# 2019 Inspection KPMG LLP

(Headquartered in New York, New York)

December 17, 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

PCAOB RELEASE NO. 104-2021-004

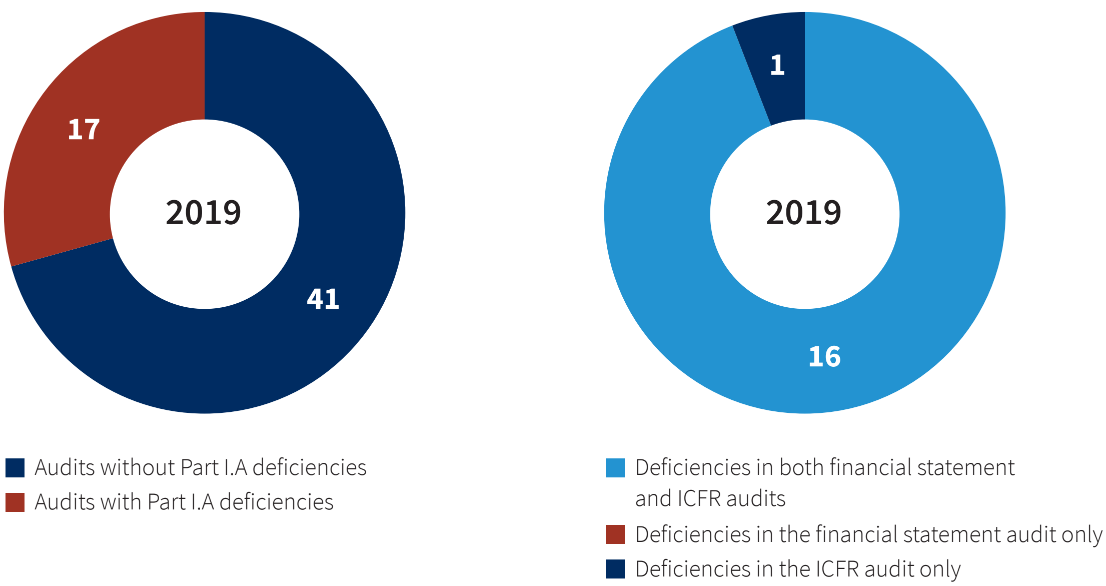
# Executive Summary

Our 2019 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 2019 Deficiencies Included in Part I

Seventeen of the 58 issuer audits we reviewed in 2019 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 and business combinations.




The most common Part I.A deficiencies in 2019 related to identifying controls related to a significant account or relevant assertion, testing the design or operating effectiveness of controls selected for testing, and in some cases the resulting overreliance on controls when performing substantive testing.

Other deficiencies identified during the 2019 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 audit committee communications, Form AP, and critical audit matters.

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# 2019 Inspection

During the PCAOB's 2019 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 58 audits of issuers with fiscal years generally ending in 2018. 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 2019 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.

## 2019 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 also select audits randomly to provide an element of unpredictability. In 2019, we established a target team to perform inspection procedures in areas of current audit risk and emerging topics. For our target team selections, our review focuses primarily on evaluating the firm's procedures related to that risk or topic.

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.

In 2019, our target team reviews focused, in part, on planning and execution of multi-location audits, including risk assessment, principal auditor considerations, and communications between the principal auditor and the other auditor. We also evaluated the firm's determination and communication of critical audit matters ("CAM"), in particular to understand the policies and procedures firms put in place to support and monitor the effective implementation of CAM requirements and how audit teams implemented CAM requirements.[1]

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.

[1] Refer to Staff Update and Preview of 2019 Inspection Observations and Critical Audit Matters Spotlight for observations from the target team reviews. Instances of non-compliance with PCAOB standards and rules identified during the target team reviews are included in Part I.A or Part I.B of this report.

# Overview of the 2019 Inspection and Historical Data by Inspection Year

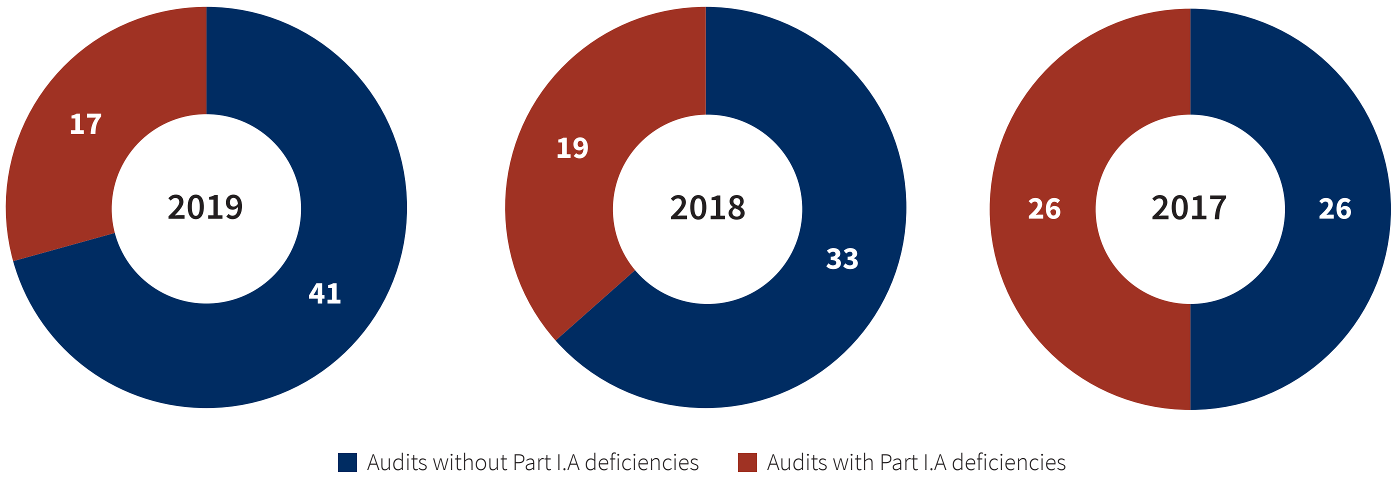
The following information provides an overview of our 2019 inspection as well as data from the previous two inspections. We use a combination of risk-based and random methods to select audits for review and to identify areas on which we focus our review. Because our inspection process evolves over time, it can, and often does, focus on a different mix of audits and audit 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

| | 2019 | 2018 | 2017 |
|---|---|---|---|
| **Total audits reviewed** | 58 | 52 | 52 |
| **Audits in which the firm was the principal auditor** | 55 | 51 | 51 |
| **Audits in which the firm was not the principal auditor** | 3 | 1 | 1 |
| **Integrated audits of financial statements and ICFR** | 52 | 51 | 50 |
| **Risk-based selections** | 39 | 42 | 42 |
| **Random selections** | 13 | 10 | 10 |
| **Target team selections** | 6 | 0 | 0 |

