2022 Inspection KPMG Huazhen LLP

(Headquartered in Beijing, People's Republic of China)

March 28, 2023

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

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

PCAOB RELEASE NO. 104-2023-049

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2022 INSPECTION

In the 2022 inspection of KPMG Huazhen LLP, the Public Company Accounting Oversight Board (PCAOB) 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 China Securities Regulatory Commission and the Ministry of Finance of the People's Republic of China.

We selected for review four audits of issuers with fiscal years generally ending in 2021. For each issuer audit selected, we reviewed a portion of the audit. We also evaluated elements of the firm's system of quality control.

2022 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 necessarily 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 or 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 2022 INSPECTION

The following information provides an overview of our 2022 inspection, which was our first inspection of this firm. 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 Selected for Review

	2022
Firm data	
Total issuer audit clients in which the firm was the principal auditor	30
Total issuer audits in which the firm was not the principal auditor	77
Total engagement partners on issuer audit work[1]	79
Audits reviewed	
Total audits reviewed[2]	4
Audits in which the firm was the principal auditor	3
Audits in which the firm was not the principal auditor	1
Integrated audits of financial statements and internal control over financial reporting (ICFR)	4
Audits with Part I.A deficiencies	4
Percentage of audits with Part I.A deficiencies	100%

If we include a deficiency 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 deficiency

[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, *Supervision of the Audit Engagement*) 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.

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.

If we include a deficiency in our report — other than those deficiencies for audits with incorrect opinions on the financial statements and/or ICFR — it 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 2022 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.

2022	
Audit area	**Audits reviewed**
Revenue and related accounts	4
Cash and cash equivalents	4
Long-lived assets	2
Inventory	1
Other investments	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(s) 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 certain deficiencies, if any, that relate to instances of non-compliance with PCAOB standards or rules other than those where the firm had not obtained sufficient appropriate audit evidence to support its opinion(s) or fulfill the objectives of its role in the audit(s). This section does not discuss instances of potential non-compliance with SEC rules or instances of non-compliance with PCAOB rules related to maintaining independence.

Part I.C discusses instances of potential non-compliance with SEC rules or instances of non-compliance with PCAOB rules, if any, related to maintaining independence.

Consistent with the Sarbanes-Oxley Act ("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. We discuss any such criticisms or potential defects in Part II. Further, you should not infer from any Part I deficiency, or combination of deficiencies, that we identified a quality control finding 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 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 audits 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 audits 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 revised its report, on ICFR.

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

Audits with Multiple Deficiencies

This classification includes audits 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 audits 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 (1) supporting the firm's opinion(s) on the issuer's financial statements and/or ICFR and (2) in audit(s) in which it was not the principal auditor, to fulfill the objectives of its role in the audit.

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

We present issuer audits 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

Type of audit and related areas affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Revenue**, **Unearned Revenue**, **Certain Liabilities**, **Long-Lived Assets**, and **Journal Entries**.

Description of the deficiencies identified

With respect to **Revenue**; **Unearned Revenue**, for which the firm identified a fraud risk; **Certain Liabilities**, for which the firm identified a fraud risk; and **Long-Lived Assets**, for which the firm identified a significant risk:

The issuer used multiple information-technology (IT) systems to initiate, process, and/or record transactions related to (1) certain revenue and unearned revenue, (2) certain liabilities, and (3) long-lived assets. In its testing of controls over these accounts, the firm tested various automated and IT-dependent manual controls that used data and reports generated or maintained by certain of these IT systems. As a result of the following deficiencies in the firm's testing of IT general controls (ITGCs), the firm's testing of these automated and IT-dependent controls was not sufficient. (AS 2201.46)

With respect to change management:

The firm selected for testing a change management control over certain IT systems that consisted of the documentation, review, testing, and approval of changes prior to their migration into production. The firm did not perform procedures to test, or test any controls over, the completeness of the population of changes from which it made its selections for testing. (AS 1105.10)

With respect to user access:

