PCAOB
Public Company Accounting Oversight Board

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PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD

In the Matter of KPMG LLP's Quality Control Remediation Submissions	PCAOB Release No.104-2014-166
	October 23, 2014

I.

The Public Company Accounting Oversight Board ("Board" or "PCAOB") has evaluated the submissions of KPMG LLP ("the Firm") pursuant to PCAOB Rule 4009(a) for the remediation periods ended November 8, 2012 and August 15, 2013 concerning the Firm's efforts to address certain quality control criticisms included in the nonpublic portions of the Board's November 8, 2011 and August 15, 2012 inspection reports on the Firm ("the Reports"). The Board has determined that as of November 8, 2012 and August 15, 2013, respectively, the Firm had not addressed certain criticisms in the Reports to the Board's satisfaction. Accordingly, pursuant to Section 104(g)(2) of the Sarbanes-Oxley Act of 2002 ("the Act") and PCAOB Rule 4009(d), the Board is making public the portions of the Reports that deal with those criticisms.[1]

The Firm has notified the Board that it will not seek Securities and Exchange Commission review of the determination, which the Firm has a right to do under the Act and Commission rules. The Firm has requested that a related statement by the Firm be attached as an Appendix to this release, and the Board has granted that request. By allowing the Firm's statement to be attached as an

[1] Those portions of the Report are now included in the version of the Report that is publicly available on the Board’s web site. Observations in Board inspection reports are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability.

Appendix to this release, however, the Board is not endorsing, confirming, or adopting as the Board's view any element of the Firm's statement.

II.

The quality control remediation process is central to the Board's efforts to cause firms to improve the quality of their audits and thereby better protect investors. The Board therefore takes very seriously the importance of firms making sufficient progress on quality control issues identified in an inspection report in the 12 months following the report. Particularly with the largest firms, which are inspected annually, the Board devotes considerable time and resources to critically evaluating whether the firm did in fact make sufficient progress in that period. The Board makes the relevant criticisms public when a firm has failed to do so to the Board's satisfaction.

It is not unusual for an inspection report to include nonpublic criticisms of several aspects of a firm's system of quality control. Any Board judgment that results in later public disclosure is a judgment about whether the firm made sufficient effort and progress to address the particular criticisms articulated in the report on that firm in the 12 months immediately following the report date. It is not a broad judgment about the effectiveness of a firm's system of quality control compared to those of other firms, and it does not signify anything about the merits of any additional efforts a firm may have made to address the criticisms after the 12-month period.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

October 23, 2014

KPMG

Statement of KPMG LLP on the PCAOB's October 23, 2014 Release No. 104-2014-166

KPMG LLP has established a culture that is built on an absolute commitment to performing consistently high-quality audits and meeting our responsibilities to investors and other participants in the capital markets system. We share the PCAOB's objectives of continually improving audit quality and building confidence in the auditing profession. The PCAOB's inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of audit quality control. We remain committed to full cooperation with the PCAOB, appreciate the professionalism and commitment of the PCAOB staff and value the important role the PCAOB plays in improving audit quality.

The Board of the PCAOB has made public portions of Part II of the Public Company Accounting Oversight Board's Reports on the 2010 and 2011 Inspections of KPMG LLP (the "Reports") because the Board determined that the firm had not submitted evidence or otherwise demonstrated that it satisfactorily addressed the quality control criticisms within the 12-month period after the date of the Reports. We accept the Board's determination and take seriously our responsibility to address these matters. We have taken remedial actions with respect to our professionals' evaluation of contrary evidence. We will take the further actions necessary to address this quality control criticism and will continue to enhance our system of audit quality control.

We remain dedicated to evaluating and improving our system of audit quality control, monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We understand our responsibility to the capital markets and are committed to continually improving our firm and working constructively with the PCAOB to improve audit quality.

Very truly yours,

KPMG LLP

John B. Veihmeyer
Chairman and Chief Executive Officer

James P. Liddy
Vice Chair, Audit

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Report on

2011 Inspection of KPMG LLP
(Headquartered in New York, New York)

Issued by the

Public Company Accounting Oversight Board

August 15, 2012

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. 104-2012-199A
(Includes portions of Part II of the full report that
were not included in PCAOB Release No. 104-2012-199)

PCAOB Release No. 104-2012-199A

PCAOB
Public Company Accounting Oversight Board

Notes Concerning this Report

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.

2. Any references in this report to violations or potential violations of law, rules, or professional standards are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.

3. Board inspections encompass, among other things, whether the firm has failed to identify financial statement misstatements, including failures to comply with Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements, in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the apparent misstatements or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning whether an issuer's financial statements are misstated or fail to comply with Commission disclosure requirements, rests with the Commission. Any description, in this report, of financial statement misstatements or failures to comply with Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.

PCAOB Release No. 104-2012-199A

2011 INSPECTION OF KPMG LLP

Preface

In 2011, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm KPMG LLP ("KPMG" or "the Firm") pursuant to the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is issuing this report in accordance with the requirements of the Act. The Board is releasing to the public Part I of the report, Appendix C, and portions of Appendix D.[1/] Appendix C provides an overview of the inspection process for annually inspected firms.[2/] Appendix D includes the Firm's comments, if any, on a draft of the report.[3/] A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system) is nonpublic, unless the firm fails to make sufficient progress in addressing those criticisms.

1/ In its Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions.

2/ The Act requires the Board to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers.

