

IFIAR Presentation – Cape Town September 2008

This document sets out (in italics) the questions that IFIAR has requested each firm to address in its individual presentation. The KPMG International response is set out below each question. The purpose of this document is to provide the IFIAR with a link between our slide presentation and its questions in order to assist it in the analysis of our response and preparation for the Cape Town meeting.

▪ ***Background***

1. How quality monitoring assesses effectiveness of firm-wide quality control of national members in ensuring high quality audits (slides 5, 24, 25, 35 & 36)

KPMG has an internationally designed monitoring program.

One program (Quality Performance – QP) for each of our Audit, Tax and Advisory functions assesses quality at the engagement level. Two cross-functional programs, the Risk Compliance Program (RCP) and the Global Compliance Review program (GCR) monitor compliance with KPMG International's policies at a Member Firm level. The QP and RCP programs are executed nationally on an annual basis, monitored regionally and overseen by KPMG International's Global Risk Management Quality Performance team. GCRs are performed by reviewers from our Global Risk Management group on a three-year cycle. In the event that the GCR review identifies significant issues which require immediate or near term attention, a follow-up review will be performed as appropriate. As such it is an integrated monitoring program that covers all Member Firms.

All Member Firms are subject to Quality Performance review each year. Exemptions may be granted to smaller practices, with no more than five Audit partners and showing a good quality record, with the authorization of the Regional RMP. These exemptions remain subject to the practice reviewing each Audit Partner at least once over each three-year cycle.

Each engagement reviewed is evaluated on a 4-level rating scale, from 1 to 4. Ratings 1 and 2 are both considered satisfactory, while 3 and 4 represent less than satisfactory performance. Definitions of each rating are presented in the response to Results - question 1 below. An action plan is prepared by the Member Firm for each 3 and 4 rated engagement to address the issues giving rise to the rating and their root causes.

The Audit practice of each Member Firm is evaluated at the end of the QP process, with a "traffic light" evaluation of Green, Yellow or Red awarded. The definitions of these colors are presented in the response to Results - question 1 below.

2. *Relationship of international quality monitoring with national monitoring programs (slides 24, 25 & 26)*

There is one International QP Program, which covers all network firms for each of our functions (i.e., Audit, Tax, and Advisory) which covers all geographies (i.e., Regions, Sub-Regions, Member Firms (MFs), Sub-Licensees and Foreign Branches). The Program is international in scope but designed to be executed locally. Where the management structure devolves certain responsibilities to the Sub-Regions, the program is executed at the sub-regional level (e.g., Latin America & CEE).

There are no separate national QP programs. The International QP program is required to be executed in all Member Firms. A Member Firm may add additional review procedures in relation to local regulatory or professional standards or regulations, but cannot eliminate or replace any elements of the international program.

3. *Information on the organizational arrangements for the quality monitoring together with an organization chart (slides 11, 12 & 29)*

Global Organization (see slide 11):

Quality monitoring in KPMG is under the responsibility of the **Global Head of Risk**, Larry Leva. Global Risk leadership is responsible for coordinating risk management responses across the KPMG network. Global quality monitoring policy is determined by the **Global Risk Management Steering Group** (GRMSG), which is chaired by the Global Head of Risk. Global quality monitoring reports are presented in the first instance to the Global Risk Management Steering Group (GRMSG), then to the International Executive Team (IET), and finally to the International Board.

The **Global Risk Management group** assists the GRMSG with policy, process and systems development through the GRM Operations Group, and coordinates our internal monitoring programs.

Within the Global Risk Management group is the **Global Compliance Group**. The Global Compliance Group includes:

- The Global Compliance Review team (headed by Jim Buckley: five full-time staff (based in New York), three staff that dedicate more than 50% of their time to the program (located "virtually" in their home office). Additional resources are drawn from Member Firms. The Global Compliance Review team manages the tri-annual GCR review program.
- The GRM Quality Performance team based in Amsterdam, Netherlands (headed by Tony Banton: six full time professionals). The GRM QP team manages the international QP and RCP programs.

Regional Organization (see slide 12):

Regional Risk Management Partners (RRMPs), members of the GRMSG, oversee risk management matters in one of three regional groups – Americas, AsPac and EMA – and act as the relay between Global and the Member Firms. The Americas and EMA also have sub-regions, which replicate this

approach for the firms which they represent (For each Sub-Region a Sub-Regional RMP and QPLP assist the Regional RMP).

Regional Quality Performance Liaison Partners (RQPLPs) – Are appointed by and report to the RRMPs and assist the RRMPs by acting as their delegates.