## Part I.A Deficiencies in Audits Reviewed

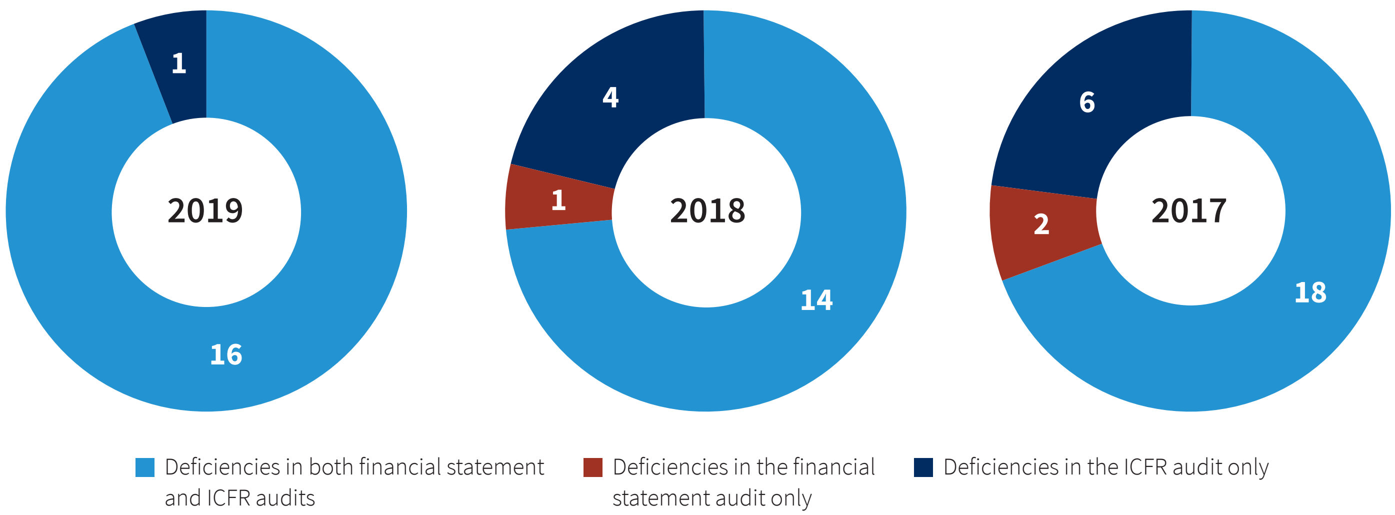
In 2019, 14 of the 17 audits appearing in Part I.A were selected for review using risk-based criteria. In 2018, 16 of the 19 audits appearing in Part I.A were selected for review using risk-based criteria. In 2017, 23 of the 26 audits appearing in Part I.A were selected for review using risk-based criteria.



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 the current 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 2019 inspection procedures for one audit, the issuer restated its financial statements and the firm revised and reissued its report on the financial statements. In connection with our 2019 inspection procedures for this audit and for one additional audit, the issuers revised their reports on ICFR and the firm modified its opinions on the effectiveness of the issuers' ICFR to express adverse opinions and reissued its reports. In addition, in connection with our 2019 inspection procedures for one audit, the issuer disclosed in a subsequent filing that a material weakness existed as of the date covered by the firm's audit that was subject to our review.

The following tables and graphs summarize inspection-related information, by inspection year, for 2019 and the previous two inspections. We caution against making 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 | | |
|---|---|---|---|
| | 2019 | 2018 | 2017 |
| **Did not perform substantive procedures to obtain sufficient evidence as a result of overreliance on controls (due to deficiencies in testing controls)** | 8 | 8 | 13 |
| **Did not perform sufficient testing related to an account or significant portion of an account or to address an identified risk** | 7 | 4 | 7 |
| **Did not sufficiently evaluate significant assumptions or data that the issuer used in developing an estimate** | 6 | 5 | 10 |

| Deficiencies in ICFR audits | Audits with Part I.A deficiencies | | |
|---|---|---|---|
| | 2019 | 2018 | 2017 |
| **Did not identify and test any controls related to a significant account or relevant assertion** | 12 | 10 | 13 |
| **Did not perform sufficient testing of the design and/or operating effectiveness of controls selected for testing** | 10 | 9 | 17 |
| **Did not identify and/or sufficiently test controls over the accuracy and completeness of data or reports that the issuer used in the operation of controls** | 3 | 8 | 6 |

## Audit Areas Most Frequently Reviewed

This table reflects the five audit 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.

| 2019 | | | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|---|---|
| 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 | 9 | Revenue and related accounts | 40 | 10 | Revenue and related accounts | 40 | 11 |
| Inventory | 14 | 2 | Inventory | 20 | 3 | Inventory | 19 | 5 |
| Investment securities | 12 | 2 | Income taxes | 13 | 1 | Business combinations | 16 | 1 |
| Business combinations | 11 | 3 | Business combinations | 12 | 3 | Long-lived assets | 12 | 2 |
| Allowance for loan losses | 11 | 2 | Investment securities | 12 | 0 | Loans and related accounts | 11 | 5 |

## Audit Areas with Frequent Part I.A Deficiencies

This table reflects the audit 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 | 2019 | | 2018 | | 2017 | |
|---|---|---|---|---|---|---|
| | 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 | 9 | 40 | 10 | 40 | 11 | 40 |
| Business combinations | 3 | 11 | 3 | 12 | 1 | 16 |
| Inventory | 2 | 14 | 3 | 20 | 5 | 19 |
| Allowance for loan losses | 2 | 11 | 2 | 11 | 5 | 10 |
| Derivatives | 2 | 5 | 1 | 3 | 3 | 5 |
| Investment securities | 2 | 12 | 0 | 12 | 3 | 11 |
| Loans and related accounts | 0 | 5 | 1 | 5 | 5 | 11 |

**Revenue and related accounts:** The deficiencies in 2019, 2018, and 2017 primarily related to substantive testing of, and testing controls over, revenue.

**Business combinations:** The deficiencies in 2019 primarily related to substantive testing of, and testing controls over, acquired loans. 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.