3/ The Board does not make public any of a firm's comments that address a nonpublic portion of the report. 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 at all. 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.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm performs audit work.[4/] To achieve that goal, Board inspections include reviews of certain aspects of selected audit work performed by the firm and reviews of certain aspects of the firm's quality control system. It is not the purpose of an inspection, however, to review all of a firm's audit work or to identify every respect in which reviewed work is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audit work, or the relevant issuers' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

If the Board inspection team identifies deficiencies that exceed a certain significance threshold in the audit work it reviews, those deficiencies are summarized in the public portion of the Board's inspection report.[5/] The Board cautions, however, against extrapolating from the results presented in the public portion of the report to broader conclusions about the frequency of deficiencies throughout the Firm's practice. Audit work is selected for inspection largely on the basis of an analysis of factors that, in the inspection team's view, heighten the possibility that auditing deficiencies are present, rather than through a process intended to identify a representative sample.

4/ This focus on weaknesses and deficiencies necessarily carries through to reports on inspections and, accordingly, Board inspection reports are not intended to serve as balanced report cards or overall rating tools.

5/ Inclusion of a deficiency in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. When audit deficiencies are identified after the date of the audit report, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to the firm's present ability to support its previously expressed opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. The inspection team may review, either in the same inspection or in subsequent inspections, the adequacy of the firm's compliance with these requirements. Failure by a firm to take appropriate actions, or a firm's misrepresentations, in responding to an inspection report, about whether it has taken such actions, could be a basis for Board disciplinary sanctions.

PART I

INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's staff ("the inspection team") conducted primary procedures for the inspection from November 2010 through October 2011. The inspection team performed field work at the Firm's National Office and at 31 of its approximately 83 U.S. practice offices.

A. Review of Audit Engagements

The 2011 inspection of the Firm included reviews of aspects of 52 audits performed by the Firm and a review of the Firm's audit work on one other issuer audit engagement in which the Firm played a role but was not the principal auditor. The inspection team selected the audits and aspects to review, and the Firm was not allowed an opportunity to limit or influence the selections.

The inspection team identified matters that it considered to be deficiencies in the performance of the work it reviewed. Those deficiencies included failures by the Firm to identify, or to address appropriately, financial statement misstatements, including failures to comply with disclosure requirements,[6/] as well as failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures. In some instances, follow-up between the Firm and the issuer led to a change in the issuer's accounting or disclosure practices.

In some cases, the conclusion that the Firm failed to perform a procedure was based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claimed to have performed the procedure.[7/]

[6/] When it comes to the Board's attention that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with applicable accounting principles, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

[7/] PCAOB Auditing Standard ("AS") No. 3, *Audit Documentation,* provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did

The inspection team considered certain of the deficiencies that it observed to be audit failures. Specifically, certain of the identified deficiencies were of such significance that it appeared that the Firm, at the time it issued its audit report, had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the financial statements and/or on the effectiveness of internal control over financial reporting ("ICFR"). The audit deficiencies that reached these levels of significance are described below.[8/]

A.1. Issuer A

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures related to the substantive testing with respect to the issuer's business combinations, allowance for loan losses ("ALL"), and deposit liabilities, and to the control and substantive testing with respect to the issuer's available-for-sale ("AFS") securities.

- The Firm failed to perform sufficient testing related to the issuer's accounting for assets acquired and liabilities assumed in two business combinations. For certain acquired loan portfolios, the engagement team failed to address the significant differences between the discount rates, as well as other assumptions, that the issuer used in its fair value measurements and those that the Firm's internal valuation specialist considered reasonable. In addition, the Firm tested the valuation of the acquired FDIC indemnification assets by developing a range of relationships between the values of indemnification assets and the underlying loans based on other recent transactions by other banks that had acquired loan portfolios from failed banks with the assistance of the FDIC. This range, however, was too wide (from approximately three percent to 60 percent of the principal of the underlying loans) to determine whether the recorded values were not materially misstated, and the Firm

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so, and that oral assertions and explanations alone do not constitute persuasive other evidence.

[8/] The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

performed no procedures to determine whether the loan portfolios acquired by the other banks had similar characteristics to those acquired by the issuer. Further, the Firm failed to test certain assertions as of the acquisition date for certain of the other asset and liability accounts acquired, beyond, for some accounts, comparing the balances to unaudited pro forma statements prepared by an external party.

- During the year, the issuer added a new unallocated reserve component to its ALL. The Firm failed to sufficiently test the ALL, as its testing of this component was limited to obtaining a general understanding of how management developed the unallocated reserve, without testing any of the specific assumptions used in determining the recorded amount.

- To test the existence and valuation of the issuer's deposit liabilities, the Firm's approach was to send confirmations as of an interim date and to perform procedures to extend its conclusions from the confirmation procedures to the year end. The Firm, however, confirmed the deposit accounts as of the last statement date, which differed from the interim date, and failed to reconcile the balances confirmed to the balances at the interim date. Further, for confirmations that were not returned, the Firm's alternative procedures were insufficient, as the procedures were limited to testing a transaction that was applicable to the deposit account and, for some of the accounts, the transaction was a system-generated transaction. For confirmations returned with exceptions, the Firm did not investigate the reasons for the exceptions.

- The issuer recorded the fair value of its AFS securities using prices from an external pricing service. The Firm failed to identify and test any controls over the prices the issuer received from the external pricing service. For some types of AFS securities without readily determinable fair values, the Firm obtained prices from external pricing services. The Firm failed to obtain an understanding of the specific methods and/or assumptions underlying the fair value measurements that were obtained from external pricing services and used in the Firm's testing, and it failed to perform other procedures to support its use of those prices in its testing. In addition, for certain AFS securities that had been in an unrealized loss position for more than twelve months, the Firm failed to test certain assumptions that the issuer used to determine whether the securities were other-than-temporarily impaired.

A.2. Issuer B

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures in its control testing related to (a) testing certain information technology general controls ("ITGCs"), (b) testing controls over the completeness and accuracy of certain financial data, (c) identifying and testing controls over the valuation of certain guarantees, and (d) testing certain controls over fixed assets. The Firm's failures in its substantive testing related to certain guarantees and fixed assets.