Sub-Regional QPLPs: Are appointed by the Sub-Regional RMP and assist the RQPLPs by acting as their delegates on a sub-regional basis.

National Organization (see slide 29):

National Risk Management Partners provide risk management leadership and implement global policies in their respective firms. Engagement related risk management is managed at the individual firm level.

Functional Quality Performance Liaison Partner - Responsible for conduct of a Member Firm's QP Program

Non-Local Lead Reviewer - Provides oversight and monitoring in the field. All Functions in all firms should involve a NLLR from another firm in the review to Lead or Co-Lead the Functional review process. The NLLR will be nominated by the R-QPLP. Exceptions: in 2007: US & Canada did not have a non-local lead reviewer. These countries did not consider it necessary to appoint a non-local lead reviewer because of their significant current and historical external monitoring of their Audit practices. In addition, in the US, a centralized core team approach to QP is utilized to conduct reviews.

Team Leader – Leads the review in each Review Unit. A Review Unit is a grouping together of engagement reviews in a logical way such that they can be adequately supervised by one individual.

Review Unit Coordinator - The Team Leader can be assisted by a Review Unit coordinator, usually a Senior Manager from the local firm, who acts as “engagement manager” for the QP Program relating to the Review Unit. The Team Leader may delegate organizational tasks to the Review Unit coordinator. The Review Unit coordinator may also carry out preparatory work on behalf of the Team Leader, such as determining whether reviewers have questions, require guidance or have enough time to complete their reviews and, in Audit, performing a preliminary review of the Issue Communication Forms (ICFs), used by the QP team to communicate deficiencies in the audit review, and to provide input to the reviewers. However, the Team Leader may not delegate tasks that are specifically identified in the QP Program Baseline as being his/her direct responsibility.

Reviewers: Individuals who perform engagement reviews – must be independent from the engagement reviewed (see slide 30 for QP Reviewer profile).

- **Non-local reviewer** : reviewer sourced from another Member Firm

- **Local reviewer:** reviewer sourced from the local firm – there are restrictions that a local reviewer should not be from the same office/business unit as the engagement partner being reviewed such that there is no direct or indirect reporting relationship between the local reviewer and the individual being reviewed.
- **Independent Specialist reviewer:** reviewers included in the review team to examine specialist areas such as tax, IT, derivatives, etc.
- **SEC Reviewers:** review teams where an SEC Foreign Private issuer is reviewed must include reviewers with lead engagement partner or senior manager responsibilities on another SEC FPI, or be from a US technical group.

4. *Are all national members subject to the same global monitoring policies, procedures and practices (slides 25, 26 & 28)*

Yes, there is one International QP Program that covers all network firms – including all functions (i.e., Audit, Tax, and Advisory) and all geographies (i.e., Regions, Sub-regions, Member Firms (MFs), Sub-licensees and Foreign Branches). The Program is international in scope but designed to be executed locally. Where the management structure devolves certain responsibilities to the Sub-Regions, in some instances the program is executed at the sub-regional level (e.g., Latin America & CEE). All Member Firms are subjected to the same global monitoring policies under KPMG International's membership agreement, and these are designed to meet ISQC1, ISAs and KPMG's own quality standards.

There are no separate national QP programs. A Member Firm may add additional review procedures in relation to local regulatory or professional standards or regulations, but cannot eliminate or replace any elements of the international program.

5. *Do quality assurance practices differ in jurisdictions that have an independent audit oversight regime and those that don't (slides 26 & 28)*

As is described in the response to question 4 above, KPMG International's quality policies and procedures are the same for all Member Firms and designed to meet KPMG's own quality standards. There are no differences in those policies and procedures from country to country, and currently they are determined without consideration of the existence of independent audit oversight regimes.

The international program provides a baseline for quality assurance practices, but individual practices may create additional processes in response to local oversight regimes and requirements.

▪ ***Governance***

1. What rewards, disciplinary or remedial or other measures are available at the international level (slides 35, 38, & 39)

The KPMG QP Program is executed nationally. The rewards and disciplinary and remedial measures are determined by the Member Firm. Action plans are developed by the Member Firms to address deficiencies and these are monitored at the regional level. Professional competencies and performances, including the results from QP, are included as part of each partner's annual evaluation. Sanctions are determined by each Member Firm, and these can include, for example, a remuneration adjustment to partners, a change to the partner's accreditations to perform certain type of engagements or the implementation of specific monitoring or training programs to assist a partner and the engagement team in correcting the weakness identified.

