Audit quality
Audit quality is fundamental to maintaining public trust and is the key measure on which our professional reputation stands.

We define “audit quality” as being the outcome when audits are executed consistently, in line with the requirements and intent of applicable professional standards, within a strong system of quality controls.

All of our related activities are undertaken in an environment of the utmost level of objectivity, independence, ethics and integrity.
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Letter to our stakeholders

Progress through change.

Audit quality is foundational to instilling confidence and trust in the capital markets. It has been, and always will be, KPMG’s fundamental promise to the audit committees, investors, companies and other stakeholders that we serve. We appreciate the importance of our work and consider it an honor to uphold the obligation we share as guardians of the capital markets, ensuring better decisions and outcomes for the investing public and the companies we audit. We also understand that with this professional privilege comes enormous responsibility, collectively and for each individual within our firm.

Our purpose at KPMG is to inspire confidence and empower change. By delivering high-quality audits, we provide investors with confidence in financial reporting. To that end, we are continuously focused on the systems, tone and governance that promote quality across our organization, supported by a culture grounded in integrity and values. Earning the public’s trust requires that every day we live up to the high standards we set for ourselves. It also requires us to be transparent about any shortcomings and make the important decisions to fix them – even when those decisions may be difficult.

In 2017, our firm was challenged in ways that led us to reexamine how we operate and rethink what we needed to do as an organization to improve. These opportunities for introspection were essential to our progress, and have
empowered critical changes that have strengthened our ability to better fulfill our roles and responsibilities as auditors.

This report outlines KPMG’s ongoing journey of progress through change and the decisive actions we have taken, guided by new levels of collaboration, accountability and an imperative to continuously assess and improve. We are making significant investments in technology, in our people and in our system of quality control. We enhanced our governance by adding highly qualified and accomplished independent directors to our Board to ensure a broader range of constructive viewpoints. We completed a comprehensive, independent enterprise-wide culture assessment to measure our current-state culture in order to manage, preserve and enhance our culture going forward. We are energized by the progress we have made and resolute about change in areas that will strengthen audit quality, encourage innovative thinking and ensure a culture centered on living our values in all we do.

Audit has been the cornerstone of our business since KPMG was founded over a century ago. Our relentless focus on audit quality and continuous improvement reflects our unwavering commitment to earning trust and inspiring confidence in the capital markets. Everything that you will read about in the following pages reflects that singular emphasis. That’s been a hallmark of KPMG’s role as trusted stewards of our profession. A quality audit is never routine. And even as we strive for and achieve progress through change, our pursuit of audit quality is never over.

Lynne Doughtie
U.S. Chairman & CEO

Frank Casal
Vice Chair—Audit
2016

- Increased national office resources to focus on audit quality
- Launch of KPMG Master of Accounting with Data and Analytics degree

2017

- National Audit Leadership changes
- Strengthened System of Quality Control
- Changed Inspections Group reporting to Legal, Risk and Regulatory
- Established National Business Leader role in Audit Quality and Professional Practice Group
- $400 million committed to build Lake Nona Training Center
- Virtual training modules and just-in-time training strategy implemented
- All-Partner meeting on firm culture
- Supported implementation of tax law changes
- Culture and tone facilitated sessions with partners
- Enhanced IT resource integration
- Professional Practice structural enhancements at the business unit level
- Enhanced methodology and new workflow limited deployment
- Core Competencies Framework
- Leverage Audit Quality Indicators
- Standardization of walkthrough documentation
- Implementation of culture action items
- Implementation of Critical Audit Matters (CAMs)
- Enhance documentation of System of Quality Control

- Additional leadership changes
- Added independent directors to our Board of Directors
- Dry run of Critical Audit Matters (CAMs)
- Increased independence resources
- Culture assessment conducted
- Development of enhanced audit methodology and workflow
- Global Audit Quality Transformation
- Quality Performance Review (QPR) enhancements

- Enhanced Risk Assessment Methodology deployment and support
- Roles and responsibilities and accountability framework deployed
- File Closure Policy Change
- Increased leadership outreach
- Use of Engagement Quality Control Reviewer (EQCR) in QPR
- Integration of enabling technologies
- Expanded Audit Quality Support Partner program

- Portions of enhanced audit methodology integrated into core training
- EQCR focus
- Broker/Dealer actions
- New Code of Conduct
- Audit Quality Action Framework
- Continued support for the new revenue standard
- Enhanced root cause analyses, and acceleration of timing
- Support for the new leasing standard

- Full deployment of enhanced audit methodology and workflow
- Support for the new credit losses standard
Audit quality—progress through change
As we work toward delivering improved, sustainable audit quality, we continue to make progress through change.

Over the past two years, KPMG has been reevaluating our approach to audit quality, challenging ourselves to learn, evolve and strengthen our systems and ways of working. We are committed to excellence in auditing and upholding expectations at every level of our organization. To reinforce audit quality, we must execute consistently, in line with the requirements and intent of applicable professional standards within a strong system of quality control.

The changes we have made reflect our integrated approach to audit quality. We are pursuing a number of multidisciplinary initiatives and investing significantly in our people and infrastructure to drive progress and enhance audit quality. Some of these investments can be measured directly in dollars, like the more than $150 million being invested globally in our new audit technology platform, KPMG Clara, or the over $400 million being invested in our new training facility in Lake Nona, Florida. Others reflect an investment in human capital, with an over 50 percent increase in resources in our national office over the last three years. Today, more than 10 percent of our total Audit partners are dedicated to providing support on a real-time basis as part of our Audit Quality and Professional Practice Group (AQPPG). We’ve also made investments in the critical intangibles that contribute to audit quality, such as our culture initiative, in order to reinforce our strong foundation through values and behaviors that support audit quality across the entire firm. These investments are measurable through the milestones achieved along our journey, from important new tools and resources to enabling technologies and platforms to governance and organizational changes.