- The Firm failed to sufficiently test ITGCs and, as a consequence of this failure, the Firm's reliance on certain system-generated reports, automated application controls, and information technology ("IT") dependent manual controls was excessive. The specific deficiencies in testing ITGCs were as follows –
    - The Firm did not test whether user-access rights granted to all financial applications that the Firm had determined were significant were consistent with the level of access approved by management. In addition, the Firm failed to identify and test any controls over the completeness and accuracy of information in periodic reports used by management to monitor changes to user access, and to test whether the review of such reports was effective.
    - Separately, the Firm identified a deficiency in the operating effectiveness of a periodic user-access review control related to these financial applications. The Firm identified compensating controls for this deficiency; however, the Firm's testing of certain of these controls either used a sample of only one item or consisted of a review of user access only at a specific date. Both of these approaches assumed ITGCs, including user-access controls, were effective.
- The Firm failed to obtain an understanding of the nature and timing of the data transfer between certain significant financial applications (including data related to revenue, inventory, and payroll) and the related issuer

controls over the completeness and accuracy of the transfer of such information.

- The Firm failed to sufficiently test certain controls over fixed assets and failed to evaluate the effect of an identified error related to fixed assets on its conclusion regarding the effectiveness of ICFR. Specifically –

    - The Firm failed to identify and test any controls over the completeness and accuracy of information that was used in the performance of controls over fixed assets and that was generated from systems for which ITGCs were not tested.

    - The Firm's testing of certain review controls did not include an evaluation of the effectiveness of the review, as its testing was limited to determining whether there was evidence that a review had been performed by the control owner.

    - The Firm failed to evaluate whether an error relating to the improper removal of an asset from the fixed asset ledger, which management had indicated was caused by a system problem, indicated a deficiency in controls.

- The issuer guaranteed loans to certain affiliated parties through a credit facility and had recorded a liability related to the fair value of the guarantees. The issuer concluded that it did not need to record an additional liability in the year under audit related to the guarantees' contingent aspect (related to the risk that the issuer might have to perform under the guarantees). The Firm assessed inherent risk as low related to the valuation assertion for the contingent aspect of the guarantees, despite the existence of factors indicating that the financial condition of certain of the affiliated parties had deteriorated. The Firm's procedures related to the guarantees were deficient in that the Firm failed to (a) identify and test any controls over the contingent aspect of the guarantees, and (b) perform substantive procedures to evaluate the issuer's assertion that it was not probable that any losses had occurred.

- The issuer identified certain fixed assets that had indicators of impairment and, for each of those, prepared cash flow projections. The Firm failed to evaluate the reasonableness of certain significant assumptions underlying the cash flow projections, other than by discussing the assumptions with an employee of the issuer and performing a sensitivity analysis that used unsupported projected growth rates.

A.3. Issuer C

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures related to the control and substantive testing with respect to the issuer's ALL and mortgage-repurchase reserve.

- With respect to the ALL –
  - o As a result of a review by its primary regulator during the year, the issuer recorded, at an interim date, an increase to the ALL that was in excess of seven times the Firm's established level of materiality. Other than by discussing the adjustment with the issuer and its primary regulator and reading a memorandum prepared by the issuer's management, the Firm failed to evaluate whether the increase in the ALL indicated that one or more prior periods' financial statements had been misstated. The issuer concluded, and the Firm agreed, that a control deficiency existed at the interim date related to the management review control over the ALL and that the control deficiency had been remediated as of the year end. The Firm, however, failed to perform sufficient procedures to test the operating effectiveness of the management review control as of year end. While the Firm's testing addressed the relevance and reliability of certain data used in the control, and the Firm obtained evidence that the issuer performed a review, the Firm did not test the effectiveness of the review. For example, the Firm failed to obtain an understanding of the metrics, thresholds, or other criteria the issuer used to identify items for investigation and failed to test whether the issuer appropriately investigated and addressed items that met those criteria.
  - o There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested certain

reclassifications of loans between the issuer's loan types, which had the effect of decreasing the calculated ALL.

- o With the exception of one small segment of loans, the Firm failed to sufficiently test the issuer's qualitative loss factors. Specifically, even though these factors were established in the year under audit, the Firm's testing was limited to obtaining an understanding of management's rationale for the factors, obtaining general market data, and noting the high-level directional trends in the factors and the issuer's loans.

- o The Firm concurred with the issuer's conclusion that no allowance was required for certain loans classified as troubled debt restructurings based on the issuer's assumption that it was probable that the issuer would receive all payments in accordance with the restructured terms of the loans. The Firm, however, failed to test this assumption beyond inquiry of management.

- The issuer has sold substantially all of the residential mortgages it originated in the past five years. During 2010, the issuer experienced increased expenses related to an increase in demands from, and disputes with, buyers of the mortgages. In addition, the Firm identified that the mortgage-repurchase reserve was understated at year end, and identified as a control deficiency the fact that the issuer did not have adequate processes and related controls to analyze and reserve for mortgage repurchases. Further, the issuer's primary regulator and a loan purchaser identified weaknesses related to the issuer's loan origination and appraisal processes. Despite these circumstances, the Firm assessed the risk of material misstatement for the mortgage-repurchase reserve as low and determined that this reserve was not a significant account. The Firm failed to sufficiently test the issuer's mortgage-repurchase reserve. Specifically –

  - o With the exception of one small component of the reserve, the Firm's substantive procedures were limited to testing for payments made after the year end and a general discussion with management.

  - o The Firm failed to appropriately evaluate the severity of the identified control deficiency related to the mortgage-repurchase reserve, as the Firm performed its evaluation based on the known misstatement rather than on the magnitude of the potential misstatement that might result from the deficiency.

A.4. Issuer D

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures related to the substantive testing of the issuer's balance sheet, the control and substantive testing with respect to the issuer's ALL, and the substantive testing of the issuer's investment securities.