The remediation plans, both at the individual engagement level for "3" and "4" rated engagements and more generally for issues identified throughout the audit practice, are reported to regional management in the Planning and Reporting Memorandum (PARM). The Regions analyze the PARMs, both in order to give an overall evaluation to the Audit practice of each Member Firm (see response to Reporting question 1 below) and to monitor the adequacy of the Member Firm's remediation plan.

2. Who decides upon execution of any measures (slides 35 & 38)

The KPMG QP Program is executed nationally, although in those sub-regions with more centralized management, the program is managed at sub-regional level (e.g., Latin America & CEE). Each Member Firm determines these elements and how they will be implemented.

3. How is the undertaking of any required measures tracked (slides 39 & 40)

Remediation measures are closely monitored by regional management, with the status of those plans and other developments in "Red" practices reviewed by the Global Risk Management Steering Group.

4. Are the national members or the individual partners subject to possible measures (slides 35, 36 & 37)

KPMG International does not have any detailed specifications of how QP results, or any other matters, are to be translated into rewards or disciplinary sanctions at the Member Firm level. Professional competencies and performances, including the results of QP, are included as part of each partner's annual evaluation as determined at the national level. Individual engagement results can result in measures against individual partners which include, for example, a remuneration adjustment to partners with less than satisfactory rated engagements, a change to the partner's accreditations to perform certain type of engagements or the implementation of specific monitoring or training programs to assist a partner and the engagement team in correcting the weakness identified.

In addition, a second engagement review is required on another engagement of a partner receiving a "4" engagement rating, and also for a "3" rating if the

Audit engagement is for a Public Interest Entity or Listed Entity or one of its affiliates.

Results of engagement reviews give rise to an overall evaluation of individual practices. The QP Program instructions require that Regional and Functional leadership provide the required support and oversight to all “Red” practices and those practices must be subject to specific monitoring by Regional Leadership. In red practices, Regional COOs and R-RMPs interact with Member Firm leadership to monitor progress and where deemed necessary provide additional resources from within the region to assist the practice and Regional leadership (through the Regional COO and RRMP) and International (through GRMSG) track and report on progress of action plans.

Global Lead Audit Engagement Partners referring work to the countries rated Red are notified and are advised to take this into account in planning their engagements and may contact the RRMP for assistance.

5. *What education and training is provided to quality monitoring reviews (slides 29, 30 & 31)*

All reviewers are selected from experienced audit professionals. International training material is developed by the central QP team and provided to each Member Firm. The Member Firm QPLP is required to ensure that all reviewers receive appropriate training prior to their first engagement review.

Those involved in the monitoring of each Member Firm's QP Program, the Team Leaders, Non Local Lead Reviewers and Quality Performance Liaison Partners, attend Regional training, developed internationally and presented by members of the GRM-QP team and the Regional QPLPs. At least one session is held in every Region or sub-region in April or May of each year and the limited number of presenters ensures that a consistent message is given throughout KPMG.

The Regional training sessions covered the following agenda:

- Managing the QP Program
- Communication
- How to use the Qubus QP questionnaire
- Effective completion of an Issue Communication Form
- Rating engagements
- Making the most of the reports available in the Qubus tool
- How to prepare and review an action plan
- Definition of the firm Traffic Light evaluation

The QPLP of each Member Firm is responsible for ensuring all reviewers originating in his or her firm, whether they are to perform reviews locally or in another Member Firm, attend training. Training materials are prepared by the GRM-QP team and provided to all Member Firms. The training material provided to Member Firms for the 2008 Audit QP season covered the following agenda:

- 2007 QP Review Results
 - Global issues
 - Local results: Significant findings & Action plans
- Objectives of QP
- New Features in 2008 QP Program

- Roles in QP Process
- Conducting the Review
- Focus Areas of Review
- 2008 Qubus Application
- Review timing and local reporting requirements
- Case Study – an example working papers file, from which participants are required to identify quality issues and document these in the Issue Communication Form

In addition to training, a detailed Reviewer's Guide and toolkit is made available to reviewers, Team Leaders and Non-Local Lead Reviewers on how to perform their roles.

It is recommended that all reviewers participate in a "face-to-face" training session in which the centrally-prepared training materials are used, adapted as appropriate to local circumstances. It is, however, recognized that such training sessions may not cover all reviewers, particularly where there are late changes to the composition of the review team.

