2 Supervision, review, and support for the engagement team

Supervision entails directing the efforts of professionals who are involved in accomplishing the objectives of the audit and determining whether those objectives were accomplished. Elements of supervision include instructing and guiding professionals; keeping informed of significant issues; reviewing the work performed; addressing auditing, accounting, and reporting matters; and agreeing on appropriate conclusions.

3.3 Consultation and differences of opinion

The firm has established protocols for consultation and documentation regarding significant accounting, reporting, and auditing matters, including procedures to resolve differences of opinion on audit engagement issues. Consultation within the firm is encouraged and, in certain circumstances, required. Technical support for each engagement team comes from AQPP and a network that includes a variety of specialists in a wide range of technical topics such as tax, valuation, technology, and other business areas, as well as the professional practice partners.

Differences of opinion may arise within the engagement team, with those consulted, or between the lead audit engagement executive, who may be a partner or (for private clients) managing director, and the engagement quality control reviewer (or limited scope quality control reviewer where applicable). In circumstances when an engagement team member does not agree with the resolution of the difference of opinion, even after appropriate consultation, and believes it necessary to be disassociated from the matter, the individual documents the matter, including the basis for resolution, in the audit documentation and consults with AQPP. Where partners or managing directors involved in the audit are unable to resolve an issue, the matter may be elevated for resolution by AQPP. In any case, we do not issue the auditor's report until differences of opinion are resolved and the resolution is implemented and documented.

3.4 Quality control review

Each KPMG LLP audit involves either an engagement quality control review or a limited scope quality control review. A quality control review is an important element of the firm's system of quality control that is designed to provide reasonable assurance that, among other things, the entity's financial statements comply with applicable accounting and reporting standards and relevant regulatory requirements and that the auditor's report is appropriate. An engagement quality control review is also designed to provide reasonable assurance that the engagement team has appropriately identified significant risks in the audit, including fraud risks, and designed and executed audit procedures to address those risks. Engagement quality control review or limited scope quality control review responsibility is assigned to a partner, or where permitted, a managing director, who has no involvement on the engagement other than that relating to performing a review of the financial statements, auditors' reports, and certain audit documentation. Engagement quality control reviewers and limited scope quality control reviewers are expected to maintain their objectivity

throughout their review, and if it is concluded that the reviewer's objectivity is impaired, another quality control reviewer is appointed.

Quality control reviewers meet certain qualifications and criteria to perform a quality control review for a particular engagement. Partners who perform engagement quality control reviews of public company audits are provided incremental internal training; these individuals are the firm's most experienced technical partners and are knowledgeable and experienced in SEC accounting and reporting matters and PCAOB professional standards (including, specifically, PCAOB Auditing Standard No. 1220, *Engagement Quality Review*).

Our firm's policies require some level of quality control review prior to the report release date of the related reports for financial statement audits, integrated audits, financial statement reviews, reviews of interim financial information, audits or reviews by component auditors (with certain exceptions), and other reports (except compilation reports) that may be used by more than one KPMG International member firm or relied upon by other parties.

In general, quality control reviewers discuss significant matters arising out of the engagement with the lead audit engagement partner or managing director, review audit documentation related to significant judgments and conclusions, review the appropriateness of the financial statements and related disclosures, review the reports to be issued, and, for engagement quality control reviews, evaluate the audit engagement team's response and conclusions with respect to significant risks. In an integrated audit, the engagement quality control review includes the review of management's report on internal control over financial reporting and the related auditor's report. Completion of a quality control review is documented when the quality control reviewer has performed the procedures in accordance with the firm's requirements and applicable professional standards and is satisfied that the significant questions raised have been satisfactorily resolved.

3.5 Engagement documentation

Our audit documentation is completed and assembled according to the timeline established by firm policy, and we have implemented administrative, technical, and physical safeguards designed to protect the confidentiality and integrity of client and firm information.

In accordance with the relevant SEC and PCAOB rules, as well as other applicable standards, laws, and contractual requirements, the firm's document retention policies set forth the retention period for audit documentation and other records relevant to an engagement, as well as related matters.

4. Relevant ethical requirements

Ethics, integrity, independence, and objectivity are the pillars of our firm and of the profession. We take our obligations to our clients and the capital markets seriously, and as required by the standards that bind us, are committed to protecting the confidentiality of our clients' sensitive information.