- The Firm used an amount greater than its established materiality level to determine the extent of its testing of certain balance sheet accounts. Consequently, the sample sizes used for testing were inadequate to enable the Firm to obtain the necessary level of assurance regarding these accounts.

- With respect to the ALL, the Firm failed to perform sufficient tests of controls and substantive procedures related to the issuer's reserves for commercial loans and unfunded commitments, and failed to perform sufficient substantive procedures to test the component of the issuer's ALL that was not allocated to any portion of the issuer's lending portfolio ("the unallocated reserve"). Specifically –

  - The issuer determined its reserves for commercial loans and unfunded commitments using models based on, in part, assigned loan grades and loss-rate factors. The Firm failed to sufficiently test two important review controls over the loan grades and loss-rate factors. Specifically, for one of these review controls, the Firm failed to test controls over the completeness and accuracy of certain data used in the review. In addition, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested whether decisions to change loan grades that resulted from the operation of this review control were appropriate. For the other review control, the Firm's tests of the control activities over the appropriateness of certain loss-rate factors consisted only of determining whether the appropriate personnel had performed a review, rather than testing the effectiveness of the review.

- o The Firm also failed to perform sufficient substantive procedures to test the issuer's loss-rate factors, which the issuer had developed based on external data with certain adjustments. The issuer gave an equal weighting to each year of the external data, which covered at least 20 years, with the most recent data being at least one year old. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered whether more recent data were more indicative of losses inherent in the year-end loan portfolio and thus should have received greater weighting than older data. Also, the Firm failed to sufficiently test the reasonableness of the adjustments the issuer made to the external data in order to develop the loss-rate factors, as the Firm's testing was limited to obtaining an understanding of the rationale for any adjustments made. In addition, the Firm failed to perform a retrospective review of the issuer's historical estimates of the commercial ALL compared with subsequent results to assess the reasonableness of the assumptions used in developing the commercial ALL.

- o During the year, the issuer increased its unallocated reserve to the maximum of a range that it had previously determined for that component of the ALL. The Firm's testing of the unallocated reserve was limited to obtaining an understanding of the qualitative factors that the issuer considered in developing the unallocated reserve. The Firm failed to assess whether the recorded amount of the unallocated reserve was reasonable, including evaluating whether the increase in the unallocated reserve over the prior year was reasonable in light of the improvement in economic and credit risk indicators.

- The Firm failed to sufficiently test the valuation of, and disclosures related to, certain of the issuer's investment securities without readily determinable fair values. Specifically –

- o The issuer used one external pricing service as its primary pricing source, and obtained additional prices for the majority of its investment securities from other external pricing services. For some of the securities, there were significant differences between or among the prices obtained. To test the valuation of the issuer's investment securities, the Firm selected a sample of securities at an interim date and at year end, and compared the prices the issuer had used in its valuation process to prices that the Firm obtained from the same external pricing services that the issuer had used. The Firm also selected a smaller sample of 15 securities at the interim date and, for each of these securities, the Firm obtained the assumptions underlying the issuer's pricing services' prices, and also obtained prices from another pricing service in order to assess the reliability of the prices the issuer had obtained. The Firm accepted the issuer's recorded value without sufficiently evaluating the significant differences in the prices for some of the individual securities. Specifically, while the Firm determined that the differences in pricing were attributable to differences in underlying assumptions, the Firm concluded that each of the assumptions used by the issuer's pricing services was reasonable. There was no evidence in the audit documentation, and no persuasive other evidence, however, that the Firm had performed procedures to provide a basis for its conclusion.

- o In addition, the Firm failed to sufficiently test the issuer's disclosures of certain investment securities without readily determinable fair values as level 2 within the hierarchy set forth in FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, as it failed to obtain an understanding of whether the significant inputs used to value the securities were observable or unobservable.

A.5. <u>Issuer E</u>

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinions on the financial statements and on the effectiveness of ICFR. The Firm's failures related to the substantive testing with respect to accounts receivable and revenue, and the testing of certain internal controls over significant financial applications.

- The Firm's approach to testing accounts receivable and revenue at a business that the issuer had acquired during the year, which represented approximately 56 percent of consolidated accounts receivable and 40 percent of consolidated revenue, consisted of only substantive procedures and did not include tests of controls for the acquired business. The Firm failed to sufficiently test accounts receivable and revenue for this acquired business. Specifically —

- The Firm sent customer confirmation requests at an interim date to test accounts receivable. For certain confirmation requests not returned, the Firm's alternative procedures were insufficient as either no procedures were performed, or the procedures were limited to one of the following: (a) agreeing only a portion of the account balance to subsequent cash receipts, or (b) agreeing the account balance to issuer invoices that were generated by a system for which controls had not been tested, and/or verifying that at least one payment had been received on the account prior to the interim date.

- The Firm's procedures to extend the interim conclusions on accounts receivable to year end were insufficient, as the Firm failed to identify that the roll-forward analysis that the issuer prepared included an incorrect adjustment that was in excess of the Firm's established level of materiality and excluded certain other adjustments that should have been included.

- The Firm's procedure to test revenue since acquisition was to estimate revenue for that period as the amount of cash received during the period, adjusted by the change in the recorded accounts receivable balance from the date of acquisition to the end of the year. Because the Firm's testing of accounts receivable was insufficient as described above, the Firm's testing of the related revenue using this procedure also was insufficient. Further, the Firm failed to identify the circular nature of the tests performed, as the accounts receivable roll-forward procedures relied upon reported revenue, and the test of revenue relied upon the accounts receivable balance.

