2019 Inspection KPMG LLP

(Headquartered in Toronto, Canada)

July 6, 2021

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. 104-2021-137A

(Includes portions of Part II of the full report that were not included in PCAOB Release No. 104-2021-137)

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2019 Inspection

During the Public Company Accounting Oversight Board ("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. Our inspection was conducted in cooperation with the Canadian Public Accountability Board.

We selected for review eight 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.

2019 Inspection Approach

In selecting issuer audits for review, we use a risk-based method of selection. We make 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. In certain situations we may select all of the firm's issuer audits for review.

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

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

View the details on the scope of our inspections and our inspections procedures.

Overview of the 2019 Inspection and Historical Data by Inspection Year

The following information provides an overview of our inspection in 2019 of the firm's issuer audits as well as data from the previous inspection. We use a risk-based method 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 inspection to inspection and firm to firm. Further, a firm's business, the applicable auditing standards, or other factors can change from the time of one inspection to the next. As a result of these variations, we caution that our inspection results are not necessarily comparable over time or among firms.

Firm Data and Audits Reviewed

	2019	2017
Firm Data		
Total issuer audit clients for which the firm was the principal auditor at the outset of the inspection procedures	72	64
Total issuer audits in which the firm was not the principal auditor	44	48
Total engagement partners on issuer audit work[1]	68	68
Audits Reviewed		
Total audits reviewed[2]	8	7
Audits in which the firm was the principal auditor	7	6
Audits in which the firm was not the principal auditor	1	1
Integrated audits of financial statements and internal control over financial reporting ("ICFR")	8	7
Audits with Part I.A deficiencies	5	3

[1] The number of engagement partners on issuer audit work represents the total number of firm personnel (not necessarily limited to personnel with an ownership interest) who had primary responsibility for an issuer audit (as defined in AS 1201) or for the firm's role in an issuer audit during the twelve-month period preceding the outset of the inspection.

[2] The population from which audits are selected for review includes both audits for which the firm was the principal auditor and those where the firm was not the principal auditor but played a role in the audit. The population of issuer audits from which audits are selected for review may differ from the issuer audits at the outset of the inspection procedures due to variations such as new issuer audit clients for which the firm has not yet issued an opinion or issuer audit clients lost prior to the outset of the inspection.

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 may include 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.

Audit Areas Most Frequently Reviewed

This table reflects the audit areas we have selected most frequently for review in the 2019 inspection and the previous inspection. 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		2017	
Audit area	**Audits reviewed**	**Audit area**	**Audits reviewed**
Revenue and related accounts	7	**Revenue and related accounts**	6
Long-lived assets	4	**Long-lived assets**	2
Business combinations	1	**Inventory**	2
Derivatives	1	**Investment securities**	1
Allowance for loan losses	1	**Allowance for loan losses**	1

Part I: Inspection Observations

Part I.A of our report discusses deficiencies, if any, that were of such significance that we believe the firm, (1) 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 or (2) in audit(s) in which it was not the principal auditor, had not obtained sufficient appropriate audit evidence to fulfill the objectives of its role in the audit. Part I.B discusses deficiencies, if any, that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) or fulfill the objectives of its role in the audit(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules. Consistent with the Sarbanes-Oxley Act ("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. Section 104(g)(2) of 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.

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.

Part I.A: Audits with Unsupported Opinions

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

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

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

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

None

Audits with Multiple Deficiencies

Issuer A – Financials

Type of audit and related areas affected

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

Description of the deficiencies identified

With respect to **Derivatives**:

The issuer used various models to value certain derivatives. The firm selected for testing a control that consisted of the review and validation of (1) new or updated models and (2) existing models based on issuer-assigned risk ratings. The firm did not evaluate the review procedures that the control owners performed, including the procedures to identify items for follow up and procedures to determine whether those items were appropriately resolved. (AS 2201.42 and .44)

With respect to the **ALL**:

The issuer used various models to estimate the ALL.