4.1 Ethics and integrity

Our culture is built on the principle that every individual must take personal responsibility for the ethical culture of the firm. As individuals, we take ownership, stay informed, lead by example, consult with others, stand firm, and raise our hands when we see something that is inconsistent with our values or professional responsibilities. Those who manage others act as role models, enhance understanding, set appropriate goals, and are responsive, responsible, fair, and accountable.

The firm's [Code of Conduct \(the Code\)](#) is the cornerstone of our ethics and compliance program. It helps us to articulate our standards of professionalism and integrity expected of all KPMG partners and employees. The Code sets forth our values, shared responsibilities, channels of communication, and key policies and protocols in clear, conversational prose and provides a roadmap to guide how our individual and collective commitments to professionalism and integrity should be manifested and maintained. This approach directly contributes to the success of our strategic priorities, as we look to grow our business by working with companies that share our values and by recruiting and retaining employees who take pride in the positive contributions they make to our ethical culture.

At the time of hire, and each year thereafter as part of an annual confirmation process, every one of our people is asked to confirm in writing that he or she has reviewed the Code, understands it, and agrees to adhere to our values, shared responsibilities, commitments, and promises.

4.2 Independence

Our independence policies require that the firm, its partners and management group, and the personnel assigned to each audit engagement be free from financial interests in and prohibited relationships with the entities we audit and their affiliates, management, directors, and significant owners. The firm requires adherence to applicable independence requirements and ethical standards, which meet or exceed the standards promulgated by the SEC, PCAOB, AICPA, Government Accountability Office (GAO), and other applicable regulatory bodies. These policies and procedures, which cover areas such as personal independence, postemployment relationships, rotation of certain engagement personnel, approval of audit and non-audit services, and the firm's business and financial relationships are subject to ongoing monitoring procedures.

The firm's Independence Group, which reports outside the Audit practice and ultimately to the Vice Chair – LRR, is responsible for the firm's policies, processes, and controls with respect to independence.

4.2.1 Personal independence

- With the support of the firm's Independence Group, each professional is ultimately responsible for maintaining his or her personal independence.
- In addition to our policies prohibiting any firm partner or employee from trading on inside information, our partners, managing directors, managers, and those providing professional services to an entity we audit may not have direct or material indirect investments in an entity we audit or its affiliates (collectively, restricted entities), regardless of whether they are in possession of inside information about such entities.
- Certain other financial relationships with restricted entities (e.g., loans, credit cards, insurance products, and brokerage accounts) may be prohibited or subject to limitations.
- Close family members of certain KPMG partners, managing directors, and employees may not hold certain accounting or financial reporting roles with restricted entities.

4.2.2 Postemployment relationships

- KPMG professionals are required to report promptly to the firm any discussions or contacts between them and a restricted entity regarding possible employment.
- Firm professionals engaged in negotiations regarding possible employment with a restricted entity who are members of the audit engagement team are immediately removed from the audit engagement and their work is reviewed to assess whether the professional exercised appropriate skepticism while working on the engagement.
- If a former professional accepts employment with a restricted entity, the engagement team gives active consideration to the appropriateness or necessity of modifying the audit procedures to adjust for risk of circumvention by the former professional of the firm.
- For SEC-registered entities we audit at the issuer level, a former member of the audit engagement team may not accept employment in a financial reporting oversight role until the required “cooling-off” period has expired.

4.2.3 Rotation

Under the Sarbanes-Oxley Act of 2002 and the SEC’s independence rules, the firm’s Audit partners, certain other partners, and managing directors are subject to specific rotation requirements that limit the number of consecutive years certain individuals may provide services to an SEC-registered entity we audit. To monitor compliance with these requirements, the firm uses its Partner Rotation System, which assists in monitoring assignments of certain personnel and initiating personnel changes on entities

we audit. Additionally, Risk Management – Audit, which reports outside of the Audit practice to the Vice Chair – LRR, must approve any proposed change of a lead audit engagement partner of an SEC registrant if the change is for any reason other than required partner rotation or normal partner retirement. Our monitoring system also aids in the development of timely transition plans that help the firm to deliver consistent quality service to the entities we audit. The process of monitoring and tracking service time and rotations is subject to compliance testing as part of various monitoring functions.