With this progress, we maintain our relentless focus on ensuring compliance with auditing standards, including addressing the specific areas noted for improvement in our inspection reports. KPMG is powered by our long history of excellence, deep experience, exceptional talent, strong culture, and rigorous processes – yet we
Audit committees engage in a rigorous, annual process to appoint and ratify auditors.

Audit appointment criteria include:

- Quality and efficiency of the current and historical services of Audit Firm.
- Audit Firm’s capability and expertise in handling the breadth and complexity of the Company’s operations.
- Quality and candor of Audit Firm’s communications with the Audit Committee.
- External data on Audit Firm’s audit quality and performance, including recent PCAOB reports.
- Audit Firm’s independence from the Company.
- Appropriateness of Audit Firm’s fees.
- Audit Firm’s tenure as the Company’s independent auditor.
know we can do better. We have marshaled all areas of the firm to meet our audit quality goals. This report showcases the initiatives we have underway, and demonstrates—to all of our stakeholders—KPMG’s commitment to progress through change.

**Earning audit committee trust through transparency**

We share information on audit effectiveness – including inspection reports and external data on audit quality and performance – with audit committee members and the management teams with whom they work.

We are proud that audit committees cite our knowledge, professionalism, communications and trusted advice as the primary reasons why they choose KPMG after annual reviews and analyses.

We consistently hear from audit committees that they trust us. Our lead partners demonstrate the appropriate depth of experience, technical acumen and grasp of company issues and industry complexities.

**Why audit committees choose KPMG**

- KPMG’s track record of quality, professionalism, expertise and experience
- KPMG’s understanding of our business, operations, accounting policies and practices, and internal control over financial reporting
- KPMG’s historical and recent performance as an independent registered public accounting firm
- KPMG’s independence
- KPMG’s reputation in the industry and knowledge of our industry
Reinforcing our audit quality foundation
Audit quality remains our highest priority and is critical to overall investor confidence in the capital markets.

Over the last two years, we have examined closely our quality foundation while also keeping pace with the transformational changes we see in the business environment and the capital markets.

Our ongoing progress and the changes we continue to make affect every element of audit quality.

**Structural changes strengthen our system of quality control**

During 2017 and early 2018, we took a fresh look at important aspects of our system of quality control, evaluating our processes based on the PCAOB and AICPA quality control standards. We concluded that our foundation was strong, but there were areas for improvement in our processes, controls and documentation. Since then, we have focused on addressing those processes and on extending our review to our organization’s broader system of quality control. We remain committed to ongoing assessment, improvement and progress.

- **Improved inspections independence:**
  Since 2017, our Inspections Group has reported to the firm’s Vice Chair—Legal, Risk and Regulatory, who reports directly to our Chairman and CEO and is insulated from business or operational pressures. This ensures that the Group’s internal inspections of the firm’s audits are objective and free from influence from engagement partners or Audit leadership. Further, we improved our inspections process by introducing new engagement selection techniques and enhancing our inspection procedures.

- **Dedicated leaders:**
  In late 2018, our Audit Practice appointed a Chief Operating Officer to focus on operational efficiency and effectiveness enhancements across our audit business, while ensuring our audit quality objectives are supported. We created dedicated Chief Technology Officer and Chief Innovation Officer roles to drive change in our audit function, oversee enabling technologies and accelerate innovation to improve quality.

  These recent developments are part of our ongoing commitment to appointing Audit leadership that is dedicated to ensuring audit quality.

- **Launched enhanced risk assessment methodology:**
  In 2018, we gave teams additional tools to assist with risk identification and assessment standards. To jumpstart our progress, we deployed the risk assessment methodology and related tools ahead of full implementation of our enhanced audit methodology. We provided extensive training, aligned our operating procedures to improve risk assessment execution, and supported
REINFORCING our audit quality foundation

Actions reinforcing audit quality

- Expanded Audit Quality Support Partner Program
- Strengthened Monitoring of Audit Quality
- Strengthened System of Quality Control
- Strengthened Audit Quality Professional Practice Group
- Enhanced Training for EQCRs
- Enhanced Risk Assessment Methodology
- Enhanced Audit Methodology
- In development Audit Quality Indicators
- New Code of Conduct
- New Chief Operating Officer
- New Chief Technology Officer
- New Chief Innovation Officer
- New Independent Directors
- New platform KPMG Clara
- New Culture Assessment and Roadmap
implementation through supervision and review. We believe these changes will positively impact our audits of internal control over financial reporting (ICFR).

Enhanced engagement supervision:
At the supervisory level, we continue to reinforce the role of our Engagement Quality Control Review (EQCR) partners. These partners undergo a rigorous accreditation process, including a formal nomination and annual review, to ensure they have the necessary skills, independence, integrity and objectivity to serve in this role.

Our EQCR partners meet annually for coaching and to share their experiences. In 2018, we convened this group for an additional in-person training focused on areas most critical to improving quality: the required intensity of review and the professional skepticism needed in ICFR and financial statement audits. The group also addressed methods for improving audit and risk assessment processes to enhance audit execution.

EQCR partners will continue to receive additional training in risk assessment and ICFR to enhance the quality of the EQCR program and strengthen our firm’s work in areas where we see room for improvement.

Expanded real-time engagement support:
We also expanded our Audit Quality Support Partner (AQSP) program in 2018. Thirty-two partners have been nominated and accredited to serve in this program overseen by KPMG’s Chief Auditor. Before deployment, each partner completes a rotation in our national AQPPG, to enhance technical auditing skills in the most critical aspects of audit execution.

