PCAOB
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

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Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions

In the Matter of KPMG AZSA LLC,

Respondent.

PCAOB Release No. 105-2023-030

November 14, 2023

By this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions ("Order"), the Public Company Accounting Oversight Board ("Board" or "PCAOB") is:

(1) censuring KPMG AZSA LLC ("KPMG Japan," "Firm," or "Respondent");

(2) imposing a civil money penalty of $500,000 on KPMG Japan; and

(3) requiring KPMG Japan to review and certify its quality control policies and procedures concerning journal entry testing.

The Board is imposing these sanctions on the basis of its findings that KPMG Japan violated PCAOB rules and quality control standards by failing to implement, maintain, and monitor quality control policies and procedures to ensure that its personnel complied with professional standards concerning journal entry testing.

I.

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

II.

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

III.

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

A. Respondent

1. **KPMG AZSA LLC** is a limited liability corporation organized under the laws of Japan and headquartered in Tokyo, Japan. The Firm is licensed by the Japan Financial Services Agency (License No. 2085). The Firm is, and at all relevant times was, registered with the Board pursuant to Section 102 of the Act and PCAOB rules.

B. Summary

2. This matter concerns KPMG Japan's failure to comply with PCAOB quality control standards. From 2019 through 2021, the Firm's quality control policies and procedures governing engagement performance were insufficient to provide it with reasonable assurance that the journal entry testing conducted by its engagement personnel in connection with audits subject to PCAOB rules and standards met applicable professional standards and regulatory requirements.

3. Additionally, KPMG Japan's system of quality control failed to include adequate monitoring procedures that enabled the Firm to obtain reasonable assurance that its system of quality control concerning journal entry testing was effective.

C. KPMG Japan Violated PCAOB Quality Control Standards

i. KPMG Japan's Quality Control Policies and Procedures Failed to Provide the Firm with Reasonable Assurance that Work Performed by Engagement Personnel Met Professional Standards and Regulatory Requirements

4. PCAOB rules require registered public accounting firms to comply with the Board's quality control standards.[2] PCAOB quality control standards, in turn, require each

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

[2] *See* PCAOB Rule 3100, *Compliance with Auditing and Related Professional Practice Standards*; PCAOB Rule 3400T, *Interim Quality Control Standards*.

registered firm to effectively design, implement, and maintain a system of quality control in the firm's accounting and auditing practice.[3] A firm's system of quality control should, among other things, include policies and procedures for engagement performance. A firm should establish policies and procedures to provide the firm with reasonable assurance that the work performed by engagement personnel meets applicable professional standards, regulatory requirements, and the firm's standards of quality.[4] Quality control policies and procedures for engagement performance should encompass all phases of the design and execution of an engagement.[5] To the extent appropriate and as required by applicable professional standards, these policies and procedures should also cover, among other things, planning, performing, and documenting the results of each engagement.[6]

5. PCAOB auditing standards specify that, "[m]aterial misstatements of financial statements due to fraud often involve the manipulation of the financial reporting process by (a) recording inappropriate or unauthorized journal entries throughout the year or at period end, or (b) making adjustments to amounts reported in the financial statements that are not reflected in formal journal entries[.]"[7] Accordingly, auditors are instructed to "[i]dentify and select journal entries and other adjustments for testing."[8] Among other things, "even though controls [over the preparation and posting of journal entries and adjustments] might be implemented and operating effectively, the auditor's substantive procedures for testing journal entries and other adjustments should include the identification and substantive testing of specific items."[9] "[T]he auditor's procedures should include selecting from the general ledger journal entries to be tested and examining support for those items."[10]

6. PCAOB auditing standards also specify that "management is in a unique position to perpetuate fraud because of its ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding established controls. . . ."[11]

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[3] Quality Control Standard 20, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* ("QC § 20"), .01-.02.

[4] QC § 20.17.

[5] QC § 20.18.

[6] *Id.*

[7] AS 2401.58, *Consideration of Fraud in a Financial Statement Audit*.

[8] *Id.*

[9] AS 2401.61.