**Inventory:** The deficiencies in 2019 related to testing controls over the existence of inventory and the resulting overreliance on controls when performing substantive testing. The deficiencies in 2018 primarily related to testing controls over the accuracy and completeness of data or reports. The deficiencies in 2017 primarily related to substantive testing of the valuation of inventory and testing cycle-count controls.

**Allowance for loan losses:** The deficiencies in 2019 primarily related to testing controls over the 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 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.

**Derivatives:** The deficiencies in 2019, 2018, and 2017 primarily related to testing controls over derivatives.

**Investment Securities:** The deficiencies in 2019 and 2017 primarily related to testing controls over investment securities.

**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 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

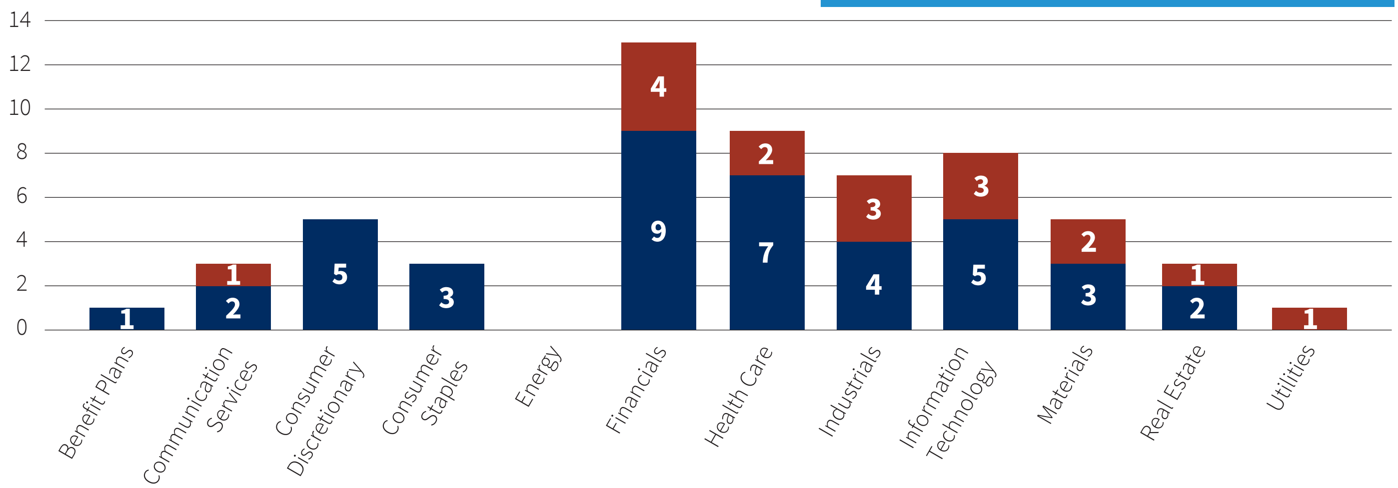
The following lists the auditing standards referenced in Part I.A of the 2019 and the previous two inspection reports and the number of times that the standard is cited in Part I.A.

| PCAOB Auditing Standards | 2019 | 2018 | 2017 |
|---|---|---|---|
| **AS 1105,** ***Audit Evidence*** | 3 | 2 | 1 |
| **AS 2101,** ***Audit Planning*** | 1 | 0 | 1 |
| **AS 2110,** ***Identifying and Assessing Risks of Material Misstatement*** | 0 | 0 | 1 |
| **AS 2201,** ***An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*** | 38 | 46 | 50 |
| **AS 2301,** ***The Auditor's Responses to the Risks of Material Misstatement*** | 15 | 13 | 22 |
| **AS 2305,** ***Substantive Analytical Procedures*** | 0 | 1 | 2 |
| **AS 2310,** ***The Confirmation Process*** | 0 | 2 | 3 |
| **AS 2315,** ***Audit Sampling*** | 9 | 9 | 16 |
| **AS 2401,** ***Consideration of Fraud in a Financial Statement Audit*** | 1 | 0 | 0 |
| **AS 2501,** ***Auditing Accounting Estimates*** | 2 | 5 | 8 |
| **AS 2502,** ***Auditing Fair Value Measurements and Disclosures*** | 5 | 5 | 6 |
| **AS 2510,** ***Auditing Inventories*** | 1 | 0 | 0 |
| **AS 2810,** ***Evaluating Audit Results*** | 1 | 4 | 1 |

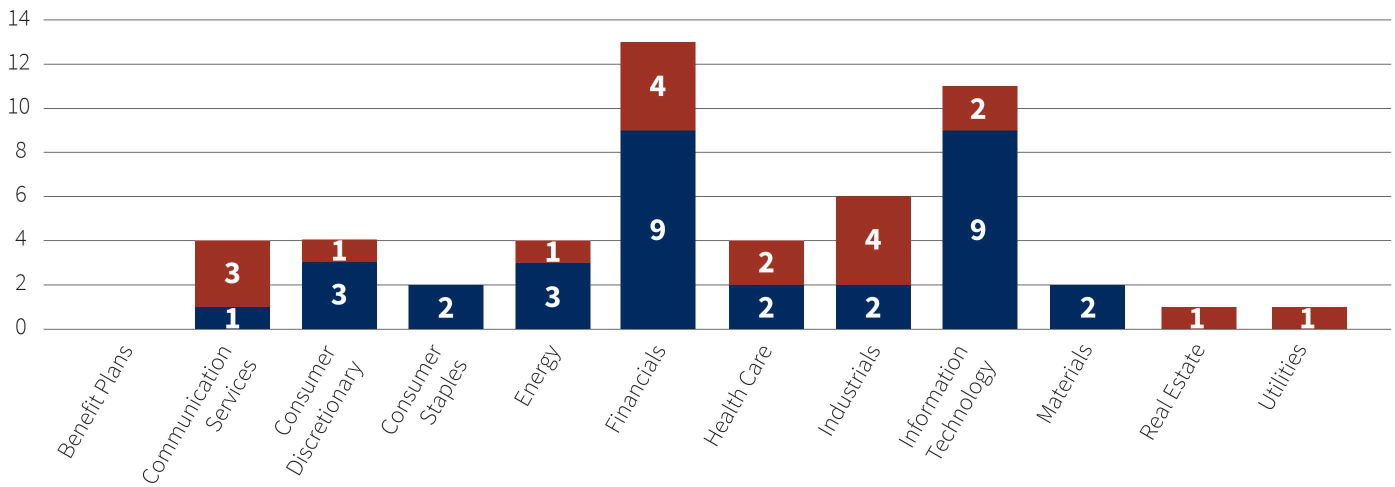
# Inspection Results by Issuer Industry Sector

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.