These partners provide direct, real-time coaching and support to engagement teams in areas where coaching will have the most significant effect on audit quality. This model connects our business units to AQPPG to help guide engagement professionals and to address quality challenges early in the audit.

Collaboration to develop audit quality indicators
The audit profession as a whole has become increasingly focused on the development and standardization of audit quality indicators (AQIs). AQIs can help provide auditors, audit committees, and clients with a framework, including both quantitative and qualitative measurements, to identify risks and evaluate audit quality. As a member firm of the Center for Audit Quality, KPMG has been actively engaged in developing and seeking perspectives on AQIs. We participate in industry-wide discussions and explore which AQIs may be most relevant to specific audit scenarios and indicative of true quality. AQIs can also help promote important dialogue among stakeholders and track aspects of the resources, processes and policies related to audit quality.

As we continue to integrate enabling technologies into our audit work, we are using our data and analytics capabilities to begin determining which AQIs correlate most with improved quality. Currently, audit leadership reviews a dashboard of metrics that could indicate unique trends or raise audit quality

Enhanced audit methodology and technology platform drive improved audit quality
KPMG is implementing an enhanced audit methodology and a new technology platform, both of which epitomize our progress through change approach and will become the backbone of our audits in the United States and globally. This advanced methodology better aligns our work product with PCAOB and other audit standards, and will drive greater consistency across our global network of member firms. It allows us to further standardize our audit approach to reduce optionality and empower our partners to focus on aspects of an engagement where their professional skepticism, experience, direction, judgment and decision-making add the greatest value to audit quality.

KPMG Clara, our new, cloud-enabled, audit technology platform, will facilitate the audit and the application of this enhanced methodology. Read more about KPMG Clara’s game-changing capabilities and features in Investing in the Future of Audit.
concerns. The dashboard is available to all Audit partners, and is reviewed by national, regional and business unit partners during performance discussions.

Leveraging our dashboard, KPMG partners can regularly monitor progress against several AQIs that KPMG has developed internally and in partnership with the Center for Audit Quality. Those include direct measures of audit quality – including internal and external inspection results, and frequency of restatements – as well as metrics that contribute to our firm’s ability to deliver sustainable quality, including employee retention and utilization rates.

The trends in our inspection results have been disappointing in recent years. However, in keeping with KPMG’s deep commitment to our journey of progress through change, we have made significant changes across our organization that have improved our ability to deliver consistent, high-quality audits.

We have a strong track record of minimal restatements and reissuances as a result of inspections and generally within our portfolio of clients.

We closely monitor retention and utilization at the associate and manager level. While these rates have historically been consistent, we saw an increase in utilization at these levels in 2018, due to the implementation of the new revenue standard and our enhanced risk assessment methodology. Increasing utilization, coupled with market factors drove a decrease in retention. As a result, we have focused efforts on further supporting our people and audit quality through continuous improvement efforts, deployment of enabling technologies and a strategic 15% increase in campus hiring for 2019.

**Other elements of quality control**

We understand that quality begins with our decisions related to the clients we accept and continue to serve. KPMG has established policies and procedures for evaluating new and continuing professional relationships. Our process related to **client acceptance and continuance** ensures that we manage, control and document potential risks, and ensure that appropriate safeguards are in place.

The Inspections Group executes our annual internal inspection program, the **Quality Performance Review**, and provides timely information to the Audit practice for use in assessing root causes of emerging audit quality challenges. During the past inspection cycle, our quality performance review program conducted over 300 inspections. The group also coordinates and acts as the principal interface for external quality reviews of our Audit practice, including the annual PCAOB inspection and the AICPA peer review program.

Our **Independence Group** performs reviews of individual professionals on a recurring basis to determine compliance with our personal independence policies, and monitors firm independence through engagement reviews and other processes. As part of these independence reviews, we audited over 1,300 individuals in the past fiscal year, including 41 percent of the firm’s partners. We also select a subset of public audit engagements that are subject to our internal inspection process to perform a supplemental independence review. These assessments give us the ability to identify, report and resolve issues, as appropriate.

Finally, our **Root Cause and Collaboration Group (RCCG)** reports to the **National Business Leader of AQPPG**, a role we established in 2017 to drive the execution of audit quality enhancement initiatives and prioritize resources to support them. Root cause analysis is instrumental to enhancing our ability to identify, analyze, and address inspection findings to continually improve our system of quality control and engagement performance. The RCCG gathers information on audit quality matters, identifies the root causes of audit deficiencies, and supports the development of remedial action plans designed to enhance audit engagement performance.
KPMG by the numbers

**PCAOB part I inspection results**

<table>
<thead>
<tr>
<th>PCAOB inspection year</th>
<th>Audits inspected</th>
<th>Inspected audits in which part I deficiencies were identified</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>52</td>
<td>28</td>
</tr>
<tr>
<td>2015</td>
<td>52</td>
<td>20</td>
</tr>
<tr>
<td>2016</td>
<td>51</td>
<td>22</td>
</tr>
<tr>
<td>2017</td>
<td>52</td>
<td>26</td>
</tr>
</tbody>
</table>

**Restatements and reissuances as a result of PCAOB inspections**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of financial statement restatements as a result of PCAOB inspection</th>
<th>Number of withdrawn/reissued ICFR reports as a result of PCAOB inspection</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 report</td>
<td>—</td>
<td>1</td>
</tr>
<tr>
<td>2015 report</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>2016 report</td>
<td>—</td>
<td>1</td>
</tr>
<tr>
<td>2017 report</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

**Restatements**

**Audits that required financial statement restatement**

- **2015 Public**
  - 1
- **2016 Public**
  - 3
- **2017 Public**
  - 3

Source: Audit Analytics Report as of January 22, 2018 for the years reported.