4.2.4 Approval of audit and non-audit services

The applicable lead audit engagement partner or managing director receives notification of all services to be provided to restricted entities. For SEC-registered entities, this partner or managing director obtains preapproval of permitted services from the audit committee.

KPMG International’s proprietary system, Sentinel, facilitates compliance with the firm’s policies related to the provision of services and also is used to identify potential conflicts of interest within and across member firms in the KPMG International network. Lead audit engagement partners and managing directors are required to maintain legal and ownership structures in Sentinel for their audit clients and their affiliates. KPMG International member firms are required to enter every engagement into Sentinel prior to starting work. For SEC-registered and certain non-public entities we audit, the applicable lead audit engagement partner or managing director reviews and approves or denies any proposed service upon receipt of the Sentinel notification. For engagements subject to



GAO standards, the firm requires approval by the lead audit engagement partner or managing director before commencement of non-audit services. Our policies and Sentinel help the firm prevent the provision of prohibited services to our audit clients and their affiliates, facilitates the process for audit committee preapproval of permitted services (as required), and allows us to identify and manage potential conflicts of interest. Sentinel and KPMG's management of conflicts of interest processes also are described in Section 5.2 of this report.

4.2.5 Business relationships, suppliers, and financial relationships

Our firm has policies and procedures in place that are designed to ensure that business, supplier, and financing relationships are identified, assessed, and maintained in accordance with applicable independence standards. Compliance with these policies and procedures is monitored by the Independence Group.

4.2.6 Training and reporting

KPMG has established processes to communicate independence policies and procedures to our personnel. Among other things, the firm requires all professionals to complete independence training every year and affirm their independence using an electronic confirmation system. This confirmation is completed upon commencement of employment at the firm, every year thereafter, and at key promotions.

4.2.7 Monitoring

KPMG monitors compliance with its independence policies related to personal financial interests through the KPMG Independence Compliance System (KICS), as well as through a compliance audit process.

KICS contains an inventory of SEC registrants and other entities that require us to be independent and the securities they have issued; these entities are marked "restricted" in KICS. Before purchasing a security, securing a loan, or initiating another financial relationship, partners, managing directors, and managers are required to use KICS to determine if the entity is restricted. Additionally, personal investments are required to be reported in KICS, which automatically notifies professionals if an investment becomes "restricted." As of September 30, 2017, and subject to limited exceptions, all managers and above were required to use only brokers that link to and automatically feed into our professionals' KICS accounts, thereby better ensuring timely identification and disposal of potentially prohibited investments.

To monitor our professionals' and the firm's independence, in fiscal year 2017, the firm audited the financial relationships of more than 500 individuals subject

to the independence requirements. Failures to comply with the firm's independence policies are referred to a panel of specified members of leadership for review, remediation, and disciplinary actions, as required, helping to ensure consistent resolution. Also to help ensure that the firm remains independent of entities for which it performs assurance services, the firm's Independence Group reviews all new firm financial transactions for potential independence issues and conducts monthly audits of the firm's investments and loans to confirm that there are no investments in, or loans from, restricted entities. Tests for ownership threshold levels are included to help ensure that any indirect financial interest in an entity we audit is not material.

Through participation in the Audit, Advisory, and Tax Quality Review Programs, the Independence Group evaluates engagements for compliance with independence requirements and related firm policies. Audit engagements are reviewed to determine compliance with requirements related to partner rotation, fees outstanding at commencement of the audit, maintenance of group legal and ownership structures for entities we audit and their affiliates in Sentinel, audit committee preapproval of services, required communications, and former partners in an accounting or financial reporting oversight role at the entity we serve. Non-audit services provided by Advisory and Tax to SEC-restricted audit entities are also reviewed to determine compliance with engagement set-up and contracting requirements and to ensure permissibility and audit committee preapproval of such services.

4.3 Objectivity

We work diligently to ensure our objectivity in all we do. Firm personnel are vigilant to recognize actual and potential conflicts of interest, identifying them at the earliest opportunity to resolve, manage, or avoid the conflict. If significant threats to objectivity cannot be reduced within an acceptable level, a conflict of interest may preclude the firm from accepting an entity as a client or a specific engagement.