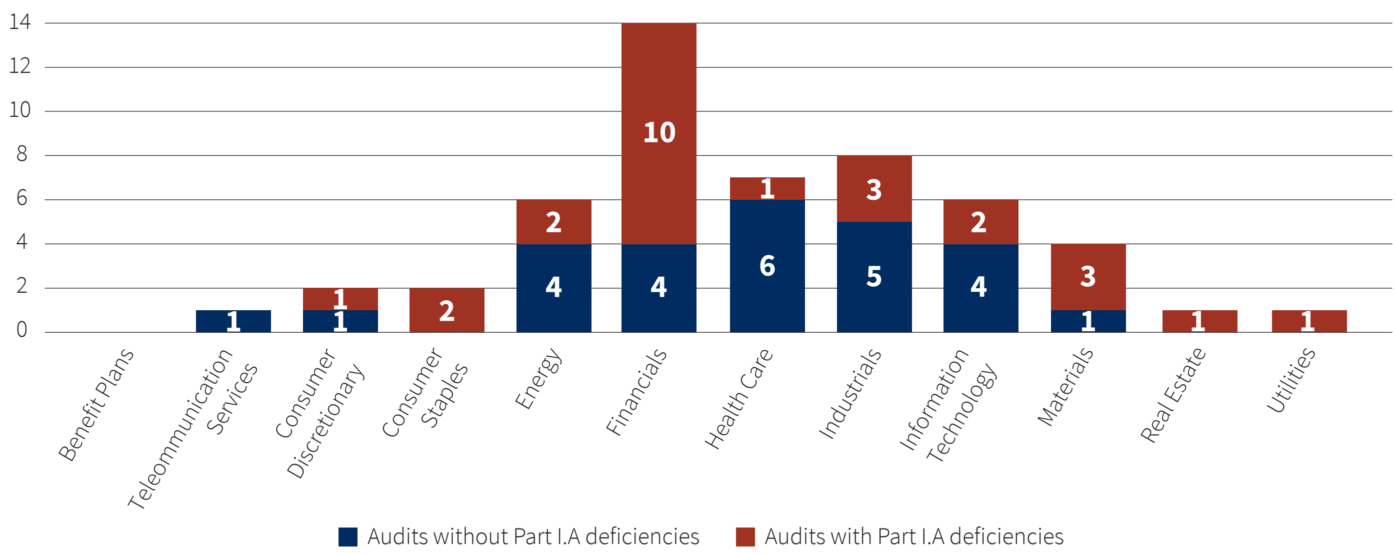
## 2019




## 2018

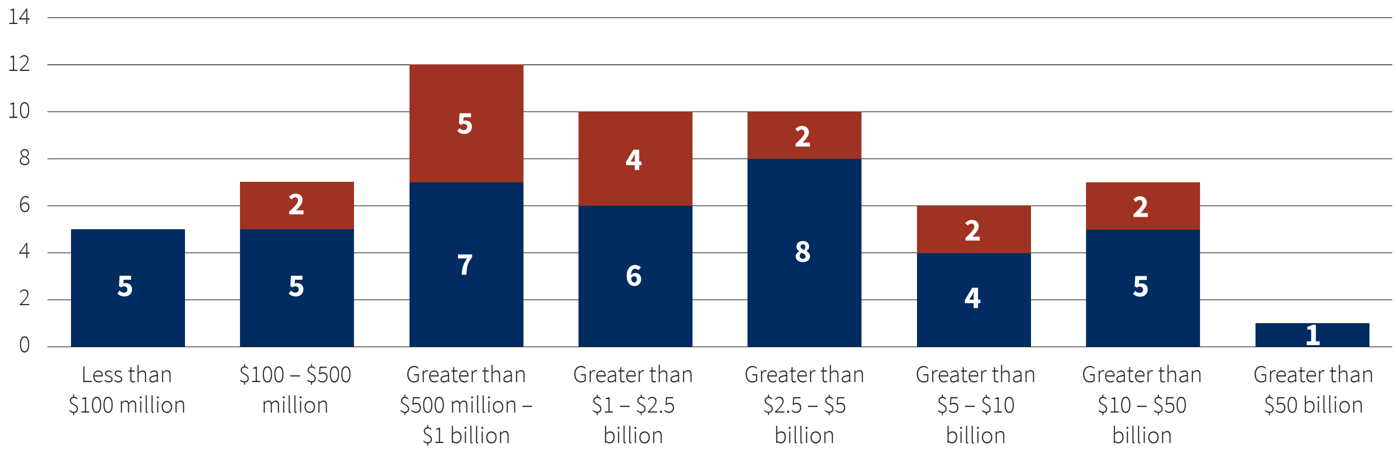



## 2017

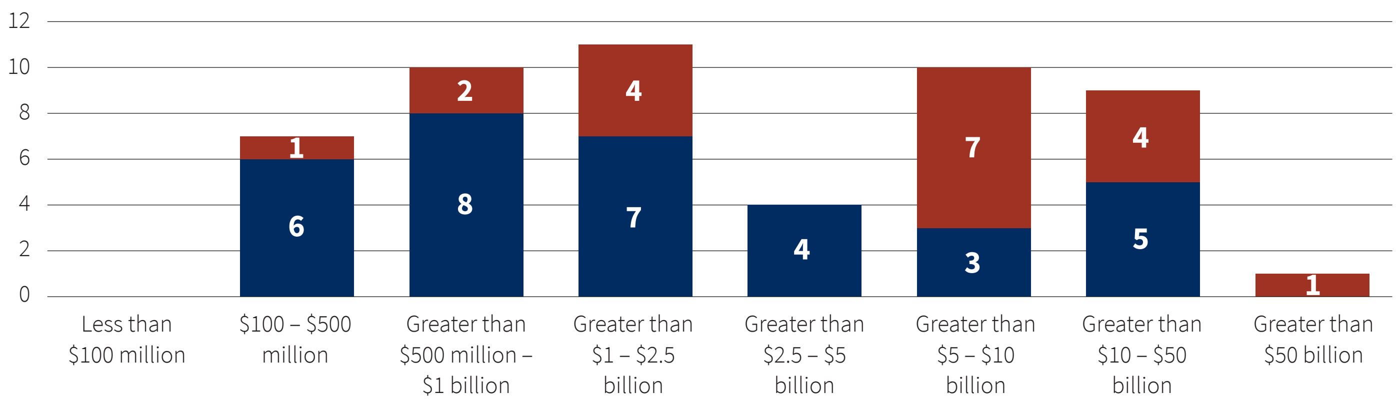


# Inspection Results by Issuer Revenue Range

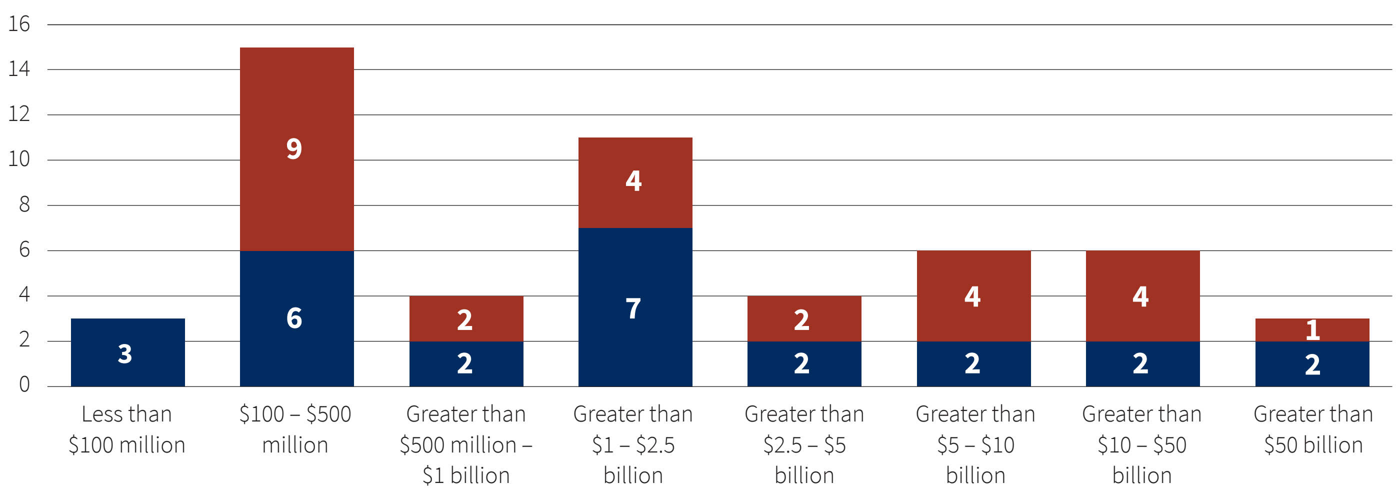
## 2019




## 2018




## 2017




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 a 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 a 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. This classification does not include instances where, unrelated to our review, an issuer restated its financial statements and/or an issuer's ICFR was determined to be ineffective. Any deficiencies identified in connection with our