**Audit retention and hiring**

- **Managers**
  - 2018: 87%
  - 2017: 87%
  - 2016: 88%

- **Associates**
  - 2018: 78%
  - 2017: 80%
  - 2016: 82%

**EXPERIENCED AUDIT HIRES**

- 2018: 230
  - 2017: 132
  - 2016: 333

**CAMPUS AUDIT HIRES**

- 2018: 1,375
  - 2017: 1,448
  - 2016: 1,536

**Audit utilization rates**

- **FY18**: 83.4%
- **FY17**: 81.5%
- **FY16**: 82.5%

Source: Audit Analytics Report as of January 22, 2018 for the years reported.
Focus on culture
At KPMG, our culture does more than support audit quality—it drives it.

KPMG’s culture is highly professional, collegial and respectful. As in any organization, our culture is also dynamic and requires continual monitoring and nourishing. From recruitment and hiring, to ongoing training and individual performance evaluations, our culture and values should align with the professional goals, compensation and growth of our people.

**Leading in trust and trustworthiness**

Living our values begins with our leaders modeling ethical, impartial and trustworthy behaviors and setting the appropriate **tone at the top**. It continues by holding our leaders accountable for the behaviors of their teams and ensuring all of our people embrace the values we have set out for ourselves. Our messaging and communications are designed to reinforce this. We are overtly integrating culture and tone-related considerations into performance, promotion and recognition processes, as well as into the partner admissions process.

By investing in the development and

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### Highlights from 2018 audit employee and partner surveys

<table>
<thead>
<tr>
<th>Survey Details</th>
<th>FY18</th>
</tr>
</thead>
<tbody>
<tr>
<td>There is a strong commitment to quality from leaders and partners at KPMG</td>
<td>90%</td>
</tr>
<tr>
<td>The people I work for demonstrate honest and ethical behavior</td>
<td>93%</td>
</tr>
<tr>
<td>Overall, I would say this is a great place to build my career</td>
<td>90%</td>
</tr>
<tr>
<td>Partners support inclusion and diversity in the workplace, recognizing and respecting the value of differences</td>
<td>89%</td>
</tr>
<tr>
<td>KPMG’s commitment to quality is apparent in what we do on a day-to-day basis</td>
<td>86%</td>
</tr>
<tr>
<td>I am willing to put in a great deal of extra effort to help KPMG succeed</td>
<td>97%</td>
</tr>
</tbody>
</table>

Source: 2018 employee engagement survey, 2018 partner pride survey
From our Code of Conduct

**Individual responsibilities**

Every individual at KPMG is personally responsible for ensuring that the Values, Commitments and Promises in the Code are met. We are expected to:

- **Take ownership.** Incorporate the principles of the Code into our daily lives. We are responsible for safeguarding KPMG’s integrity. KPMG’s reputation impacts everyone and can be damaged by anyone.

- **Lead by example.** Be a role model, talk about ethics, and act in a manner consistent with KPMG’s Values.

- **Stay informed.** Participate in training, read communications, use KPMG resources and consult when necessary to stay informed about laws, professional standards, and KPMG policies that apply to us in our work.

- **Consult with others.** We are not expected to know all the answers, but we do have a personal responsibility to ask for help and be aware of professional standards and other situations that require consultation with others.

- **Stand firm.** Never compromise our Values no matter how strong the internal or external pressure may be to perform, meet goals, or fulfill expectations. Do not be afraid to express differences of opinion or unwelcome messages, knowing that leadership fully supports us.

- **Raise your hand.** Individual voices count. So speak up if something does not seem right, seek advice when needed, and offer suggestions to improve our work environment. Every individual is expected to report all potential violations of law or policy that may impact KPMG or our clients.

**Management responsibilities**

Whether a partner, a supervisor of a team, or a People Management Leader, those with any type of leadership or management responsibilities are expected to help ensure that our people understand that ethics and integrity are the cornerstone of our business. Leaders are expected to:

- **Lead by example.** Show what it means to act with integrity and in accordance with the principles in the KPMG Code.

- **Support their teams.** Ensure that those they lead or supervise understand the Code and have access to the resources they need to adhere to KPMG’s Values.

- **Develop their team.** Establish clear, measurable and challenging goals that promote ethical behavior and the highest standards of quality.

- **Uphold exemplary standards.** Leaders should enforce KPMG’s standards consistently and fairly, and promote compliance with the Code among those they lead.

- **Exercise good judgment.** Respond thoughtfully and carefully to those who raise questions or concerns, supporting and encouraging those who raise their hands.

- **Be accountable.** Leaders should be prepared to be held personally accountable for any shortcomings in their own behavior, as well as those of the people they lead.
dissemination of clear expectations around how culture and performance intersect for our professionals, we can better align goals and incentives with specific behaviors. Shifting our culture in these deliberate ways will enhance our ability to adapt, pivot and respond to change in today’s complex and dynamic environment while retaining audit quality as our number one priority.

Values underpinned by ethics and integrity

Each KPMG employee assumes personal responsibility for the firm’s culture, as articulated in our Code of Conduct (“the Code”), the foundation of our ethics and compliance program. In February 2018, we released a new Code as part of the deeper firm-wide dialogue about our culture and values.

No KPMG value is more important to audit quality than integrity. We expect our professionals to act with integrity by upholding our values, maintaining professional skepticism and speaking up when they encounter a challenging situation.

An enterprise-wide culture assessment

Culture involves more than just a code of conduct. Therefore, we undertook an enterprise-wide culture assessment with external experts in organizational ethics and culture change to explore how we can integrate culture more explicitly into our sustainable operating model. We listened, collected and analyzed responses to inform an integrated, comprehensive and multidisciplinary approach to achieve progress toward strengthening our firm’s culture.
KPMG’s commitment to culture

To deepen firm-wide understanding of our...