- The issuer and the Firm identified a control deficiency in that a significant number of users, including program developers, had the ability to make changes to certain significant financial applications. To mitigate this deficiency, the issuer identified a manual control over the review and approval of changes to the applications. The Firm identified this manual control and certain other manual review and reconciliation controls as compensating controls, but failed to sufficiently test these controls. Specifically —

- To test the review and approval of changes to the financially significant applications, the Firm tested a sample of changes to determine whether they had been appropriately approved. The Firm's testing was not sufficient, as (a) it failed to determine whether the population from which the sample was selected was complete, and (b) its sample was limited to changes made in only one month (the third month before year end) and the Firm failed to consider whether this month was representative of changes made throughout the year.

- To test the manual review and reconciliation controls, the Firm obtained certain monthly operating review reports and reconciliations and attended certain monthly management meetings where the reports and reconciliations were discussed. The Firm's testing was not sufficient, as (a) it did not test controls over the completeness and accuracy of the data in the reports, and (b) it failed to test whether these controls identified all of the relevant issues for investigation and, if so, whether such issues were appropriately investigated and resolved.

As a consequence of the Firm's failure to sufficiently test the controls described above, the Firm's reliance on certain system-generated reports, automated application controls, and IT-dependent manual controls was excessive.

A.6. Issuer F

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of ICFR. Due to the deficiencies described below, the Firm's conclusion that it could rely on ITGCs was not supported. As a result, the Firm's testing of certain automated application controls, IT-dependent manual controls, and system-generated reports, on which it relied for its control testing, was insufficient. The specific deficiencies in testing ITGCs were as follows –

- The Firm's tests of controls related to user access to certain significant financial applications, including its tests related to segregation of duties, were insufficient. The Firm tested controls over user access for these significant financial applications primarily by testing the control over access granted to new users and a control that consisted of an annual review of user access.

  - The Firm's testing of the new-user access control consisted of determining that the appropriate approval had been obtained before the user was granted access to an application, but did not address whether the actual access granted was consistent with that approval, nor did the Firm determine whether the control was designed to detect potential segregation of duties issues related to that access.

  - The Firm's testing of the annual review control addressed only whether the reviews were performed and whether any changes requested as a result of the reviews were transmitted to the appropriate department. The Firm's procedures did not include evaluating the decisions the individual performing the review made regarding the appropriateness of the access that had been provided to a user or testing whether the individual considered any potential segregation of duties issues related to that access.

  - The issuer's policy allowed for certain members of senior management both to request and to approve access to significant financial applications, and also to perform the annual review of user access to these applications. In addition, the issuer's general ledger application was set up in a way that could allow users to circumvent user-access controls to make changes to the data in the general ledger. There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had identified the risks associated with either of these circumstances or had tested controls that addressed these risks.

- o While the Firm identified and tested controls that addressed the risks associated with the fact that certain users could access all programs and data without first needing to access an application, its testing did not address the risk that the issuer had granted other users similar access to some, but not all, programs and data without first needing to access an application.

- For the inventory, sales, and accounts receivable applications related to one of the issuer's business segments, the Firm failed to determine whether the processing of data and the monitoring of this processing within these applications were subject to the ITGCs that the Firm had tested.

A.7. Issuer G

In this audit, the Firm chose to review and test management's process for developing the fair value measurements of the issuer's investments. The majority of these investments were in the debt and equity securities of private companies ("traditional investments"), although the issuer also invested in private finance companies ("finance companies"). The Firm selected certain of the issuer's individual investments for testing, but its procedures to test some of these investments were not sufficient. Specifically –

- With respect to traditional investments –

  - o For most of the investments selected for testing, the issuer used the investees' financial results as one of the significant factors in determining the fair value measurements. The investees' financial results that the issuer used were for an interim period that was generally eleven months after the investees' most recently audited financial statements (the "interim data"). The Firm's testing of the interim data was not sufficient. Specifically –

    - ▪ In some situations, the issuer made adjustments to the interim data, and there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested these adjustments, beyond inquiry of management.

        - There was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had considered specific investee risk factors in designing and performing its audit procedures to test the interim data.

        - The Firm used the most recent audited investee financial statements to evaluate the reliability of the investees' interim data. The Firm, in certain cases, failed to determine whether the reports of the investees' auditors were satisfactory, as it failed to assess the professional reputation and standing of the investees' auditors.

    - For some of these investments, the fair value measurements were based on information other than the interim data, and there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested this other information, beyond inquiry of management.

- With respect to investments in finance companies –

    - For one investment, the Firm failed to test the projected cash flows and the underlying assumptions the issuer used in estimating the fair value.

    - For another investment, the issuer valued the investment on a liquidation basis and the Firm failed to test the issuer's estimate of the value of the investee's net assets.

A.8. Issuer H

In this audit, the Firm failed to obtain sufficient appropriate audit evidence to support its opinions on the financial statements and on the effectiveness of ICFR. The issuer uses FASB ASC Topic 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* to account for its investment in loans that it has purchased. The income on these loans that the issuer records depends on the amount and timing of projected cash flows and the resulting yield associated with those projections. The Firm failed to sufficiently identify and test controls over revisions made to the projected cash flows and the resulting changes in the yields, as the Firm's testing was limited to verifying that certain analyses had been prepared for each loan portfolio, and that there was evidence that a review had been performed by the control owner. The Firm's testing did not include evaluating how the issuer's review, performed as part of the controls selected for testing, addressed whether the changes in the projected cash flows or in the yields were appropriate.

Further, the Firm's substantive testing of the changes the issuer made to the amount and timing of the projected cash flows and the resulting increase in the yields was limited to testing whether the changes were directionally consistent with the differences between actual and projected cash flows (*e.g.*, if actual cash flows were higher than had been projected, the Firm verified that the revised projected cash flows and/or the yields were also higher). The Firm's testing did not include evaluating whether the revised projected cash flows and yields were reasonable or supported.