4.4 Confidentiality

KPMG has policies and processes in place to help ensure that any nonpublic information that comes to the attention of our personnel as a result of their association with the firm (confidential information) is treated confidentially, in accordance with applicable laws, professional standards, and contractual requirements. All KPMG personnel are trained on the firm's confidentiality policies when they join the firm and confirm their understanding of and adherence to KPMG's confidentiality policies at the time of hire and annually thereafter.

5. Acceptance and continuance reviews of audit entities and specific engagements

We recognize that rigorous entity and engagement acceptance and continuance policies are vitally important to the firm's ability to provide high-quality professional services, and the firm has established policies and procedures for deciding whether to accept or continue a professional relationship and whether to perform specific services for a particular entity. We developed and utilize a tool, known as CLEAS (Client/Engagement Acceptance and Setup), to manage, control, and document entity and engagement acceptance and continuance processes. An engagement code cannot be set up in the firm's financial system, and an engagement team is not permitted to commence work on an engagement, before approval is obtained.

Risk Management – Audit is responsible for developing risk management policies for the Audit practice, including those relating to entity and engagement acceptance and continuance. The firm's risk management systems, including CLEAS and the Partner Rotation System, fall under the responsibilities of the firm's Risk Management group, which reports outside of the Audit practice to the Vice Chair – LRR and of which Risk Management – Audit is a part.

5.1 Prospective entity and engagement evaluation processes

Prior to accepting an audit engagement with a new audit entity, firm policies require an evaluation of the entity and its principals, its business, and engagement-related matters, as appropriate. This evaluation typically includes a background investigation of the entity and selected senior management personnel.

Factors considered during the acceptance process include, but are not limited to:

- Character and competency of management and those charged with governance of the entity (company reputation, financial viability, and control environment)
- Business-related matters (industry, products, competitors, and extent and location of key foreign operations)

- Service-related matters (firm and engagement team competency and capacity and technical risk associated with services requested)
- Independence-related matters (employment-related matters, financial relationships, investments, loans, and non-audit services).

5.2 Independence and conflict check system

Engagement teams proposing to perform a new audit engagement and the Independence Group perform a series of procedures, including a review of relationships the firm or covered persons may have with the prospective audit client, including the non-audit services, if any, provided by the firm to the prospective audit client and its affiliates. The Sentinel system, discussed earlier in this report, is used to identify and manage potential independence issues and other conflicts of interest within and across member firms in the KPMG International network. If a potential independence issue or conflict cannot be resolved satisfactorily, in accordance with professional and firm standards, the prospective entity or engagement is declined.

5.3 Continuance process

Lead audit engagement partners and managing directors are required to review and evaluate their existing audit and attestation engagements with their professional practice partner at least annually. An engagement continuance evaluation is a process of formal approvals by various parties, including the regional professional practice partner in certain situations. The objective of these reviews is to identify those engagements where the firm should consider implementing additional safeguards to address audit risk and/or those instances where the firm should discontinue its professional association with the entity. In addition, certain factors that may alter the risk profile of the client, such as a significant change in the nature, size, structure, ownership, or management of an entity's business, require additional evaluation procedures to be conducted.

6. Personnel management

The firm's personnel management system encompasses the areas of:

- Recruitment and hiring
- Assignment of engagement teams
- Professional development
- Performance measurement, advancement, and compensation.

6.1 Recruitment and hiring

Prior to receiving an offer of employment, all candidates for professional positions complete and submit an application for employment and are provided access to the firm's independence guidelines to ensure these requirements are understood early in the recruiting process. Candidates are interviewed and a decision is made whether to extend an offer to the candidate. For all hires, if an offer is made and accepted, they are asked to complete an authorization for release of information, which authorizes the firm to conduct a background investigation on a candidate. Candidates are subject to background checks where the information provided is verified through independent sources. Upon joining the firm, personnel are also required to complete training programs on independence, ethics, respect and dignity, protection of confidential information, document retention, and security, in addition to any applicable practice-related training programs. Situations involving independence or conflicts of interest are resolved before the individual can begin employment.

6.2 Assignment of engagement teams

Individuals are assigned to specific engagements based on their skill sets, relevant professional and industry experience, the nature of the assignment or engagement, and available capacity. Lead audit engagement partners and managing directors and engagement quality control reviewer and limited scope quality control reviewer assignments are approved by business unit leadership and may be approved by regional and national leadership based on the individual characteristics of the entity being audited.