**...purpose**
We will clearly articulate our purpose to drive clarity, consistency and engagement in everyone’s work

**...values**
We will better integrate our values into our day-to-day strategy, decisions and actions

To encourage...

**...growth**
We will sustain our focus on culture by nourishing and strengthening it every day

**...candor**
We will foster an environment where constructive challenge is highly valued

To strengthen our...

**...rewards**
We will better align ethical and cultural expectations with assessments and rewards

**...environment**
We will equip our people to openly discuss and navigate pressures together

**...governance**
We will review our Board’s role and expectations to take full advantage of its expertise

To reinforce the importance of...

**...accountability**
We will equip our leaders at all levels with clear values-based standards and hold them accountable

**...compliance**
We will evolve our compliance program and strengthen transparency
The culture assessment has identified areas where we can take meaningful, measurable action toward a culture that further supports our audit quality goals. We have already started executing on a roadmap with an aim to deepen our common purpose and sharpen the connection between our values and our everyday conduct.

**Enhanced governance through independent directors**

We continue to adapt our governance structure to reinforce key aspects of independence and objectivity. Most notably, we have added two independent directors to our Board of Directors to diversify the conversation in our boardroom and provide additional, objective points of view and constructive challenge. We expect to add a third independent director.

With these appointments, KPMG gains the immediate and substantial benefit of outside and diverse perspectives as we continue to evolve to meet the needs of our clients and the capital markets. Their experience complements that of our partners, and is a crucial element of embedding long-term vigilance on culture.
Developing our extraordinary talent
We seek critical thinkers and the intellectually curious who bring fresh perspectives and the utmost integrity.

We believe our progress relies on diversity of thought and skills, technical aptitude, professional skepticism, personal accountability, and the courage to prevent biases or blind spots from compromising our work. In an age of disruption, it has become essential for our auditors to embrace change and continually adapt as professionals in the relentless pursuit of audit quality.

KPMG aims to have the right experience supporting the right role within the audit. Our strong and complementary team allows us to staff our engagements with direct expertise to focus on the areas that require significant judgments by our senior team members, while also mentoring and growing our practice for the future.

**An authentic and diverse workforce**

KPMG takes deliberate, concrete steps to create an environment where our people bring their authentic selves to work every day. We foster an atmosphere of belonging for all, regardless of gender identity and expression, sex, race and ethnic background, disability, religion, beliefs or age. We consistently engage different perspectives and recognize the value that a diverse workforce brings.

In August 2018, we hired externally a new Chief Diversity Officer to continue to advance our firm-wide diversity and inclusion strategies while providing fresh perspectives. The Chief Diversity Officer’s role includes promoting employee engagement and meeting client expectations of an inclusive, diverse and vibrant workforce.

These efforts include participation in initiatives like the CEO Action for Diversity & Inclusion Coalition’s Day of Understanding. The program is intended to increase understanding around differences and explore ways to foster an environment of inclusion through facilitated workshops. KPMG hosted our first Day of Understanding in December 2018, in tandem with the corporate community, including many of our clients.
In 2016, KPMG teamed with two universities to develop the **KPMG Master of Accounting with Data and Analytics program**, an innovative way to both prepare future auditors with digital skills and disrupt the way we recruit. The program (now at nine schools) involves scholarships and a promise of employment – 51 students in the inaugural class began work at KPMG in September 2018, and the second group intern with the firm in January 2019. The program won the **National Association of Colleges and Employers’ 2017 Recruiting Excellence Award**.

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**Our future learning, development and innovation facility**

Lake Nona, Orlando, FL

- Meeting and learning spaces with flexibility to accommodate 1,000 attendees
- Opportunities to learn through different approaches
- An innovation center, designed for team creativity and collaboration as well as client interaction
- Pairing our people with AI and other emerging technologies

- Drives increased engagement
- Ingrains culture and values
- Fosters innovation and new ideas
- Leverages most advanced digital capabilities
As part of our focus on cultivating diverse thought and mindset in our engagement teams, KPMG has partnered with some of the country’s leading business schools to establish a first-of-its-kind master’s degree for accounting professionals in the digital age. The KPMG Master of Accounting with Data and Analytics degree equips students with the analytic skills and critical thinking to leverage data science for audit quality. Following its successful launch in 2016, the program, which has over 60 percent diverse participants, has extended to additional universities, and has more than doubled the number of KPMG-sponsored students.

**Innovation in training approaches**

We have made our largest capital investment ever to build a more than $400 million transformational learning facility in Lake Nona, Florida. Scheduled for completion in late 2019, the Lake Nona campus will feature cutting-edge technology to enable diverse approaches to learning. The curriculum will include programs to continually enhance the skills of our employees on the many emerging competencies needed across our organization, while the facility is designed with a focus on sustainability.

With auditors deployed across the country and around the world, we’ve created an online training platform that is accessible anytime, anywhere. This Performance Support Navigator (PSN) training content library offers approximately 400 micro-learning resources and short instructional videos for our audit professionals. The PSN online content library supplements our robust in-person training programs, including our Business Process Simulation. The simulation provides audit campus hires and interns with the skills needed to conduct an audit, support their teams, and be successful as first-year associates. Learners complete the simulation at their own pace and receive real-time feedback customized to the decisions they make in the exercises.

All of our audit professionals are required to maintain their technical competence and to comply with applicable regulatory and professional Continuing Professional Education (CPE) requirements. CPE requirements and licensing are monitored, and our online system helps professionals track their own compliance activities.