A.9. Issuer I

In this audit, the Firm failed to perform sufficient procedures to test the valuation of the issuer's investment securities. The Firm selected a statistical sample of securities for testing at an interim date, a statistical sample of a portion of the population of the securities at a second interim date, and a significantly smaller judgmental sample at the balance sheet date. At each date, the Firm tested the fair value of the securities by comparing the issuer's recorded fair value to a price the Firm obtained from one of five external pricing services or, in some instances, an average of two or more prices from these pricing services. The deficiencies in the Firm's testing were as follows –

- For certain securities without readily determinable fair values, the Firm did not obtain an understanding of the specific methods and/or assumptions underlying the prices for individual securities that were obtained from the external pricing services and used in the Firm's testing of fair value. The Firm performed certain other procedures that were intended to support its use of these prices in its testing, but these procedures were not sufficient. In fact, the Firm obtained evidence that indicated that the prices for some securities may not have been reliable, and the Firm failed to evaluate this contrary evidence. Specifically –
    - For some securities, the difference between the issuer's recorded value and the Firm's estimate of fair value using the prices provided by the pricing services exceeded the Firm's established threshold for acceptable differences, and the Firm obtained an additional price from an internal valuation specialist. While, for all of these

securities, the difference between the issuer's recorded value and the internal valuation specialist's price was below the Firm's established threshold, the Firm failed to consider whether the significant differences between the prices obtained from the pricing services and the prices obtained from the Firm's internal valuation specialist for these securities had a bearing on the reliability of the prices obtained from the pricing services for other securities.

- The Firm also performed procedures to assess the reliability of the pricing services' prices. Although these procedures provided contrary evidence, the Firm did not take this evidence into account in determining to use the pricing services' prices. Specifically –

  - For certain securities on a sample basis, the Firm obtained prices from the internal valuation specialist in order to test the reliability of the prices provided by the pricing services. For some of the securities sampled, the difference between the internal specialist's fair value measurement and the prices obtained from the pricing services exceeded the Firm's established threshold, but the Firm failed to evaluate the reasons for, and consider the implications of, these differences, and continued to use prices from these pricing services in testing the fair value of similar securities, without performing any additional procedures.

  - The Firm selected a sample of the issuer's purchases and sales of investment securities and requested the pricing services' fair value measurements for the selected investments for the day before the issuer's transaction, so that it could compare the transaction price to the pricing services' prices.

    - For three of the pricing services, for some of the securities in the sample, the difference between the transaction price and the price provided by the pricing service exceeded the Firm's established threshold, but the Firm failed to evaluate the reasons for, and consider the implications of, the differences and inappropriately concluded that the testing supported its conclusion that prices received from these pricing services were reliable.

- In addition, one of the pricing services provides prices only upon request, and the Firm failed to consider that this pricing service could have developed its estimate of fair value for the securities involved in this procedure using the same transaction that the Firm was using for comparison.

- The Firm failed to sufficiently test the issuer's disclosures of certain investment securities without readily determinable fair values as level 2 within the fair value hierarchy, because it failed to obtain an understanding of whether the significant inputs used to value the investment securities were observable or unobservable.

- For certain types of investment securities, the Firm's substantive procedures to extend its conclusions from the first interim date to year end were limited to an analytical procedure disaggregated by type of investment security, and for others, the procedures included both an analytical procedure and tests of the fair values of a sample of the securities at the second interim date. The analytical procedures for certain of the investment securities were insufficient since, for some of the investment securities, the Firm failed to establish an expectation, and for others, the Firm's expectation was expressed as a range that was too wide to detect a potential misstatement that could be material.

- The Firm excluded from its tests of the valuation of securities at year end securities purchased during two of the last three months of the issuer's fiscal year, whose aggregate recorded value was approximately ten times the Firm's established level of materiality.

A.10. Issuer J

In this audit, for certain of the issuer's investment securities, the Firm obtained estimates of fair values from external pricing services for comparison to the issuer's fair value measurements. The Firm established a threshold to identify pricing differences for further testing. The threshold, however, was for an aggregate difference at the portfolio level; this threshold caused the Firm not to identify significant differences in prices for individual securities. In addition, the Firm failed to test the fair value of certain securities for which it had requested, but not received, a price from the external pricing services.

A.11. Issuer K

In this audit, for the issuer's investment securities, the Firm obtained estimates of fair values from an external pricing service for comparison to the issuer's fair value measurements and established a threshold to identify pricing differences for further testing. For a certain type of security, a number of the individual securities had a recorded value significantly below par value ("the identified securities"). For the identified securities, the difference between the issuer's price and the price obtained from the external pricing service exceeded the Firm's established threshold. For individual securities for which the amount of the difference was over the established threshold plus the amount that the Firm used to accumulate misstatements for evaluation, the Firm obtained prices from another external pricing service and calculated an average price from the two pricing services. For each of the securities subject to this procedure, the difference between the average price and the recorded price still exceeded the Firm's established threshold. For each of the identified securities, the Firm accepted the issuer's recorded value without sufficiently evaluating the significant differences in the prices. Specifically, the Firm determined that the differences in pricing were attributable to differences in a key underlying assumption and concluded that these differences were reasonable. There was no evidence in the audit documentation, and no persuasive other evidence, however, that the Firm performed procedures to provide a basis for its conclusion.

In addition, the Firm failed to sufficiently test the issuer's disclosures of these securities as level 2 within the fair value hierarchy, because it failed to obtain an understanding of whether any of the significant inputs used to value the securities were observable or unobservable.

A.12. Issuer L

In this audit, the Firm tested the valuation of the majority of the issuer's investments in securities at an interim date; however, the Firm failed to perform sufficient procedures to provide a reasonable basis for extending its conclusions on the valuation of those securities to the balance sheet date. Specifically, with respect to equity securities, the analytical procedures that the Firm performed to roll forward its conclusions to year end consisted only of determining that the issuer's returns, by industry sector, were directionally consistent with publicly reported returns for the industry sector, and the publicly reported returns used in the comparison were for a period that was longer than the roll-forward period. For debt securities, the Firm compared the issuer's yield for its debt portfolio to corresponding publicly available yield rates, but the publicly available information used in the comparison were for a period that was longer than the roll-forward period. In addition, in this analysis, the Firm failed to incorporate the effects of the issuer's purchases and sales of debt securities during the roll-forward period.