reviews of these audits would be included in the audits with multiple deficiencies or audits with a single deficiency classification below.

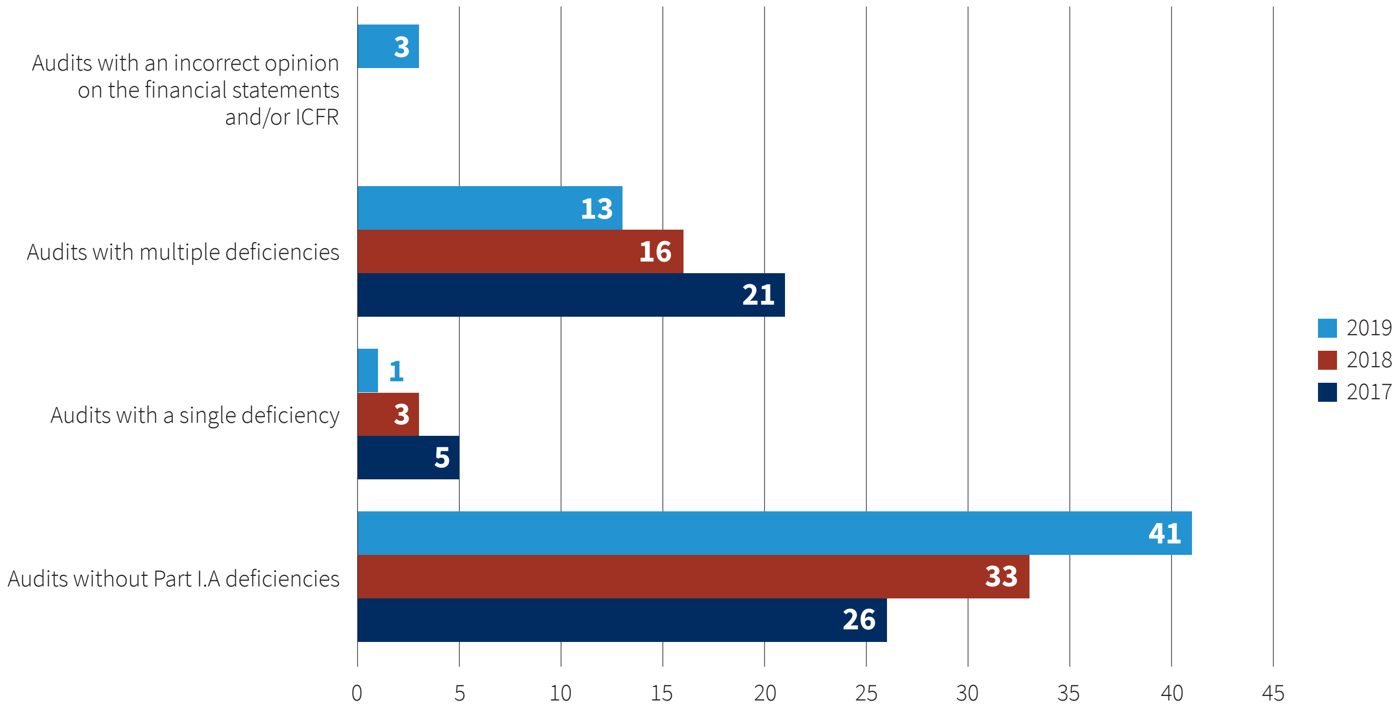
### Audits with Multiple Deficiencies

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

### Issuer A – Information Technology

#### 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 firm did not identify that, at the time of the audit, the issuer's recognition of certain revenue from arrangements with multiple elements that consisted of software license and maintenance deliverables was not in conformity with FASB ASC Subtopic 985-605, *Software Revenue Recognition*. (AS 2810.30)