We also provide continuous improvement workshops to reinforce skills and promote stronger teamwork and collaboration. Workshop facilitators trained in process-improvement principles help teams build quality into the audit by strengthening planning and coordination processes within engagement teams.

<table>
<thead>
<tr>
<th>Average training hours earned by level</th>
<th>FY18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners/Managing Directors</td>
<td>91</td>
</tr>
<tr>
<td>Managers</td>
<td>99</td>
</tr>
<tr>
<td>Associates</td>
<td>94</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Training hours we required by level</th>
<th>FY18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partners/Managing Directors</td>
<td>33 – 36</td>
</tr>
<tr>
<td>Managers</td>
<td>33 – 36</td>
</tr>
<tr>
<td>Associates</td>
<td>65 – 90</td>
</tr>
</tbody>
</table>
Under the oversight of our dedicated Chief Learning Officer, we continuously evaluate and improve our instruction methods, assessing results through course evaluations, focus groups, testing and follow-up surveys.

**Supporting and nurturing careers**

KPMG professionals at all levels are encouraged to take ownership of their careers, and they have access to strong sponsors and mentors to advise and promote their development and progress. From our earliest recruiting outreach, to new hire onboarding, to our appointment of partners and senior firm leadership, KPMG supports auditors at every step in their careers with training and professional development opportunities.

Our people management leaders, senior team members and leadership commit to supporting ongoing learning through formal evaluation and as mentors, and sponsors, who assist auditors as they seek new opportunities and work through challenges.

**Staffing strong engagement teams**

Taking into account workloads and audit quality responsibilities, we staff our audit engagement teams to bring diversity of thought and experience, which facilitates professional skepticism and ethical decision-making. Each team member receives significant training grounded in the applicable standards, and understands the expectations of the role and how they will be evaluated.

We are formalizing and documenting Core Competencies to support staffing efforts by defining expectations for audit professional training, performance, assessment, evaluation and promotion in relation to key auditing and accounting standards for each role in our practice. These expectations also include skills surrounding enabling technologies in the audit. Our goal is to create a framework over time as new competencies are needed in this changing marketplace.

Business unit, regional or national audit leaders approve the assignment of lead partners and engagement quality control reviewers. The lead audit engagement partner considers whether the engagement team collectively has the appropriate competencies, capabilities and time to perform a quality audit in accordance with auditing standards. The lead audit engagement partner also determines the appropriate use of specialists. In 2018, 13 percent of our total audit hours were supported by specialists. In addition, audit teams consult with AQPPG, which supports engagement teams in technical accounting or complex audit issues.

**Recognizing and rewarding performance**

All partners and staff participate in annual goal-setting and semi-annual performance evaluations. We recently made changes to enhance how we assess our Audit partners, managing directors, and audit and firm leaders on audit quality. And we have established guidelines to assess individual contributions to audit quality for all partners and managing directors directly serving in a client service role. We also evaluate our AQPPG, business unit, regional, national and firm-wide leaders based on specific audit quality objectives to underscore individual and collective accountability.

Performance evaluations focus on audit quality, compliance with professional standards and firm policies, technical competencies, leadership activities and learning. Evaluation results directly affect compensation and advancement for all
professionals, including partners, and in some cases affect continued association with the firm. Our evaluation framework provides our people with constructive, ongoing feedback, on-the-job learning opportunities, and frequent and effective coaching.

Audit partner compensation is determined annually by Audit leadership and approved by our Management Committee and Board of Directors. Our professional practice partners have significant involvement in evaluating Audit partner performance, using AQIs such as engagement inspection results, training and independence compliance. The results directly impact compensation.

**Identifying and nurturing future leaders**

We’ve designed a number of programs to cultivate the next generation of leaders, to increase diversity, and to advance the skills of our professionals. These programs are developed and led by a combination of KPMG partners and outside subject matter experts.

**Cultivating the next generation of leaders**

**Leadership in Action**

This program helps prepare senior audit managers and managing directors for advancement through simulations that represent the range of issues that partners are likely to encounter. Instructors include both KPMG partners and outside facilitators who supervise participants working in teams to develop decision-making and planning skills.

**Audit 90**

Women at the senior associate level are selected to participate in three in-person, multiday workshops over 18 months to build leadership skills. The program includes one-on-one coaching facilitated by a third party, as well as coaching and mentoring from KPMG Audit partners and senior managers.

**Stacy Lewis Rising Stars Invitational**

Now in its fifth year, this program brings together high-performing women senior managers and directors across the firm for a two-day leadership training and networking event with instructors from leading institutions. Following the initial event, the program continues with a series of facilitated sessions where smaller groups of participants meet to discuss their own career development and leadership skills.
Investing in the future of audit
Dynamic forces—the explosion of data, rapidly advancing disruptive technologies, digital labor and the internet of things...

...are transforming the global business environment, how customers engage, and the workforce of the future. KPMG’s commitment to quality demands that we anticipate and drive change within our own profession through innovative ideas, processes and tools. We’re doing just that to ensure we are prepared to conduct quality audits today, and tomorrow, as we earn the trust and confidence of our clients and their stakeholders with every audit we complete.

Innovation at KPMG is a shared mindset of continuous improvement that drives progress through change in our audit approach. We enhance quality by always improving our people’s capabilities and refining our processes, while using cutting edge tools and technology. We are investing significant monetary and personnel resources to ensure we leverage and develop innovative solutions to enhance our audit quality, while adapting to these dynamic forces.

**Enabling technologies in the audit**

We are aggressively investing in the development and deployment of enabling technologies that are necessary to address the audit risks and opportunities presented by the modern enterprise. Since 2016, our U.S. firm has invested nearly $750 million firm-wide in our commitment to innovation and the use of enabling technologies. We’ve also entered into strategic partnerships with external parties and are collaborating globally on technology initiatives and investments.