B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following five areas (1) management structure and processes, including the tone at the top; (2) practices for partner management, including allocation of partner resources and partner evaluation, compensation, admission, and disciplinary actions; (3) policies and procedures for considering and addressing the risks involved in accepting and retaining clients, including the application of the Firm's risk-rating system; (4) processes related to the Firm's use of audit work that the Firm's foreign affiliates perform on the foreign operations of the Firm's U.S. issuer audit clients; and (5) the Firm's processes for monitoring audit performance, including processes for identifying and assessing indicators of deficiencies in audit performance, independence policies and procedures, and processes for responding to weaknesses in quality control. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I

PORTIONS OF THE REST OF THIS REPORT ARE NONPUBLIC AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

PART II

ISSUES RELATED TO QUALITY CONTROLS

This Part II contains a discussion of criticisms of and potential defects in the Firm's quality control system.[9/] Assessment of a firm's quality control system rests both on review of a firm's stated quality control policies and procedures and on inferences that can be drawn from identified deficiencies in audit performance. These deficiencies, whether alone or when aggregated, may indicate respects in which a firm's system has failed to assure quality in the performance of engagements. Not every deficiency in an audit indicates that a firm's quality control system is insufficient to provide that assurance, and this report does not discuss every auditing deficiency observed by the inspection team. On the other hand, some deficiencies, or repeated instances of similar deficiencies, may indicate a significant defect in a firm's quality control system even when the deficiency has not resulted in an insufficiently supported audit opinion. In addition, reviews specifically focused on aspects of a firm's system of quality control may indicate a significant defect in that system.

As described below, an analysis of the inspection results reported by the inspection team indicates that the Firm's system of quality control requires remedial action in order to provide sufficient assurance that the Firm's audit work will meet applicable standards and requirements.

* * * *

Failure to Sufficiently Evaluate Contrary Evidence

The inspection results continue to indicate a failure by some of the Firm's professionals to evaluate, or in certain situations to sufficiently evaluate, contrary evidence. In [certain audits with identified deficiencies], the Firm determined that the issuer's assumptions or conclusions were reasonable * * * * without evaluating, or sufficiently evaluating, evidence that appeared to contradict the Firm's determinations. * * * *.

[9/] This report's description of quality control issues is based on the inspection team's observations during the primary inspection procedures. Any changes or improvements that the Firm may have made in its system of quality control since that time may not be reflected in this report, but will be taken into account by the Board during the 12-month remediation process following the issuance of this report.

The Firm introduced training in late 2009, which continued in 2010, that specifically highlighted the inappropriateness of engagement teams truncating their information search as soon as they find evidence that supports the issuer's conclusion, especially when there is more information that could support an alternative conclusion. In October 2011, the Firm released guidance that included a suggested template to document engagement teams' analysis and test work associated with significant risks related to significant judgments and estimates, including the evaluation of contrary audit evidence. While these remedial actions appear to be designed to address some of the concerns identified in the 2010 report and this report, additional actions may be needed. The Firm should evaluate the root causes of the deficiencies described above, assess the effectiveness of the existing remedial actions, and consider whether those remedial actions are sufficient to address the deficiencies.

* * * *

APPENDIX C

THE INSPECTION PROCESS FOR ANNUALLY INSPECTED FIRMS

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to auditing issuers. This appendix describes the inspection process for those annually inspected firms that have multiple practice offices and a national office structure. While this appendix describes the general inspection process applied in the 2011 inspections of these firms, the process was customized to each firm's inspection, bearing in mind the firm's structure, past inspection observations, observations during the course of the 2011 inspection, and other factors. Accordingly, procedures described in this Appendix, while generally applicable to annual inspections, may not have been applied, or may not have been applied fully, in the inspection of any individual firm, and additional procedures, not described in this appendix, may have been applied in the inspection of an individual firm.

The inspection process included reviews of aspects of selected issuer audits completed by the inspected firm. These reviews were intended both to identify deficiencies, if any, in those aspects of the audits and to determine whether those deficiencies indicated weaknesses or defects in the firm's system of quality control over audits. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the firm that could be expected to affect audit quality.

C.1. Review of Selected Audits

Inspections include reviews of aspects of selected audits of financial statements and ICFR. For each audit selected, the inspection team reviewed certain of the issuer's SEC filings. The inspection team selected certain aspects of the audits for review and inspected the engagement team's work papers and interviewed engagement personnel regarding those aspects. The inspection team also analyzed potential adjustments to the issuer's financial statements that were identified during the audit but not corrected. For certain selected engagements, the inspection team reviewed written communications between the firm and the issuer's audit committee and, for some engagements, the inspection team interviewed the chairperson of the issuer's audit committee.

When the inspection team identified a potential issue, it discussed the issue with members of the engagement team. If the inspection team was unable to resolve the issue through this discussion and any review of additional work papers or other documentation, the inspection team issued a comment form on the matter and the Firm was allowed the opportunity to provide a written response to the comment form.

C.2. Review of Firm Management and Monitoring Processes Related to Audit Quality Control

The inspection team's review of a firm's system of quality control was intended to provide a basis for assessing whether that system was appropriately designed and implemented to achieve the goal of conducting audits that are in compliance with applicable standards. This review included an evaluation of the firm's ability to respond effectively to indications of possible defects in its system of quality control.