The firm selected for testing user access controls over certain IT systems that consisted of (1) restricting access to implement program and/or configuration changes to authorized IT personnel with no development responsibilities, (2) the approval of privileged system access for all layers based on the user's position and duties, and (3) the removal of system access in a timely manner. The following deficiencies were identified:

- The firm did not perform procedures to test, or test any controls over, the accuracy and completeness of the data from which it made its selections to test controls one and two. (AS 1105.10)

- The firm also did not perform sufficient procedures to test the operating effectiveness of control two because its procedures were limited to testing one instance of the control's operation for each layer. (AS 2201.46)

- The firm did not perform sufficient procedures to test control three because the firm did not perform procedures to understand the specific timing in which access was to be removed and test whether access was removed within this timeframe. (AS 2201.42 and .44)

The firm identified deficiencies in the design and operating effectiveness of other user access controls for certain of the issuer's IT systems. The firm identified and tested controls that it believed would mitigate the deficiencies. The firm did not identify that these controls did not address the risks that (1) user access or privileged access may be granted to unauthorized users and (2) inappropriate access may be granted to users. Further, the firm did not test the design and operating effectiveness of one compensating control for certain of these IT systems. (AS 2201.68)

As a result of the firm's ITGC testing deficiencies discussed above, the firm did not perform sufficient substantive procedures, as follows:

- The firm used certain system-generated data to substantively test certain liabilities, unearned revenue, and long-lived assets but did not test, or (as discussed above) sufficiently test controls over, the accuracy and completeness of this data. (AS 1105.10)

- The firm performed substantive analytical procedures as part of its testing of certain revenue. The firm used certain system-generated data to develop its expectations but did not test, or (as discussed above) sufficiently test controls over, the accuracy and completeness of this data. (AS 2305.16)

With respect to **Revenue**, which was affected by the audit deficiencies discussed above related to change management and user access, the following additional deficiencies were identified:

- For certain revenue, the firm selected for testing controls that consisted of the (1) reconciliation and review of certain data used to recognize revenue and (2) reconciliation and review of billed amounts prior to the recording of revenue. For the items selected for testing, the firm did not test the management review aspects of these controls involving the review of (1) data used to recognize revenue and (2) billed amounts prior to the recording of revenue. (AS 2201.44)

- The firm selected for testing other controls over certain revenue. The firm tested these controls through an interim date but did not perform any procedures to update the results of its testing from that interim date to year end. (AS 2201.55)

- The firm performed other substantive analytical procedures as part of its testing of certain revenue. The firm used data derived from the recorded amounts of revenue to develop its expectations but did not evaluate whether this data was sufficiently reliable for purposes of achieving its audit objectives. (AS 2305.16)

With respect to **Long-Lived Assets**, which was affected by the audit deficiencies discussed above related to change management and user access, the following additional deficiencies were identified:

- The firm selected for testing a control that consisted of the issuer's review of an assessment of long-lived assets for potential impairment, including the underlying cash-flow forecasts. The firm did not evaluate the specific review procedures that the control owner performed to assess the reasonableness of the significant assumptions underlying these cash-flow forecasts. (AS 2201.42 and .44)

- The firm selected for testing certain other IT-dependent manual controls over long-lived assets. The firm tested these controls through an interim date but did not perform any procedures to update the results of its testing from that interim date to year end. (AS 2201.55)

- The firm's approach for substantively testing the impairment of certain long-lived assets was to test the issuer's process. The firm did not sufficiently evaluate whether the method the issuer used to perform its impairment analyses was in conformity with the applicable financial reporting framework, including the requirements of International Accounting Standard 36, *Impairment of Assets*, because the firm did not evaluate evidence that indicated whether the recoverable amount of the individual assets was estimable and available. (AS 2501.10; AS 2810.03)

- The issuer engaged a specialist to perform a quantitative assessment of certain long-lived assets for the purpose of determining whether the carrying amounts of those assets were recoverable as of the end of the prior year. The firm did not perform procedures to test the recoverable amounts of these long-lived assets as of the end of the current year beyond obtaining the issuer's impairment schedule and the valuation report prepared by the company's specialist in the prior year. Further, the firm did not perform any procedures to use the work of the company's specialist as audit evidence. (AS 1105.A1 - .A10; AS 2501.07)