We have built our new tool development platform through [KPMG Clara](https://www.kpmg.com) in order to embrace the full spectrum of advanced technologies available – including robotic process automation, artificial intelligence/cognitive capabilities, blockchain and others. Our objective is to enable the robust use of data in the audit of evolving business and operating platforms.

**Algorithms and software** will enable auditors to conduct comprehensive digital analysis of data that was simply not possible just a few years ago. KPMG has established relationships with major intelligent automation partners, such as Microsoft, IBM, Google, and Amazon web services. Cognitive technology includes machine learning computer programs that can access data and use it to learn and progressively improve their performance on a specific task.

In 2016, we established a partnership with IBM...
to harness the power of Watson to decipher data and to help develop tools that will deliver insights to our auditors on a company’s financial information more quickly and with greater confidence.

Robotics, or robotic process automation (RPA), is also playing an important role in KPMG’s cognitive ecosystem. RPA can handle many of the more routine tasks that consume audit team hours, which will free our professionals to spend more time on higher risk areas and data analysis.

With data and analytics as the hub, RPA, predictive analytics and cognitive technologies together can allow the automation of processes in an audit, as well as the analysis of 100 percent of a company’s transactions in selected accounts.

Our portfolio includes more than 500 bots that have been developed for our audit teams to use. We are also developing a number of use cases for even more advanced processing and analysis of unstructured data – such as client invoices, lease contracts and revenue contracts – that leverage our machine-learning platforms.

As part of our system of quality control, we established the **New Audit Tool Governance Committee** and related governance process to oversee the development and deployment of emerging technologies and tools. The incorporation of any new technology into our audit processes follows a rigorous evaluation framework, testing and vetting process to ensure it meets our primary goal of enhancing audit quality and is introduced with full consideration of required quality controls.
KPMG has built a commercial loan grading platform that integrates IBM Watson’s intelligent automation, machine learning and other AI technologies with KPMG’s audit methodology and intellectual property. Our goal is to automate extraction of relevant attributes from credit file documents to help evaluate our clients’ loan grades. Using intelligent automation, the platform will process relevant documentation to provide richer, more detailed evidence, such as the rating of loan risks. It will help our professionals analyze larger volumes of structured and unstructured data from credit files, enhance their ability to identify data outliers and anomalies, and provide deeper insights into a company’s risks, processes and controls.
Protecting data used in the audit

We continue to make significant investments in cyber security. We have a dedicated team of professionals that focuses on strengthening our ability to identify and respond quickly to cyber events. The team tests new systems to ensure they are secure prior to release. This entails assessing the security programs at third-party organizations with whom we do business, managing vulnerabilities, and ensuring compliance with regulatory and client obligations.

Our awareness of and focus on the unique challenges presented by cyber risks have led to our advanced cyber security objectives and protocols, creating a robust control environment that protects the data we receive and use in our audits. We have built our information security program on an extensive framework of policies, standards and processes that consider and incorporate aspects of ISO 27001.

New global audit technology platform: KPMG Clara

Our most important technology initiative for audit quality is our global smart audit platform, KPMG Clara. Considerable enhancements are underway to implement our enhanced audit methodology and workflow delivered through KPMG Clara, our smart audit platform. This will further reinforce alignment with audit standards and drive greater consistency across our global network of member firms. The enhanced methodology will provide a clearer, more user-friendly process. It integrates powerful data and analytics capabilities, enabling technologies, and audit workflow in a single, scalable and agile interface. The KPMG Clara workflow component will be deployed partially in 2019, with full deployment of the cloud-enabled platform planned for 2020.

KPMG Clara will empower our professionals to work smarter, and will drive enhanced audit quality through a cloud-based, rich workflow experience that provides consistent application of the auditing standards, leverages data in the audit and facilitates real-time learning. The platform will also significantly enhance productivity and provide insights to make better decisions and judgments in the audit.
KPMG Clara capabilities and outcomes

Technology Enablers
- Automation
- Artificial Intelligence
- Collaboration
- Data Analysis

Standards & Methodology
Real Time Knowledge
Tools & Resources
Integrated Workflow

Quality
Productivity
Insights
Addressing inspection findings
Our dedication to making progress through change is driven by our unwavering commitment to fulfilling our critical role in the capital markets by performing high-quality audits and consistently executing on our responsibilities to audit committees and investors. Nothing is more important to KPMG.

During a significant portion of the applicable periods of our recently released PCAOB inspection reports and most recent Peer Review report, our remedial efforts were being led, and the tone for the Audit practice was being set, by individuals who engaged in conduct that undermined the integrity of the regulatory inspection process. The conduct of these individuals was contrary to the firm’s Code of Conduct and our values. Upon learning of such conduct through an internal source in February 2017, we took appropriate, decisive and timely remedial actions to clearly demonstrate our commitment to professional integrity, audit quality and the regulatory process – including separating responsible individuals from the firm and embarking on our journey to enhanced audit quality, which this 2018 Audit Quality Report chronicles.

We are seeing progress as a result of the changes we have made and expect our PCAOB inspection findings to show improvement for the 2018 inspection year.

We recognize, however, that there is still progress to be made in our audit quality efforts and that our quality efforts will require constant vigilance. We believe the significant actions highlighted throughout this report, among many others, will continue to propel us along our journey of progress through change. We will continue to be responsive to any future findings of our own monitoring processes and the results of inspections performed by others. As part of our process, we are committed to transparency with our stakeholders about the actions we are taking.