In connection with our review, the issuer reevaluated its accounting for these arrangements and concluded that a material misstatement existed that had not been previously identified. The issuer subsequently restated its financial statements, and the firm revised and reissued its report on the financial statements. The issuer also reevaluated its controls over the accounting for these arrangements and concluded that a material weakness existed that had not been previously identified. The issuer subsequently revised its report on ICFR to reflect this material weakness, and the firm modified its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

The issuer recognized revenue from certain other types of arrangements based on the amount of time incurred to provide professional services and the rates in the agreements with its customers. The firm did not identify and test any controls over the accuracy of the time information that the issuer used to calculate this revenue. (AS 2201.39)

The firm used the issuer's time information in its substantive testing of this revenue. The firm did not test, or (as discussed above) test controls over, the accuracy of this information. (AS 1105.10)

## 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 **Inventory** and **Revenue**.

### Description of the deficiencies identified

With respect to **Inventory**:

The issuer designed its cycle-count procedures at one of its locations to exclude a portion of the inventory from the cycle counts. In evaluating the design of this control, the firm did not assess the effect of the issuer excluding this portion of inventory on the control's ability to effectively prevent or detect a material misstatement. (AS 2201.42)

In connection with our review, the issuer reevaluated its control over this inventory and concluded that a material weakness existed that had not been previously identified. The issuer disclosed the material weakness in a subsequent filing and noted that the material weakness existed as of the date covered by the firm's audit that was subject to our review.

Due to the deficiency discussed above, the firm did not obtain sufficient appropriate audit evidence that the cycle-count procedures the issuer used for this inventory were sufficiently reliable to produce results substantially the same as those that would have been obtained by a count of all items each year. (AS 2510.11)

With respect to **Revenue**:

The issuer recognized certain revenue from contracts using the percentage-of-completion method. The following deficiencies were identified:

- The firm selected for testing a control over this revenue that consisted of the review of an analysis of estimated gross margin by contract. The firm did not evaluate the review procedures that the control owner performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44) In addition, the firm did not test the aspect of this control related to the control owner's assessment of whether the costs incurred to date included in the analysis were accurate, complete, and allowable under the contracts. (AS 2201.42 and. 44)
- The firm did not perform any substantive procedures to evaluate the reasonableness of the estimated costs to complete open contracts. (AS 2501.07)
- The firm did not perform any substantive procedures to test the completeness of the costs incurred to date and whether the costs incurred were allowable under the contracts. (AS 2301.08)
- The sample sizes the firm used in certain of its substantive procedures to test certain contracts 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)

The issuer recognized certain other revenue from contracts based on costs incurred. The following deficiencies were identified:

- The firm did not identify and test any controls over the costs incurred to date for these contracts, including whether these costs were allowable under the contracts. (AS 2201.39)
- The firm did not perform any substantive procedures to test the completeness of the costs incurred to date and whether the costs incurred were allowable under the contracts. (AS 2301.08)

### Issuer C – Communication Services

#### 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 did not identify and test controls that addressed the valuation of certain assets acquired and liabilities assumed. (AS 2201.39)

In connection with our review, the issuer reevaluated its controls over the valuation of these assets acquired and liabilities assumed and concluded that a material weakness existed that had not been previously identified. The issuer subsequently revised its report on ICFR to reflect this material weakness, and the firm modified its opinion on the effectiveness of the issuer's ICFR to express an adverse opinion and reissued its report.

The firm did not test, or in the alternative, test any controls over, the completeness of a system-generated report that it used to make its selections to test the operating effectiveness of a control over the allocation of acquisition-related costs. (AS 1105.10)

The firm did not perform any substantive procedures to assess the reasonableness of management's assertion that the book value of the acquired property, plant, and equipment approximated its fair value. (AS 2502.26 and .28)

## Audits with Multiple Deficiencies

### Issuer D – Health Care

#### Type of audit and related areas affected

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

#### Description of the deficiencies identified

With respect to **Revenue**:

The issuer recognized revenue from certain contracts that provided for the reimbursement of (1) employee-related costs, which the issuer calculated using the time incurred by its employees to perform certain services under these contracts, and (2) other expenses incurred by the issuer. The following deficiencies were identified:

- The firm selected for testing a control that included a review of the employee-related costs and other expenses. The firm did not evaluate the specific review procedures the control owners performed to assess (1) the appropriateness of the time used to calculate the employee-related costs and (2) whether the other expenses were reimbursable under these contracts. (AS 2201.42 and .44) In addition, the firm did not identify and test any controls over the accuracy and completeness of the time and expense information that the control owners used in the performance of this control. (AS 2201.39)
- The firm did not perform any substantive procedures to evaluate whether the amounts recorded as revenue were reimbursable under these contracts. (AS 2301.08)
- The firm used the issuer's time information in its substantive testing of this revenue. The firm did not test, or (as discussed above) test controls over, the accuracy and completeness of this information. (AS 1105.10)

With respect to **Research and Development Expenses**:

The firm identified a significant deficiency related to the absence of controls over the completeness of purchase order information that the issuer used to calculate accrued expenses. The firm identified and tested one of the controls discussed below to address this significant deficiency. The firm did not identify that this control was not designed to address the completeness of the purchase order information. (AS 2201.68)

The firm selected for testing controls over one type of research and development expenses that consisted of reviews of the calculation of accrued expenses. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

The sample sizes the firm used in certain of its substantive procedures to test this type of research and development expenses 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 **Payroll Expenses**:

The firm selected for testing a control over payroll expenses but did not identify and test any controls over the completeness, and, in some instances, the accuracy of certain payroll information that the issuer used in the performance of this control. (AS 2201.39)

## Issuer E – Materials

### 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** at two of the issuer's business units:

For one business unit, the firm selected for testing a control that consisted of the comparison of the invoice price for the sale of a product to the issuer's supporting documentation of the approved price for that product. The firm identified exceptions in the operation of this control and concluded, without evaluating the effect of these exceptions on the operating effectiveness of the control, that these exceptions did not result in a control deficiency. (AS 2201.48)

For the other business unit, the firm did not identify and test any controls that addressed whether customer orders were processed using approved prices. (AS 2201.39)

For each of these business units, the firm selected for testing a control that consisted of reviews of manual journal entries related to revenue. The firm did not test the operating effectiveness of these controls, beyond inspecting documents that included signatures or other notations that indicated reviews performed as part of the controls had occurred. (AS 2201.44)

With respect to **Inventory** at one of the issuer's business units:

The firm selected for testing certain controls over the existence of this inventory. The firm identified exceptions in the operation of these controls and concluded, without evaluating the effect of these exceptions on the operating effectiveness of the controls, that these exceptions did not result in a control deficiency. (AS 2201.48)

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)

## Issuer F – 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 **Journal Entries**.

### Description of the deficiencies identified

With respect to **Revenue**:

The issuer entered into contracts with customers at certain of its locations that required revenue to be recognized over time based on costs incurred to date relative to total estimated costs to complete these contracts.