The lead audit engagement partner or managing director considers whether the engagement team collectively has the appropriate competencies and capabilities,

including capacity to perform the audit engagement in accordance with firm policies, professional standards, and applicable legal and regulatory requirements and to enable an appropriate auditors' report(s) to be issued. The competencies and capabilities of an engagement team include:

- An understanding of, and practical experience with, audit engagements of a similar nature and complexity through appropriate training and participation
- An understanding of professional standards and legal and regulatory requirements
- Technical skills, including in specialized areas of accounting or auditing such as tax, actuarial, and valuation
- Knowledge of relevant industries in which the audit entity operates
- Ability to apply judgment and professional skepticism
- An understanding of KPMG's audit quality control policies and procedures.

6.3 Professional development

Our professionals are required to maintain their technical competence and to comply with applicable regulatory and professional requirements regarding continuing professional education (CPE). The firm offers a broad range of learning opportunities to help our professionals meet these requirements, as well as their own professional development goals, while supporting the firm's commitment to audit quality. Our methods of instruction include traditional classroom environments, live virtual classroom sessions, and a variety of technology-based learning solutions, such as Web-based self-studies, performance support assets, instructional videos, and audit simulations. To continuously improve the effectiveness and impact of our learning solutions, the firm assesses results through course evaluations, focus groups, testing, and follow-up surveys. We also provide our professionals with an online system to help them and the firm monitor compliance with the requirements.

The firm requires that client service professionals who are eligible to hold a certified public accountant (CPA) license (i.e., those who have passed the CPA exam and met applicable state educational and experience requirements) be licensed to practice in the state where their principal place of business is located and meet CPA licensing or reciprocity requirements in any other state in which they practice public accounting. We closely monitor license expiration and renewal for our professionals using a database that automatically generates a notification prior to license expiration. Professionals who are deficient in meeting the firm's CPA licensing requirements may be subject to disciplinary action.

The firm's Ethics and Compliance Group is responsible for testing and monitoring compliance with firm policies related to continuing professional education and licensing.

6.4 Performance measurement, advancement, and compensation

The firm's professionals, including partners, are subject to annual goal setting and performance evaluations conducted by trained people management leaders, who are familiar with the professionals' performance. The firm's performance measurement model has been developed to provide a consistent framework by which leadership and people management leaders may discuss performance relative to goals and objectives and career development aspirations. Each professional is evaluated on his or her attainment of agreed-upon goals, demonstration of skills and behaviors, and adherence to the firm's values. Skills and behaviors evaluated include quality focus and professionalism (including baseline ethics and integrity goals for all personnel), technical knowledge, accountability, business and strategic focus, leading and developing people, continuous learning, and relationship building. The results of the annual performance evaluation directly affect compensation and advancement of firm personnel, including partners, and in some cases, their continued association with the firm.

Our process for admission to the partnership is rigorous and thorough. Each candidate for the partnership, whether a direct-entry hire or internal nomination, undergoes a background check and is interviewed by several members of firm leadership, including a professional practice or risk management partner and a member of the Board of Directors. Furthermore, an extensive review for each internal partner candidate is completed by a number of departments, including the Ethics and Compliance Group, AQPP, Risk Management, and the Office of General Counsel. All recommendations for admission to the partnership must be approved by an affirmative vote of two-thirds of the firm's Board of Directors.

Audit partner compensation is determined annually by Audit leadership and approved by the firm's Management Committee and Board of Directors. The professional practice partners have significant involvement in evaluating Audit partner performance, including consideration of audit quality indicators, and compensation.

All partners are compensated out of the distributable profits of the firm. The determination of the profits available for distribution is based on the results of the firm as a whole and is not dependent directly on the performance of any particular line of business or function. Partner compensation is composed primarily of a predetermined proportion of the profits for the year, which is based, in part, on the experience and responsibilities of each partner.

Audit quality performance is the central factor in evaluating and compensating Audit partners. Audit partners and leaders are evaluated based on an assessment of audit quality indicators. Additionally, one of the factors considered in the compensation of Tax and Advisory partners who participate in audit engagements includes achievement of appropriate audit quality goals. Our policies for setting compensation amounts do not allow an Audit partner (and certain other partners meeting the definition of an Audit partner for purposes of this policy) to be compensated for the sale of non-audit services to an entity that he or she audits.