In such circumstances, other training options include:

- Training session(s) by conference call, using the Reviewer Training slide-pack as supporting documentation
- Holding a training session on the first morning of the Review Unit's review
- Detailed briefing on a one-to-one basis before the reviewer starts the first review
- Shadowing of a new reviewer by an experienced reviewer for the first review

6. *How are the results of the international reviews shared with Member Firms and followed up (slides 39 & 40)*

The results are monitored regionally and globally. It must be noted that GCR, RCP and QP results are treated confidentially and are handled by the Regional Risk Management Partners with caution and care. Aggregated and individual Member Firm results, including the traffic lights evaluations and engagement ratings are communicated to the Regional and International Boards, the Global Risk Management Steering Group, the International Executive Team, and the International Management Council.

KPMG International, with the agreement of the Board and the respective Member Firms, provides the following information in relation to the results of QP and Compliance reviews:

- Lead Audit Engagement Partners on KPMG's Global Accounts are informed if their client has an affiliate which is included in the group audit scope in a practice with a Red evaluation.
- Lead Audit Engagement Partners on KPMG's Global Accounts and SEC filers are also informed of any engagement ratings of "3" or "4" on an affiliate of their client. LAEPs are encouraged to contact either the Member Firm RMP or the engagement partner to make additional enquiries and determine what action should be taken.

Regional level - Engagement ratings and the nature and extent of issues identified are the key drivers of the traffic light evaluation process. Engagement ratings (non-nominative) are presented within each of the three geographic regions at Annual QP Wrap-Up meetings as part of the information used to finalize QP traffic light evaluations. Traffic light evaluations are communicated to each individual Member Firm after the Regional Wrap-Up meetings.

Aggregated Regional results are reported to Regional management at Regional Board meetings. Regional leadership follows-up on progress on a regular basis with each Red practice.

In 2007, two small audit practices were evaluated as Red. Lead Audit Engagement Partners on KPMG's Global clients were informed of their identity if they referred work to one of these Member Firms.

Global level - Engagement ratings and traffic light evaluations are summarized and the number of Member Firms with each traffic light color in each sub-region and region is presented to various Leadership groups, including the GRMSG, the GASG, Heads of Audit, Regional Boards, the IET and the International Board. Red practices are named at each of these meetings.

As each Regional RMP sits on the GRMSG, he or she has access to all engagement ratings and traffic light evaluations and so is able to provide information, on request, to Lead Audit Engagement Partners in his or her Region.

7. *Are there any reflections of inspections reviewed by independent audit regulators, in your quality monitoring reviews (slide 26)*

To date the engagement coverage and selection are independent from external regulatory reviews. Specific allowance, however, can be made to exclude from the review selection a PIE/listed engagement that has already been subjected to a recent 'satisfactory' regulatory review.

Each Member Firm can supplement the international QP Program to monitor specific topics raised by the local audit regulator during its review.

8. *How does a firm policy, including a quality monitoring programme, ensure the consistent application of IFRS (slide 14 & 15)*

The IFR Group supports the IFRS Panel, which is composed of representatives of Departments of Professional Practice (DPP) of Member Firms. The IFRS Panel meets monthly and its role includes determining the KPMG International technical position on areas of application of IFRS. Positions taken by the IFRS Panel positions are binding on Member Firms, subject to an appeal process.

The IFR Group publishes "Insights" annually, which sets out the KPMG position on matters of interpretation of IFRS. "Insights" is a technical reference book that is used extensively by Member Firms throughout the network to achieve consistent application of the standards. The IFR Group must be consulted (under the terms of the Panel operating procedures) if a

Member Firm wishes to depart from the application of the guidance in Insights.

In order to ensure that we have appropriately qualified individuals involved on IFRS engagements an IFRS accreditation policy exists, the application of which is monitored as part of the Quality Performance program. The QP questionnaire includes questions requesting the reviewer to verify that the engagement team is accredited to perform the engagement. In addition, IFRS engagements, for high risk and Public Interest Entity audits, require the involvement of an IFRS reviewing partner. This also is monitored as part of the annual QP and Risk Compliance Programs. Global IFRS training is made available to all Member Firms.

The International Standards on Auditing Group within the ISG functions in a similar manner to the IFR Group, and technical matters relating to the interpretation and application of ISAs are reviewed by the ISA Panel.

The Global Services Centre in New Jersey is responsible for developing and maintaining our International Audit Methodology in full compliance with International Standards on Auditing.

The Global Services Centre and International Standards Group are the key contributors to the drafting of the Audit QP questionnaire, ensuring that the reviews focus on relevant auditing and accounting standards and their consistent application across KPMG.