The firm selected for testing controls that consisted of the (1) review and validation, at least annually, of all models and (2) quarterly review of backtesting results using historical loan information to assess the performance of certain models. The firm did not sufficiently test the first control because the firm's sample primarily consisted of models that the issuer had validated in the prior year, which did not provide sufficient appropriate audit evidence as of the date of management's assessment of the effectiveness of the issuer's ICFR due to the (1) length of time that had passed between the instances of the control the firm tested and the date of management's assessment, (2) higher risk associated with the control, and (3) sensitivity and complexity of the models covered by the control.

(AS 2201.46 and .52) For the second control, the firm did not identify and test any controls over the accuracy and completeness of the historical loan information used in the operation of that control. (AS 2201.39)

The firm's approach for substantively testing the ALL was to review and test management's process. The firm did not sufficiently evaluate the reasonableness of the ALL because the firm did not perform procedures to test certain factors and assumptions the issuer developed in the prior year and used to determine the ALL in the current year. (AS 2501.09, .10, and .11)

Issuer B – Energy

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Long-Lived Assets**.

Description of the deficiencies identified

The issuer had multiple cash generating units ("CGUs"). For one CGU, the issuer concluded that there were no indicators of potential impairment. For another CGU, the issuer identified indicators of potential impairment, performed an impairment analysis, and recorded an impairment charge. The firm selected for testing controls over the issuer's evaluation of long-lived assets for possible impairment that included the issuer's reviews of (1) potential indicators of impairment and (2) assumptions underlying the forecasted operating costs, capital expenditures, and discount rates used in the impairment analysis. The firm did not evaluate the specific review procedures that the control owners performed (1) with respect to potential indicators of impairment related to the first CGU and (2) to assess the reasonableness of the forecasted operating costs, capital expenditures, and discount rates used in the impairment analysis for the second CGU. (AS 2201.42 and .44)

The firm did not evaluate management's determination that there were no indicators of potential impairment for the first CGU beyond inquiring of management and reading the issuer's impairment indicator memorandum and a reserves report prepared by an external specialist. (AS 2301.08)

The firm's approach for substantively testing the impairment analysis for the second CGU was to review and test management's process. The firm did not sufficiently test the impairment analysis for this CGU because the firm did not perform procedures to evaluate the reasonableness of the discount rates and the forecasted operating costs and capital expenditures beyond the first year that the issuer used in the impairment analysis. (AS 2501.09, 10, and .11)

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 **Long-Lived Assets**.

Description of the deficiencies identified

The issuer capitalized certain employee and contractor labor costs to long-lived assets. The following deficiencies were identified:

- The firm did not identify and test any controls over the accuracy of the employee labor hours associated with the employee labor costs capitalized to long-lived assets. (AS 2201.39)

- The firm selected for testing a control that consisted of the review and approval of contractor labor hours. The firm did not evaluate the specific review procedures that the control owners performed to address the accuracy of the contractor labor hours associated with the contractor labor costs capitalized to long-lived assets. (AS 2201.42 and .44)

- The firm used employee and contractor hours derived from the issuer's time recording system in its substantive testing of these capitalized labor costs. The firm did not test, or (as discussed above) test or sufficiently test controls over, the accuracy of the employee or contractor hours. (AS 1105.10)

Issuer D – 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 issuer entered into arrangements with multiple elements that consisted of software and professional services. The issuer determined that professional services represented separate performance obligations and recognized revenue related to these services separately from the software revenue. The firm selected for testing controls that consisted of the issuer's reviews of contracts for appropriate revenue recognition. The firm did not evaluate the specific review procedures that the control owners performed to determine that professional services represented separate performance obligations. (AS 2201.42 and .44)

The firm did not perform any substantive procedures to evaluate whether the issuer's treatment of professional services as separate performance obligations was in conformity with FASB ASC Topic 606, *Revenue from Contracts with Customers*. (AS 2810.30)

Audits with a Single Deficiency

Issuer E – Energy

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 identified indicators of potential impairment related to certain CGUs, performed an impairment analysis over those CGUs, and recorded an impairment charge. The firm selected for testing a control that included the issuer's review of the assumptions used in the impairment analysis. The firm did not evaluate the specific review procedures that the control owners performed to assess the reasonableness of these assumptions. (AS 2201.42 and .44)

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

In the 2019 inspection, we did not identify any deficiencies related to other instances of non-compliance with PCAOB standards or rules.