C.2.a. Review of Management Structure and Processes, Including the Tone at the Top

Procedures in this area were designed to focus on (a) how the firm's management is structured and operates the firm's business, and the implications that the management structure and processes have on audit performance, and (b) whether actions and communications by the firm's leadership – the "tone at the top" – demonstrate a commitment to audit quality. The inspection team interviewed members of the firm's leadership to obtain an understanding of any significant changes in the firm's approach to, and processes for, its management, including the mechanisms, formal or informal, that assess, monitor, or affect audit performance. The inspection team also reviewed significant management reports and documents, as well as information regarding financial metrics and the budget and goal setting processes that the Firm uses to plan for, and evaluate the success of, its business.

C.2.b. Review of Practices for Partner Management, Including Allocation of Partner Resources and Partner Evaluation, Compensation, Admission, and Disciplinary Actions

Procedures in this area were designed to focus on (a) whether the firm's processes related to partner evaluation, compensation, admission, termination, and disciplinary actions could be expected to encourage an appropriate emphasis on audit quality and technical competence, as compared to marketing or other activities of the firm; (b) the firm's processes for allocating its partner resources; and (c) the accountability and responsibilities of the different levels of firm management with respect to partner management. The inspection team interviewed members of the firm's management and also reviewed documentation related to certain of these topics. In addition, the inspection team's interviews of audit partners included questions regarding their responsibilities and allocation of time and the interviews of firm management included the performance of partners being inspected, the evaluation and compensation process, any disciplinary actions, and any situations where a client requested a change in the lead audit partner. In addition, the inspection team reviewed a sample of partners' personnel files, including files of partners who resigned or took early retirement and partners who had significant negative inspection results from recent internal and PCAOB inspections.

C.2.c. Review of Policies and Procedures for Considering and Addressing the Risks Involved in Accepting and Retaining Clients, Including the Application of the Firm's Risk-Rating System

The inspection team selected certain issuer audits to (a) evaluate compliance with the firm's policies and procedures for identifying and assessing the risks involved in accepting or continuing the client and (b) observe whether the audit procedures were responsive to the risks identified during the process.

C.2.d. Review of Processes Related to the Firm's Use of Audit Work that the Firm's Foreign Affiliates Perform on the Foreign Operations of the Firm's U.S. Issuer Audit Clients

The inspection team reviewed the firm's policies and procedures related to its supervision and control of work performed by foreign affiliates on the operations of U.S. issuer clients, reviewed available information relating to the most recent foreign affiliated firms' internal inspections, interviewed members of the firm's leadership, and reviewed the U.S. engagement teams' supervision and control procedures concerning the audit work that the firm's foreign affiliates performed on a sample of audits. In some cases, the inspection team also reviewed, on a limited basis, certain of the audit work performed by the firm's foreign affiliates on the foreign operations of U.S. issuer clients.

C.2.e. Review of the Firm's Processes for Monitoring Audit Performance, Including Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance, Independence Policies and Procedures, and Processes for Responding to Weaknesses in Quality Control

C.2.e.i Review of Processes for Identifying and Assessing Indicators of Deficiencies in Audit Performance

Procedures in this area were designed to identify and assess the monitoring processes that the firm uses to monitor audit quality for individual engagements and for the firm as a whole. The inspection team interviewed members of the firm's management and reviewed documents regarding how the firm identifies, evaluates, and responds to possible indicators of deficiencies in audit performance, including internal inspection findings, PCAOB inspection observations, restatements, and litigation. In addition, the inspection team reviewed documents related to the design, operation, and evaluation of findings of the firm's internal inspection program. The inspection team also reviewed certain audits that the firm had inspected and compared its results to those from the internal inspection.

C.2.e.ii Review of Response to Weaknesses in Quality Control

The inspection team reviewed steps the firm has taken in the past several years to address possible quality control deficiencies. The inspection team then assessed the design and evaluated the effectiveness of the processes identified. In addition, the inspection team conducted focused inspections of audits of certain issuers whose audits had been reviewed during previous PCAOB inspections of the firm to ascertain whether the audit procedures in areas with previous deficiencies had been improved.

C.2.e.iii Review of Certain Other Policies and Procedures Related to Monitoring Audit Quality

The inspection team assessed policies, procedures, and guidance related to aspects of the firm's independence requirements and its consultation processes and the firm's compliance with them. In addition, the inspection team reviewed documents, including certain newly issued policies and procedures, and interviewed firm management to consider the firm's methods for developing audit policies, procedures, and methodologies, including internal guidance and training materials.

APPENDIX D

RESPONSE OF THE FIRM TO 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, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.[10/]

[10/] In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.

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July 31, 2012

Ms. Helen A. Munter
Director - Division of Registration and Inspections
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: Response to Part I of Public Company Accounting Oversight Board (PCAOB) Draft Report on 2011 Inspection of KPMG LLP

Dear Ms. Munter:

We appreciate the opportunity to read and comment on Part I of the PCAOB's Draft Report on the 2011 Inspection of KPMG LLP dated June 29, 2012 ("Draft Report"). We share a common objective – serving our capital markets by performing high quality audits – and the PCAOB's inspection process serves to assist us in identifying areas where we can continue to improve our performance and strengthen our system of audit quality control. We also would like to acknowledge the professionalism and commitment of the PCAOB staff and the important role the PCAOB plays in improving audit quality.

We conducted a thorough evaluation of the matters identified in the Draft Report and addressed the engagement-specific findings in a manner consistent with PCAOB auditing standards and KPMG policies and procedures.

We remain dedicated to evaluating our system of quality control, monitoring audit quality and implementing changes to our policies and practices in order to enhance audit quality. We are mindful of our responsibility to the capital markets and are committed to continually improving our firm and the profession and working constructively with the PCAOB to improve audit quality.

Very truly yours,

KPMG LLP

James P. Liddy

James P. Liddy
Vice Chair, Audit

cc: Mr. James R. Doty
Mr. Lewis H. Ferguson
Ms. Jeanette M. Franzel
Mr. Jay D. Hanson
Mr. Steven B. Harris