With respect to **Journal Entries**, for which the firm identified a fraud risk:

The firm identified fraud criteria for journal entries and obtained a listing of all journal entries that met the criteria. The firm did not perform sufficient substantive procedures to test those journal entries, because it limited its procedures to certain journal entries from the listing of entries that met the fraud criteria, without having an appropriate rationale for limiting its testing to those journal entries. (AS 2401.61)

Issuer B – Consumer Discretionary

Type of audit and related areas affected

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

Description of the deficiencies identified

With respect to **Revenue**; **Deferred Revenue**; and **Long-Lived Assets**, for which the firm identified a significant risk:

The issuer used multiple IT systems to initiate, process, and/or record transactions related to certain revenue, deferred revenue, and long-lived assets. In its testing of controls over these accounts, the firm tested various automated and IT-dependent manual controls that used data and reports generated or maintained by certain of these IT systems. As a result of the following deficiency in the firm's testing of ITGCs, the firm's testing of these automated and IT-dependent manual controls was not sufficient. (AS 2201.46)

With respect to change management:

The firm selected for testing a change management control over certain IT systems that consisted of the documentation, review, testing, and approval of changes prior to their migration into production. The firm did not perform procedures to test, or test any controls over, the completeness of the population of changes from which it made its selections for testing. (AS 1105.10)

As a result of the firm's ITGC testing deficiency discussed above, the firm did not perform sufficient substantive procedures, as follows:

- The firm used certain system-generated data to substantively test deferred revenue, long-lived assets, and certain revenue but did not test, or (as discussed above) sufficiently test controls over, the accuracy and completeness of this data. (AS 1105.10)

- The firm performed substantive analytical procedures as part of its testing of certain revenue and depreciation expense. The firm used certain system-generated data to develop its expectations but did not test, or (as discussed above) sufficiently test controls over, the accuracy and completeness of this data. (AS 2305.16)

- The sample size the firm used in certain of its substantive procedures to test revenue and long-lived assets 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 C – Consumer Discretionary

Type of audit and related areas affected

In our review of an 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 **Inventory**.

Description of the deficiencies identified

With respect to **Revenue**:

The principal auditor instructed the firm to perform specific substantive procedures to address the identified risks of material misstatement related to revenue. The firm did not perform sufficient substantive procedures to test revenue because the firm did not perform certain procedures for each transaction selected for testing and did not perform certain other procedures that it was instructed to perform. (AS 2301.08)

With respect to **Inventory**:

As instructed by the principal auditor, the firm selected for testing controls that consisted of the performance of physical inventory counts, a reconciliation of those counts to the inventory records, and the adjustment of those records, as appropriate. The firm did not perform sufficient procedures to test the operating effectiveness of these controls because the firm did not test the aspect of the control involving the performance of the physical inventory counts performed during the operation of these controls. (AS 2201.44)

Issuer D

Type of audit and related area affected

In our review, we identified deficiencies in the financial statement and ICFR audits related to **Variable Interest Entities (VIEs)**.

Description of the deficiencies identified

The issuer derives revenue through consolidated VIEs and relies on contractual arrangements with the VIEs and their shareholders to control the business operations of the consolidated VIEs. The issuer engaged an external specialist to provide a legal opinion regarding the issuer's consolidated VIEs, including the validity and enforceability of contractual arrangements with the VIEs and their shareholders.

The firm did not identify and test any controls over the identification and monitoring of events requiring a reassessment of VIEs as a reconsideration event under FASB ASC Topic 810, *Consolidation*. (AS 2201.39)

The firm did not perform substantive procedures to evaluate whether reconsideration events, under FASB ASC Topic 810, had occurred requiring a reassessment of the VIEs, beyond obtaining and reading the legal opinion prepared by the company's specialist. Further, the firm did not perform any procedures to use the work of the company's specialist as audit evidence. (AS 1105.A1 - .A10; AS 2301.08)

Audits with a Single Deficiency

None

PART I.B: OTHER INSTANCES OF NON-COMPLIANCE WITH PCAOB STANDARDS OR RULES

This section of our report discusses certain deficiencies that relate to instances of non-compliance with PCAOB standards or rules other than those where the firm had not obtained sufficient appropriate audit evidence to support its opinion(s) or fulfill the objectives of its role in the audit(s). This section does not discuss instances of potential non-compliance with SEC rules or instances of non-compliance with PCAOB rules related to maintaining independence.