[10] *Id.*

[11] AS 2401.57.

Accordingly, auditors should perform procedures to specifically address the risk of management override of controls.[12]

7. During certain issuer audit work conducted by the Firm between 2019 and 2021,[13] Firm personnel identified management override of controls as a fraud risk and performed procedures to test certain subsets of journal entries they identified as high-risk ("High-Risk Journal Entries") as part of their response to this risk. The procedures performed included identifying manual journal entries of a certain magnitude that were submitted by employees at a given level of seniority and related to the recording of sales or reduction of expenses or losses, or involved reclassification of amounts within the profit and loss statement.

8. However, the Firm's journal entry testing work papers for the audits in question often reflected only cursory analysis of the High-Risk Journal Entries, typically referencing general observations and/or discussions with management. In many instances, the Firm's testing relied on an understanding of the High-Risk Journal Entries gleaned from other audit procedures, and generally failed to incorporate the substantive testing of supporting evidence required by PCAOB standards.[14]

9. The version of KPMG Japan's audit methodology and accompanying guidance in effect from 2019 through 2021 included a general instruction that audit teams should document procedures performed over journal entries selected for testing, but the guidance provided by the Firm was not specific enough to provide reasonable assurance that engagement teams would adequately test the High-Risk Journal Entries, which contributed to the deficiencies in journal entry testing.

10. Accordingly, KPMG Japan violated QC § 20.

ii. KPMG Japan's Monitoring Procedures Failed to Provide the Firm with Reasonable Assurance That its System of Quality Control Concerning Journal Entry Testing Was Operating Effectively

11. A firm should establish policies and procedures to provide it with reasonable assurance that its quality control policies and procedures are suitably designed and are being

12 *Id.*

13 The term "issuer" means an issuer (as defined in Section 3 of the Securities Exchange Act of 1934 ("Exchange Act")), the securities of which are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of the Exchange Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn. *See* PCAOB Rule 1001(i)(iii).

14 *See* AS 2401.61.

effectively applied.[15] Monitoring involves an ongoing consideration and evaluation of the (a) relevance and adequacy of the firm's policies and procedures; (b) appropriateness of the firm's guidance materials and any practice aids; (c) effectiveness of professional development activities; and (d) compliance with the firm's policies and procedures.[16]

12. Monitoring procedures, taken as a whole, should enable the firm to obtain reasonable assurance that its system of quality control is effective.[17] "Procedures that provide the firm with a means of identifying and communicating circumstances that may necessitate changes to, or the need to improve compliance with, the firm's policies and procedures contribute to the monitoring element."[18] Among other things, a firm's monitoring procedures may include inspection procedures, preissuance or postissuance review of selected engagements, determination of any corrective actions to be taken and improvements to be made in the quality control system, communication to appropriate firm personnel of any weaknesses identified, and follow up to ensure that any necessary modifications are made to the quality control policies and procedures on a timely basis.[19]

13. As part of KPMG Japan's quality control monitoring, the Firm conducted periodic internal quality reviews designed to identify potential deficiencies in audit work, which could either be escalated as formal findings or communicated informally by reviewers to engagement team members. Only formal findings were documented and maintained in the inspection report for a quality review.

14. KPMG Japan conducted an internal quality review of an issuer audit performed in 2020, during which the reviewers evaluated testing of High-Risk Journal Entries. The internal quality review team identified certain deficiencies in the testing, and discussed those deficiencies with the engagement team, but concluded that the deficiencies did not warrant a formal finding. The failure of the Firm's internal review program to issue a formal finding concerning the deficient journal entry testing or otherwise escalate the issue within the Firm contributed to deficient testing of High-Risk Journal Entries in 2021.

15. Accordingly, KPMG Japan violated QC § 30.

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15 *See* QC § 20.20; Quality Control Standard 30, *Monitoring a CPA Firm's Accounting and Auditing Practice* ("QC § 30"), .02.