7. Monitoring

Our monitoring procedures include the firm's internal inspection program, or QPR Program, our internal independence and compliance testing processes, preissuance monitoring programs, root cause analysis process, and other activities elsewhere described in this report. The results of these monitoring activities, as well as the results of external regulatory inspections by the PCAOB and other auditor regulators and peer reviews, are evaluated continuously and involve ongoing consideration and evaluation by the firm of the following matters:

- Relevance and adequacy of the firm's messaging, policies, procedures, and practices
- Appropriateness of the firm's guidance materials, tools, and practice aids
- Effectiveness of professional development activities
- Compliance with professional and firm standards, policies, and procedures
- Effectiveness of action plans developed to address systemic findings related to audit engagement performance and our system of audit quality control.

7.1 Internal inspection processes

KPMG annually reviews, through its QPR Program, a selection of the audits conducted during the annual time period. The QPR Program is designed to meet the quality control element of monitoring required by applicable professional standards promulgated by the PCAOB and the AICPA. Like most companies with quality review programs, we identify areas for continuous improvement and address our findings through enhancement of our audit process, audit quality infrastructure, people and processes; policies, tools, and guidance, where appropriate; other communications to our professionals; internal training; and periodic partner, manager, and staff meetings. Areas for improvement identified in prior periods are emphasized in subsequent years of the QPR Program to assist understanding whether we are improving performance in those areas.

Components of the QPR Program include:

- A central review team, or the Inspections Group, that consists of partners, managing directors, directors, and senior managers, supplemented by other firm professionals with applicable industry and technical knowledge



- Regular reviews of audit engagements of individual partners and managing directors generally following a three-year rotating schedule
- Reviews of audit engagements of selected individual managers in a lead role for an SEC-registered entity we audit
- Reviews of other audit engagements using risk-based selection criteria
- Reviews of general and functional controls, including independence, audit entity acceptance and continuance, personnel evaluations, and document retention
- Frequent, timely reporting of firmwide inspection results
- Identification of common inspection findings, those areas where audit quality can be improved, and, where appropriate, recommendations on actions to be taken to achieve improvements in audit quality, which are provided to AQPP for consideration in developing training and guidance for Audit professionals.

7.2 Global Compliance Reviews

Like all member firms of the KPMG International network, we are subject to a cross-functional Global Compliance Review (GCR) once every three years. This GCR is designed by KPMG International and performed by individuals in KPMG International's Global Compliance Group who are external to KPMG LLP. Participation in this program is a condition of ongoing membership in the network. The overall objectives of the GCR are to assess the firm's compliance with selected KPMG International policies and procedures and to share best practices expected to be implemented by KPMG International member firms.

7.3 Risk Compliance Program

In addition to the GCR, the firm is also subject to an annual Risk Compliance Program (RCP). The RCP is a cross-functional self-review program designed by KPMG International to help KPMG International member firms monitor, assess, and document the extent of compliance of their system of quality control with KPMG International's Quality & Risk Management policies, the related International Ethics Standards Board for Accountants code, and International Standard on Quality Control-1 requirements. We utilize various RCP tools to complete our control descriptions, document compliance testing results, and record resulting action plan items. The GCR program acts as a periodic external validation of our annual RCP, and as with the GCR program, participation in the RCP is a condition of ongoing membership in the KPMG network.

7.4 Regulatory external reviews

The PCAOB is empowered to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. To assist it in fulfilling its mission, the PCAOB conducts periodic inspections of registered public accounting firms. We are subject to annual inspection by the PCAOB. Because the PCAOB plays an important role in improving audit quality, the PCAOB's inspection process serves to assist the firm in corroborating areas of focus with our internal inspection program to enhance our engagement performance and strengthen our system of audit quality control.

KPMG has been subject to 14 periodic PCAOB inspections (excluding a limited inspection in 2003). In each of the PCAOB's inspections, certain of KPMG's public company audit engagements were selected for review and certain procedures relating to the activities and responsibilities of KPMG's executive and national offices were performed. The status of the five most recent PCAOB inspections follows:

The PCAOB has not yet released KPMG's 2016 and 2017 inspection reports.