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 reviewed and include any 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 two of four audits reviewed, the firm did not include all relevant work papers in the final set of audit documentation it was required to assemble. In these instances, the firm was non-compliant with AS 1215, *Audit Documentation.*

- In one of three audits reviewed, the firm did not make a required communication to the issuer's audit committee related to the issuer's critical accounting policies and practices and critical accounting estimates. In this instance, the firm was non-compliant with AS 1301, *Communications with Audit Committees*.

- In two of three audits reviewed, the firm did not provide a copy of the management representation letter to the issuer's audit committee. In these instances, the firm was non-compliant with AS 1301, *Communications with Audit Committees*, and AS 2805, *Management Representations*.

- In one of four audits reviewed, the firm did not evaluate certain factors when determining that there were no risks of material misstatement related to a significant account and disclosure. In this instance, the firm was non-compliant with AS 2110, *Identifying and Assessing Risks of Material Misstatement*.

- In one of three audits reviewed, the engagement team performed procedures to determine whether or not matters were critical audit matters but, in performing those procedures, did not include a matter that was communicated, or required to be communicated, to the issuer's audit committee and that related to accounts or disclosures that were material to the financial statements. 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*. This instance of non-compliance does not necessarily mean that other critical audit matters should have been communicated in the auditor's report.

PART I.C: INDEPENDENCE

In the 2022 inspection, we did not identify, and the firm did not bring to our attention, any instances of potential non-compliance with SEC rules or instances of non-compliance with PCAOB rules related to maintaining independence. Although this section does not include any instances of potential non-compliance that we identified or the firm brought to our attention, there may be instances of non-compliance with SEC or PCAOB rules related to independence that were not identified through our procedures or the firm's monitoring activities.

While the firm did not bring to our attention any instances of potential non-compliance, the number, large or small, of firm-identified instances of potential non-compliance may be reflective of the size of the firm, including the number of associated firms; the design and effectiveness of the firm's independence monitoring activities; and the size and/or complexity of the issuers it audits, including the number of affiliates of those issuers. Therefore, we caution against making any comparison of firm-identified instances of potential non-compliance across firms.

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.

We include deficiencies 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.

This report does not reflect changes or improvements to the firm's system of quality control that the firm may have made subsequent to the period covered by our inspection. The Board does consider such changes or improvements in assessing whether the firm has satisfactorily addressed the quality control criticisms or defects no later than 12 months after the issuance of this report.

When we issue our reports, we do not make public criticisms of, and potential defects in, the firm's system of quality control, to the extent any are identified. 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, we will make public any such deficiency.

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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March 20, 2023

Mr. George Botic
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Response to Part I of Public Company Accounting Oversight Board Draft Report on 2022 Inspection of KPMG Huazhen LLP

Dear Mr. Botic,

We are pleased to provide our response to Part I of the Public Company Accounting Oversight Board's ("PCAOB") Draft Report on 2022 Inspection of KPMG Huazhen LLP dated February 15, 2023 ("Draft Report").

Consistently executing high-quality audits is our top priority. We take findings from the PCAOB inspection process seriously and believe the inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of audit quality management. We appreciate the professionalism and commitment of the PCAOB staff and value the important role the PCAOB plays in improving audit quality.

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

We remain dedicated to evaluating and improving our system of quality management, including monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We understand our responsibility to our policies and practices in order to enhance audit quality. We understand our responsibility to investors and other participants in the capital markets and are committed to continuing to work constructively with the PCAOB to improve audit quality and build confidence in the auditing profession.

Yours sincerely,

KPMG Huazhen LLP
Jacky Zou
Senior Partner