16 *Id.*

17 QC § 30.03.

18 *Id.*

19 *Id.*; *see also* QC §§ 30.04-.08.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. In ordering sanctions, the Board took into consideration certain remedial steps KPMG Japan has undertaken, including revisions to certain quality control policies and procedures. The Firm's revised procedures more explicitly instruct teams to examine underlying support for journal entries selected for testing, and provide a direct link to relevant PCAOB auditing standards governing such testing.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 105(c)(4)(E) of the Act and PCAOB Rule 5300(a)(5), KPMG Japan is hereby censured.

B. Pursuant to Section 105(c)(4)(D) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of $500,000 is imposed upon KPMG Japan.

1. All funds collected by the PCAOB as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act.

2. KPMG Japan shall pay this civil money penalty within ten (10) days of the issuance of this Order by: (1) wire transfer pursuant to instructions provided by PCAOB staff; or (2) United States Postal Service money order, bank money order, certified check, or bank cashier's check (a) made payable to the Public Company Accounting Oversight Board, (b) delivered to the Office of Finance, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006, and (c) submitted under a cover letter, which identifies the Firm as a respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

3. If timely payment is not made, additional interest shall accrue at the federal debt collection rate set for the current quarter pursuant to 31 U.S.C. § 3717. Payments shall be applied first to post-Order interest.

4. With respect to any civil money penalty amounts that KPMG Japan shall pay pursuant to this Order, KPMG Japan shall not, directly or indirectly, (a) seek or accept reimbursement or indemnification from any source including, but not limited to, any current or former affiliated firm or professional or any payment made pursuant to any insurance policy; (b) claim, assert, or apply for a tax deduction or tax credit in connection with any federal, state, local, or foreign tax; nor (c) seek or benefit by any offset or reduction of any award of compensatory damages, by the amount of any part of KPMG Japan's payment of the civil money penalty pursuant to this Order, in any private action brought against KPMG Japan based on substantially the same facts as set out in the findings in this Order.

5. KPMG Japan understands that its failure to pay the civil money penalty described above may result in summary suspension of the Firm's registration, pursuant to PCAOB Rule 5304(a), following written notice to it at the address on file with the PCAOB at the time of the issuance of this Order.

C. Pursuant to Section 105(c)(4)(G) of the Act and PCAOB Rule 5300(a)(9), the Board orders that:

1. Review by KPMG Japan. Within 90 days of the date of this Order, KPMG Japan shall review and evaluate its quality control policies and procedures intended to provide the Firm with reasonable assurance that its personnel comply with professional standards and regulatory requirements for journal entry testing applicable to audits and reviews conducted pursuant to PCAOB standards.

2. Reporting. Within 120 days of the date of this Order, KPMG Japan shall submit a written report to the Director of the Division of Enforcement and Investigations summarizing the review and evaluation of the area specified in paragraph C.1 above ("Report"). The Report shall describe any modified or additional policies or procedures adopted or to be adopted by KPMG Japan or, if KPMG Japan concludes no such modifications or additions should be adopted, a detailed and satisfactory explanation of why the Firm believes changes are not warranted. In addition, KPMG Japan shall submit any additional information and evidence concerning the Report, the information in the Report, and KPMG Japan's compliance with this Order as the staff of the Division of Enforcement and Investigations may reasonably request.

3. Certificate of Implementation. Within 150 days of the date of this Order, KPMG Japan's head of quality assurance shall certify in writing ("Certificate of Implementation") to the Director of the Division of Enforcement and Investigations that KPMG Japan has implemented all of the modifications and additions to its policies and procedures, if any, that were described in the Report. The Certificate of Implementation shall provide written evidence of KPMG Japan's adoptions of such modifications and additions in narrative form, identify the actions taken to implement such modifications and additions, and be supported by exhibits sufficient to demonstrate implementation. KPMG Japan shall also submit such additional evidence of, and information concerning, implementation as the staff of the Division of Enforcement and Investigations may reasonably request.

4. Noncompliance. KPMG Japan understands that a failure to satisfy these undertakings may constitute a violation of PCAOB Rule 5000 and could provide a basis for the imposition of additional sanctions in a subsequent disciplinary proceeding.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

November 14, 2023