On December 6, 2016, the PCAOB released its 2015 report on the inspection of KPMG. The public portions of the report are available on our Web site, <https://home.kpmg.com/us/en/home/about/regulatory-and-peer-reviews.html>. KPMG submitted its response to the nonpublic portion of this report to the PCAOB in November 2017. The PCAOB has not yet determined whether the firm satisfactorily addressed the quality control matters in the nonpublic portion of the 2015 inspection report.

The PCAOB released its 2014 report on the inspection of KPMG in November 2015. The public portions of the report are available on our Web site, <https://home.kpmg.com/us/en/home/about/regulatory-and-peer-reviews.html>. KPMG submitted its response to the nonpublic portion of this report to the PCAOB in October 2016. The PCAOB has not yet determined whether the firm satisfactorily addressed the quality control matters in the nonpublic portion of the 2014 inspection report.

The PCAOB released its 2013 report on the inspection of KPMG in October 2014. The public portions of the report are available on our Web site, <https://home.kpmg.com/us/en/home/about/regulatory-and-peer-reviews.html>. KPMG submitted its response to the

nonpublic portion of this report to the PCAOB in September 2015. The PCAOB has determined that the firm satisfactorily addressed the quality control matters in the nonpublic portion of the 2013 inspection report.

The PCAOB released its 2012 report on the inspection of KPMG in August 2013. The public portions of the report are available on our Web site, <https://home.kpmg.com/us/en/home/about/regulatory-and-peer-reviews.html>. KPMG submitted its response to the nonpublic portion of this report to the PCAOB in July 2014. The PCAOB has determined that the firm satisfactorily addressed the quality control matters in the nonpublic portion of the 2012 inspection report.

The public portions of the PCAOB's reports do not include information that, under the Act, is considered nonpublic, including any criticisms of a firm's system of quality control. KPMG does not otherwise publicize nonpublic portions of PCAOB inspection reports. However, the firm would be pleased to discuss with our clients significant information contained in the reports and the areas of focus for audit performance improvements.

7.5 External peer review

To comply with licensing requirements of state boards of accountancy and the GAO and membership in the AICPA, we undergo triennial external peer review. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. The firm's most recent peer review report was issued by PricewaterhouseCoopers LLP in December 2014 on the firm's system of audit quality control applicable to engagements not subject to PCAOB permanent inspection (nonpublic entity accounting and auditing practice). KPMG LLP received a peer review rating of *pass* for the year ended March 31, 2014.

KPMG's most recent peer review report and the AICPA's acceptance letter are public documents and are accessible through our Web site at <https://home.kpmg.com/us/en/home/about/regulatory-and-peer-reviews.html>.

7.6 Complaints and allegations (Ethics and Compliance Hotline)

To further our commitment to integrity and an ethical culture, KPMG maintains an Ethics and Compliance Hotline that allows both phone and Web reports to be made through an independent third-party provider by calling the toll-free number, 1-877-576-4033, or by submitting a report via the Web at www.kpmgethics.com. The firm encourages use of the hotline when KPMG partners and employees feel uncomfortable reporting concerns about possible illegal, unethical, or improper conduct through normal channels or when the reporter desires to remain anonymous. The hotline is available to external parties as well, including personnel at entities we serve, vendors, and professionals from other KPMG International member firms. Reports filed through the hotline are directed to the firm's Chief Compliance Officer for review and, if necessary, for assignment of appropriate firm resources for investigation and resolution. All reports are handled confidentially (to the extent allowable by law and consistent with the needs of a thorough investigation). Retaliation for good-faith reporting or for otherwise participating in an investigation is strictly prohibited.





8. Statement of effectiveness of audit quality controls

As set forth earlier in this report, the Vice Chair – Audit has responsibility for our Audit practice, which includes our system of audit quality control, and the National Managing Partner of Audit Quality and Professional Practice is responsible for the day-to-day operation of our system of audit quality control. These individuals regularly review the operation and results of the firm’s internal inspection program as well as the results of the external regulatory and peer reviews. Based on their review of these matters, the Vice Chair – Audit and the National Managing Partner of Audit Quality and Professional Practice confirm with a reasonable level of assurance that KPMG LLP’s system of audit quality control has operated effectively throughout the past year.