9. *Is there an international ‘governance framework’ which set out how the results /ratings based on the international reviews of network members are translated into measurement and subsequent rewards/disciplinary measures for the individual Member Firms (slides 35, 36, 37)*

There is no formal “governance framework” for such purpose. However, the protocols for engagement ratings and functional evaluations are set out in the annual instructions. The definitions of these ratings and evaluations are presented in the response to Reporting - question 1.

Other than the traffic light evaluation, no other ranking is determined and practices are not ranked in any order within each band of color evaluation.

The evaluation process will include the following assessment:

- does the firm qualify as a "green" practice
- does the firm have serious issues that make it a "red" practice
- If it is neither green nor red, then the practice is, by default, "yellow."
This is expected to be frequent as many functions have issues, particularly in the application of engagement methodology.

KPMG International has not prescribed how QP results, or any other matters, are to be translated into rewards or disciplinary sanctions at the Member Firm level.

However, the QP Program does state that Regional and Functional leadership should provide the required support and oversight to all “red” practices and those practices are subject to specific monitoring by Regional Leadership including reporting of progress made to the GRMSG, in addition to the monitoring performed by each Region of the progress of implementation of all action plans, including those of "green" and "yellow" practices.

10. How does a firm policy, including a quality monitoring programme, ensure compliance with the auditor independence rules and code of ethics (slides 6, 7 & 13)

The KPMG Risk Management Manual-Global (RMM-G) and QP, RCP and CGR programs are designed to ensure compliance with the ISQC 1 and the IFAC Code of Ethics, in addition to the KPMG Code of Conduct. The KPMG Membership Agreement requires all Member Firms to comply with the RMM-G.

KPMG's Core Values define how we go about our work. Each value is captured in a powerful phrase. These words have real meaning when all of us—from the most senior to the most junior—transform them into action.

We lead by example - at all levels acting in a way that exemplifies what we expect of each other and our Member Firms' clients.

We work together - bringing out the best in each other and creating strong and successful working relationships.

We respect the individual - respecting people for who they are and for their knowledge, skills, and experience as individuals and team members.

We seek the facts and provide insight - challenging assumptions, pursuing facts, and strengthening our reputation as trusted and objective business advisers.

We are open and honest in our communication - sharing information, insight, and advice frequently and constructively and managing tough situations with courage and candor.

We are committed to our communities - acting as responsible corporate citizens and broadening our skills, experience, and perspectives through work in our communities.

Above all, we act with integrity - constantly striving to uphold the highest professional standards, provide sound advice, and rigorously maintain our independence.

At the level of individual professionals, KPMG's Global Code of Conduct underlines the critical importance of compliance with ethical standards. This is supported by the International Hotline, which is a vehicle for partners, employees, clients and other parties to confidentially report possible illegal, unethical, or improper conduct as it relates to KPMG International and its Global Code of Conduct. Compliance with the Global Code of Conduct is monitored by both RCP and GCR.

Compliance with Independence rules is also monitored through the KPMG Independence Compliance System (KICS), which requires both personal and firm investments to be recorded.

KPMG's monitoring programs include the verification of the effective implementation of RMM-G policies on auditor independence and ethics and are supported by the Global Independence Group (GIG) based in NY as described below. The GIG focuses on compliance with international independence requirements – including SEC, PCAOB and IFAC independence requirements. The head of the independence group (David Winetroub) has been a member of the IFAC Ethics Committee since 2003 and he is also a member of the AICPA (American Institute of Certified Public Accountants) Ethics Committee.

- At an individual engagement level, independence aspects are reviewed as part of the engagement Quality Performance program. KPMG Member Firms use Sentinel, which is a tool designed to cover both engagement independence and conflicts of interest, and is required to be used on all engagements. A Sentinel Approval Number (SAN) is required to be obtained prior to the commencement of work. Initially designed for SEC Independence, it was extended to cover conflicts of interests and all clients of KPMG since May 2005.
 - At a Member Firm level, there is an annual self-assessment of compliance with the RMM-G through the Risk Compliance Program, which includes testing of effectiveness.
 - In addition, the Global Compliance team carries out compliance reviews of all Member Firms on a three-year cycle, with particular emphasis on independence rules. Compliance with the KPMG Code of Conduct is also assessed during those reviews. Members of the GIG may participate on these reviews.
- Also, each employee is required to complete annual independence training and an affidavit to confirm compliance with KPMG's ethics and independence policies.
 - Finally, compliance with Independence rules is also monitored through KICS, which tracks personal independence of partners and managers and Member Firm independence, for each Member Firm. This started as a tool to record investments in SEC filers only, but has now been extended to include all listed entities in all the countries in which KPMG operates. All investments are required to be registered in KICS and not only those that relate to KPMG's audit clients. Member Firms are required to carry out an annual independence and compliance audit in relation to selected partners and managers.