The firm excluded from the scope of its audits a large number of these locations. The firm did not (1) evaluate whether the risks of material misstatement the firm identified related to revenue recognized over time for the in-scope locations also applied to the excluded locations and (2) consider whether specific risks of material misstatement related to the issuer's use of centralized service centers to determine the amount of revenue to be recognized over time existed at the excluded locations. (AS 2101.11 and .12; AS 2201.B10)

For two locations, the firm selected for testing controls that included the review of the estimated costs to complete. The firm did not evaluate the specific review procedures the control owners performed to assess the reasonableness of the estimated costs to complete. (AS 2201.42 and .44)

For the two locations discussed above, the firm did not evaluate the reasonableness of the estimated costs to complete for contracts open at year end, beyond (1) comparing, in the aggregate for all contracts, estimated costs to complete at year end to the estimated costs at the subsequent month end and (2) comparing the gross margin for certain contracts completed during the year to the initial estimated margin for these contracts. (AS 2501.07)

With respect to **Journal Entries**:

The firm identified a fraud risk related to the potential for management to use manual journal entries to override controls at certain of the issuer's locations. For some of these locations, the firm did not perform journal-entry testing to address the risk. (AS 2401.58)

## Issuer G – 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")**, **Deposit Liabilities**, and **Business Combinations**.

### Description of the deficiencies identified

With respect to the **ALL**:

For loans that the issuer assessed collectively for impairment, the issuer estimated the ALL using a model that included various loan data as inputs into the model. The issuer's independent loan review group identified numerous discrepancies in the loan data subject to its review during the year and reported these discrepancies to the issuer's ALL committee. The firm did not identify and test any controls that addressed the issuer's evaluation and resolution of these discrepancies. (AS 2201.39)

The sample size the firm used in certain of its substantive procedures to test the accuracy of the loan data input into the model 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 **Deposit Liabilities**:

The issuer placed items in deposit clearing or suspense accounts when the items required further evaluation. The firm selected for testing controls that included reviews of daily reconciliations of the issuer's deposit clearing and suspense accounts. The firm did not evaluate the specific review procedures that the control owners performed to understand the nature of reconciling items and assess whether items that had been cleared from those accounts had been appropriately resolved. (AS 2201.42 and .44)

To substantively test deposit liabilities, the firm tested certain deposit clearing and suspense account reconciliations. The firm did not test the reconciling items and whether items that had been cleared from those accounts had been appropriately resolved. (AS 2301.08)

With respect to **Business Combinations**:

During the year, the issuer acquired multiple businesses, including commercial loan portfolios that consisted of various subtypes. The following deficiencies were identified:

- The firm selected for testing a control that consisted of the review of the external valuation reports that the issuer used to determine the fair value of the loans acquired in these business combinations. The firm did not evaluate the specific review procedures that the control owner performed to assess the reasonableness of the prepayment rate assumptions that the external valuation specialist used to estimate the fair value of the acquired commercial loans. (AS 2201.42 and .44)
- To substantively test the acquired commercial loans, the firm selected certain loans and, for each loan selected, evaluated the reasonableness of the prepayment rate, the loss given default, and the annual loss rate assumptions used to estimate the fair value of these loans by comparing these assumptions to market-based ranges for commercial loans. The firm did not perform procedures to obtain evidence that this market information was precise enough to enable the firm to identify potential material misstatements in the valuation of the various subtypes of the acquired commercial loans. (AS 2502.26, .28, and .31)
- In determining its sample sizes used to test the acquired commercial loans, the firm did not take into account tolerable misstatement. As a result, the samples that the firm used to test the valuation of these loans were too small to provide sufficient appropriate evidence. (AS 2315.16, .23, and .23A)

## Issuer H – Health Care

### 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**, and **Derivatives**.

### Description of the deficiencies identified

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

The firm did not identify and test any controls that addressed the accuracy of the prices and quantities that were used to record revenue at two of the issuer's business units. (AS 2201.39)

The sample sizes the firm used in certain of its substantive procedures to test revenue and accounts receivable at these business units 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)

With respect to **Derivatives**:

The issuer determined the recorded fair value of its derivatives based on valuations provided by an external valuation specialist. The firm selected for testing a control that consisted of the review of the valuation report prepared by the external valuation specialist, including underlying inputs and assumptions. The firm did not evaluate the review procedures that the control owner performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44) In addition, the firm did not identify and test any controls over the accuracy and completeness of the information that was used in the operation of this control. (AS 2201.39)

The firm selected for testing a control that consisted of the issuer's review of the appropriateness of the accounting treatment for a convertible debt transaction and related derivatives that the issuer entered into during the year. The firm did not evaluate the review procedures that the control owner performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

## Issuer I – Information Technology

### 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

Revenue for certain of the issuer's sales transactions was processed by one of the issuer's information-technology ("IT") systems. This system automatically assigned predefined codes to each transaction based on the customer and type of service being provided. These codes were used by the issuer's billing system to record the related revenue. The firm did not identify and test any controls that addressed whether these codes were appropriately assigned by the IT system. (AS 2201.39)

The firm did not identify and test any controls over the accuracy and completeness of certain sales transactions that were manually entered into the IT system for processing. (AS 2201.39)

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 J – Industrials

### 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

For certain of the issuer's operations, the firm selected for testing a control that consisted of the review of monthly comparisons of actual revenue by distribution channel and by product category to budgeted amounts. In testing the operating effectiveness of this control, the firm did not evaluate the specific review procedures that the control owner performed to investigate identified variances and determine whether items identified for follow up had been appropriately resolved. (AS 2201.44)

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 deficiency in the firm's control testing discussed above. (AS 2301.16, .18, and .37; AS 2315.19, .23, and .23A)