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.

A. Testing Controls

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel with respect to testing controls will meet the requirements of AS 2201. (QC 20.03 and .17)

In five audits,[3] which are included in Part I.A, the inspection team identified deficiencies related to the firm's (1) testing of the design and operating effectiveness of controls, including testing controls that included a review element and (2) identifying and testing of controls that addressed (a) the accuracy and completeness of data or reports used in the operation of a control and (b) the risk that data relevant to a significant account were not accurate.

B. Testing Estimates

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel with respect to testing accounting estimates will meet the requirements of AS 2501. (QC 20.03 and .17)

In two audits,[4] which are included in Part I.A. the inspection team identified deficiencies related to the firm's evaluation of reasonableness of certain assumptions.

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[3] Issuers A, B, C, D, and E
[4] Issuers A and B

C. Testing Long-Lived Assets

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the work performed by the firm's personnel with respect to testing long-lived assets will meet the requirements of AS 1105 and AS 2301. (QC 20.03 and .17)

In two audits,[5] which are included in Part I.A, the inspection team identified deficiencies related to the firm's substantive testing of long-lived assets.

D. Engagement Quality Review

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the review procedures performed by the firm's engagement quality review ("EQR") partners will meet the requirements of AS 1220. (QC 20.03 and .17)

In three audits,[6] which are included in Part I.A, the inspection team identified one or more deficiencies in an area that the EQR partner was required to evaluate. In these audits, the EQR partner did not identify a deficiency in an area in which the engagement team identified a significant risk or fraud risk.

E. Policies for Financial Holdings Disclosures

The inspection results indicate that the firm's system of quality control does not provide reasonable assurance that the firm and its personnel will comply with the firm's policies and procedures with respect to independence-related regulatory requirements. (QC 20.04, .09, and .10)

The firm conducts periodic audits of a sample of its personnel to monitor compliance with certain of its independence policies. In the audits conducted, the firm identified that 25 percent of the partners and 22 percent of the managers who were audited in 2017 and 17 percent of the partners and 36 percent of the managers who were audited in 2018 had not reported financial relationships that were required to be reported in accordance with the firm's policies. These high rates of non-compliance with the firm's policies, which are designed to provide compliance with applicable independence regulatory requirements, provide cause for concern, especially considering that these individuals are required to certify on an annual basis that they have complied with the firm's independence policies and procedures.

5 Issuers B and C
6 Issuers A, B, and E

Appendix A: Firm’s Response to the Draft Inspection Report

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the firm’s response, excluding any portion granted confidential treatment, is attached hereto and made part of this final inspection report.

The Board does not make public any of a firm’s comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm’s response is made publicly available.

In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm’s comments on a draft report, the Board does not include those comments in the final report. The Board routinely grants confidential treatment, if requested, for any portion of a firm’s response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

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April 15, 2021

Re: Response to Public Company Accounting Oversight Board (PCAOB) Draft Report on the 2019 Inspection of KPMG LLP

Dear Mr. Botic:

We are pleased to provide our response to the PCAOB's Draft Report on the 2019 Inspection of KPMG LLP ("Report").

We have evaluated the matters identified by the PCAOB in Part I of the Report and have taken actions as appropriate in accordance with PCAOB standards and our policies.

We value and respect the important role of the PCAOB in improving audit quality. The inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of quality management. We appreciate the professionalism and commitment of the PCAOB staff and look forward to continuing to work with the PCAOB to achieve our shared objective of improving audit quality and serving investors and the public interest.

We understand our importance and responsibility to the capital markets and we remain dedicated to continuous improvement of our audit engagement performance and our system of quality management. We are taking action to continue to enhance the skillset of our people, implement advanced technology and invest in implementing changes to our policies, practices and quality controls in order to enhance audit quality.

Very truly yours,

KPMG LLP

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