**PCAOB Reports – Part I Findings**

During January 2019, the PCAOB issued the 2016 and 2017 reports on the inspection of KPMG’s 2015 and 2016 year-end public company audits. The public portions of the reports are available on our website. Part I of the 2016 inspection notes 51 audits were inspected and deficiencies were identified in 22 of those audits. The 2016 report also addresses issues in the inspection process resulting from individuals who engaged in conduct that undermined the integrity of the regulatory process as noted above, and the related impact on certain financial services audit inspections. Part I of the 2017 inspection report notes that 52 audits were inspected and deficiencies were identified in 26 audits. By comparison, the number of audits identified in Part I of our prior PCAOB reports were 20 out of 52 inspected in 2015, and 28 out of 52 inspected in 2014.

The 2016 and 2017 deficiencies primarily included the areas of the audit of internal controls over financial reporting and management estimates, and related areas of supervision.

External inspections may identify areas requiring financial statement restatement or revision of previously issued opinions on internal controls over financial reporting. Of the 207 KPMG audits inspected from 2014 to 2017, no audits required a financial statement restatement and two required a revision of the ICFR opinion.

**PCAOB Reports - Part II Findings**

The PCAOB has made public portions of Part II of its reports on the 2014 and 2015 inspections of KPMG, upon determination that the firm had not satisfactorily addressed the quality control criticisms in the 12 months following publication of the reports. We accept the
PCAOB’s determination, and we regret that we did not satisfactorily address these criticisms within the prescribed time frame.

**Tone at the top**

Over the last 18 months, we have made significant changes to our audit leadership team, including the appointment of a new Vice Chair—Audit, a new National Managing Partner—Audit Quality and Professional Practice, a new Chief Auditor, and a new Inspections Leader. All were chosen for their roles, first and foremost, because of their demonstrated record of sound judgment, professionalism, ethics and integrity, as well as their ability to inspire the trust of our people and command confidence from our clients. In addition, over the last year we undertook an enterprise-wide culture assessment with external experts in organizational ethics and culture change, to explore how we can integrate culture more explicitly into our sustainable operating model. We listened, collected and analyzed responses to inform an integrated, comprehensive and multidisciplinary approach to achieve progress toward improving our firm’s culture. We also enhanced our overall governance process with the addition of two independent directors to our Board of Directors. We believe that our new leaders and directors, our focus on our culture and the quality-focused investments and audit quality actions described below, make clear a new tone at the top and underscore our commitment to audit quality.

**Internal control and estimates**

We have made significant investments in a new audit methodology and the related workflow technology that supports the execution of our audits. These investments, in particular are specifically focused on auditing internal controls over financial reporting and estimates. These investments, to be fully implemented in 2020, will ensure a clear alignment of our audit methodology with the auditing standards and the facilitation of audit execution through a new technology platform. Certain elements of the methodology related to risk assessment were accelerated into 2018 to expedite improvement in the auditing of internal controls over financial reporting and estimates.

**Professional skepticism, supervision and review, and engagement quality control review**

We recognize the importance of our responsibilities related to professional skepticism, supervision and review, and engagement quality control reviews (“EQCR”), and we have increased training, clarified roles, modified processes and enhanced accountability to ensure improved execution in these areas. For example, we have enhanced our workflow to require and document early partner and EQCR involvement in key areas of the work.

**Monitoring programs**

We have changed our approach to engagement monitoring and the oversight of our Inspections Group. This group now reports outside of our Audit practice and into our Vice Chairman—Legal, Risk and Regulatory. The group serves no engagement support role (that role now being confined to the Audit practice itself), ensuring that its activities are directed solely to a critical assessment of our professionals’ performance. The output of our own monitoring and the results of external inspections are synthesized through our root cause analysis to ensure that we develop remedial actions that are responsive to our control deficiencies and meet the standards required of those actions.
Accountability

As noted above, responsibilities for audit quality have been clearly defined for roles from the engagement partner to the Chairman and CEO, which has given us a framework to ensure accountability for audit quality beyond the engagement team. We have implemented performance assessment and compensation processes to align with those roles and responsibilities. More broadly, we have initiated a project to more clearly delineate core competencies by organizational level. Our training curriculum and promotional processes will align directly to this core competency framework.

Our commitment to continuous improvement

We define audit quality as the outcome when audits are executed consistently, in line with the requirements and intent of applicable professional standards, within a strong system of quality controls. We have gained global alignment on this definition to ensure our professionals have a clear vision of our view of quality at both the engagement level and related to our overall system of quality controls. Because the quality of each audit rests on our foundational quality controls, we are building a process to document and continually evaluate our overall system of quality controls and our implementation of the quality control standards applicable to our work.

We recognize and support the PCAOB’s mission of promoting high-quality auditing, we appreciate the professionalism and commitment of the PCAOB and its staff, and we value the important role the PCAOB plays in improving audit quality at our firm and across the profession.

We take this feedback very seriously, and we are committed to working constructively with the PCAOB to resolve the concerns they have identified. We remain singularly focused on our responsibilities to the capital markets and will continue to work with the PCAOB and other industry participants to improve the quality of audits performed by our firm and in our industry in general.

Peer Review

The firm’s most recent peer review report was issued by PricewaterhouseCoopers LLP in March 2018 relating to the period ended March 31, 2017 on our system of audit quality control applicable to engagements not subject to PCAOB permanent inspection (nonpublic entity accounting and auditing practice). The peer review rating was a pass with deficiency.

The rating indicates that our system of quality control has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects, with the exception of a certain deficiency. The deficiency cited in the report is based on the inappropriate conduct of our former personnel. As the firm pointed out in its response, the risk that was identified in the peer review report was addressed and fully remediated by KPMG in an appropriate, decisive and timely manner. The AICPA’s acceptance letter notes that further remedial action is not required.