## Issuer K – 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

A portion of the issuer's loans had payment terms that allowed borrowers to make interest-only payments for a fixed period with the repayment of the outstanding principal balance due at a later date. The following deficiencies were identified:

- The firm did not identify and test any controls that addressed the timely identification and evaluation of any indicators of deterioration in a borrower's ability to repay the principal associated with these loans. (AS 2201.39)
- The firm did not perform procedures to evaluate whether any impairment indicators existed for these loans beyond testing the collateral valuation for one loan. (AS 2301.08)

## Issuer L – Financials

### Type of audit and related area affected

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

### Description of the deficiencies identified

The issuer recorded the fair values of available-for-sale ("AFS") securities based on the prices it obtained from external pricing services. The firm selected for testing a control that consisted of meetings that the issuer held with the external pricing services to assess the appropriateness of the methods and assumptions used by the external pricing services to price those securities. The firm did not evaluate the specific procedures that the control owner performed to obtain an understanding of the methods and assumptions underlying the prices obtained from the pricing services. (AS 2201.42 and .44)

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

The firm's approach for testing the valuation of certain AFS securities was to develop an independent estimate of the fair values for a sample of these AFS securities using prices the firm obtained from various other external pricing services. For purposes of evaluating the reasonableness of the differences between its independent estimates and the issuer's estimates, the firm did not obtain an understanding of the assumptions used by the issuer's external pricing services for the individual securities selected for testing. (AS 2502.40)

## Issuer M – Information Technology

### Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Investment Securities** and **Intangible Assets**.

### Description of the deficiencies identified

With respect to **Investment Securities**:

The issuer held investment securities that it classified, based on original maturity, as either cash equivalents or short-term investments in its financial statements. The firm did not identify and test any controls that addressed the appropriateness of the classification of these investments. (AS 2201.39)

The firm did not perform any substantive procedures that addressed the appropriateness of the classification of these investments. (AS 2301.08)

With respect to **Intangible Assets**:

The firm did not identify and test any controls over the quantitative impairment analysis that the issuer performed over certain finite-lived intangible assets. (AS 2201.39)

## Issuer N – Materials

### Type of audit and related areas affected

In our review of this audit in which the firm played a role but was not the principal auditor, we identified deficiencies in connection with the firm's role in the financial statement and ICFR audits related to **Revenue** and **Post-Retirement Benefit Obligations**.

### Description of the deficiencies identified

With respect to **Revenue** at one of the issuer's subsidiaries:

The firm did not perform any substantive procedures to evaluate whether this revenue was appropriately recognized based on the contractual terms and conditions. (AS 2301.08)

With respect to **Post-Retirement Benefit Obligations** at another of the issuer's subsidiaries:

The firm selected for testing a control that consisted of the review of the assumptions used to estimate post-retirement benefit obligations. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

## Issuer O – Financials

### 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 portfolio of loans and leases and accounted for the transaction as a business combination. The firm did not identify and test any controls over the valuation of the loans and leases acquired in this business combination. (AS 2201.39)

The firm did not perform any substantive procedures to test the valuation of the loans and leases acquired in this business combination. (AS 2502.15)

## Issuer P – Utilities

### Type of audit and related area affected

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

### Description of the deficiencies identified

The firm selected for testing a control that consisted of the review of the price curves that the issuer used to determine the value of commodity derivatives. The firm did not evaluate the review procedures that the control owner performed, including the procedures to identify items for follow up and the procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

The firm did not identify and test any controls that addressed the reasonableness of a significant assumption that the issuer used to value commodity derivatives for which monthly price quotes were not available. (AS 2201.39)

The firm did not perform any substantive procedures to evaluate the reasonableness of the significant assumption discussed above. (AS 2502.26 and .28)

The issuer's determination of whether to present gains and losses on derivative trades on a gross or net basis in the issuer's income statement was dependent on how the derivative trades were designated in the issuer's derivatives system. The firm did not identify and test any controls that addressed whether derivative trades had been appropriately designated in the system by the issuer's traders. (AS 2201.39)

The sample sizes the firm used in certain of its substantive procedures to test the presentation and disclosure of derivative trades 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)

# Audits with a Single Deficiency

## Issuer Q – Real Estate

### Type of audit and related area affected

In our review, we identified a deficiency in the ICFR audit related to **Long-Lived Assets**.

### Description of the deficiency identified

The issuer had determined during the first and second quarters that one of its properties was not impaired based on the results of analyses that it had performed in those quarters to determine whether the carrying value of the property was recoverable. The firm did not identify and test any controls over these analyses. (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 necessarily reviewed on every audit. In some cases, we assess the firm's compliance with specific PCAOB standards or rules on other audits that were not otherwise selected for review and may include instances of non-compliance below.

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 three of 19 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 one of three audits reviewed, the communication of a CAM in the audit report included inaccurate language in the description of (1) the principal considerations that led the firm to determine that the matter was a CAM and (2) how that CAM was addressed in the firm's audit. In this instance, the firm was non-compliant with AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.
- In two of 20 audits reviewed, the firm's report on Form AP omitted information related to the participation in the audit by certain other accounting firms. 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 certain 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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November 30, 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 the Draft Report on the 2019 Inspection of KPMG LLP**

Dear Mr. Botic:

KPMG LLP is pleased to provide our response to the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on the 2019 Inspection of KPMG LLP, dated October 30, 2020 (the "Report").

We respect the important perspective the PCAOB inspection process provides to us and to our stakeholders and we share the PCAOB's goal of improving audit quality. The inspection process provides us with valuable insights to improve the quality of our audits as we continuously enhance the skills of our people and implement advanced technology.

We have conducted a thorough evaluation of the observations identified in Part I of the Report and have taken appropriate actions to address the engagement-specific findings in accordance with PCAOB auditing standards and our own policies and procedures.

We recognize the importance the capital markets places on high quality audits and consistently executing at that level is our highest priority. To that end, we remain dedicated to the continuous improvement of our audit engagement performance and our system of audit quality control. The specific actions we have taken and continue to take to achieve these improvements are discussed in our 2020 Audit Quality Report as we seek to provide transparency to our stakeholders about our overall efforts to improve audit quality.

We value and appreciate the professionalism and commitment of the PCAOB staff, and the important role of the PCAOB in the improvement of audit quality and we remain committed to continuous dialogue with the PCAOB to improve audit quality and strengthen the integrity of financial reporting.

Sincerely yours,

KPMG LLP

Paul J. Knopp
*Chair and CEO*

Scott D. Flynn
*Vice Chair – Audit*