▪ ***Scope of the global quality control/ Monitoring***

1. What resources are available for monitoring quality, i.e. how many people are assigned to global quality monitoring and by what criteria are they selected (slides 11 & 29)

The central Global Risk Management Quality Performance group (headed by Tony Banton) which leads the development and monitoring of the RCP and QP Programs is a team of six professionals, led by a partner, all of whom are dedicated to the international Compliance programs. The partner in charge is selected from candidates identified by the Regional RMPs and have usually been a key member of the Regional Risk Management team with significant involvement in compliance activities or led a larger firm's Department of Professional Practice. The criteria used for selection include experience in quality and compliance monitoring, reputation and strength of character to be able to reach objective judgments and communicate results clearly. The partner in charge role is generally for a three to five year period. As vacancies arise in the rest of the team, individuals with an appropriate profile and above average performance ratings are identified through KPMG's Global Mobility program for a two to three year secondment to the QP team.

The Global Compliance Team (headed by Jim Buckley), which carries out Global Compliance Reviews in each Member Firm on a three-year cycle has five full-time staff including the partner in charge. Six additional partners lead GCR reviews, two of whom spend 40-50% of their time on GCRs. Other reviewers are drawn from a pool of twenty-eight managers and directors who each devotes 15-40% of his or her time. GCR Team members are generally high-performing professionals having demonstrated an interest in and competency for QP or Risk Management matters. They will often have held a QP or RM role in their national practice and are targeted to join the Global teams as vacancies arise.

The regions also have dedicated personnel responsible for the regional oversight of execution of the QP and Compliance programs, generally two to three per region, supplemented by field professionals who dedicate significant time to the QP program.

In 2007, a total of 1,428 QP reviewers completed the reviews of 2,740 audit engagements across KPMG's three regions for a total investment of 60,000 hours, in addition to which 18,500 hours was spent by the Member Firms on administration of the Audit QP program. The engagements reviewed represented a total of 4.6 million engagement hours.

2. How is the frequency of the review determined, i.e. how often is an individual national firm, office, partner subject to review (slide 28)

All Member Firms are subject to QP review each year. Exemptions may be granted to smaller practices, with no more than five Audit partners and showing a good quality record, with the authorization of the Regional RMP. As partners have to be covered at least once every three years, a Member Firm (or Sub-licensee) can not be exempt from review more than two years in a row. In 2007, Audit QP reviews took place in 118 out of the 145 countries in which KPMG operates. Of the 27 countries not subject to review in 2007, only one had not been reviewed in 2006.

There is no specific requirement for the coverage of offices. However, partners must be reviewed at least once in every three-year cycle, which means that every office is also covered, at a minimum, once in three years. The QP Program Baseline states: *“Partners (which includes partner equivalents and other engagement leaders), must be subjected to QP Review at least once in every three-year period. As a result, all partners who have not been reviewed since 2005, and who are client-facing, must be reviewed in 2008. In addition, any partner who received a “3 – Performance Improvement Necessary” (and did not subsequently receive a “1” or “2” rating on an additional reviewed engagement) or “4 – Unsatisfactory” engagement rating in 2007 and who remains with the firm at the time of the 2008 QP review must be subjected to review in 2008.*

In addition to the above criteria, a risk-based approach should be used when selecting partners for QP review who were reviewed in 2006 or 2007 in order to introduce unpredictability into the review cycle.”

The above approach is consistent with ISQC1, which requires *“Engagements selected for inspection include at least one engagement for each engagement partner over an inspection cycle, which ordinarily spans no more than three years.”* (ISQC1 §78)

3. ***What is the depth of the review as to working papers, independence, engagement acceptance/continuance and other elements of quality control including internal review process of specific audit engagements, does it include on-site inspections accompanied by hearing (interviewing) the relevant people, or is the assessment conducted only on an off-site basis (slide 28)***

All engagement reviews are performed to the same scope, using the Audit QP questionnaire. This represents a review of all aspects of the engagement through a review of the working papers, including the risk management procedures (Independence, client acceptance or engagement acceptance, etc.) and the different stages of execution of the audit (planning, control evaluation, substantive testing and completion). Extensive individual interviews are conducted.

The review generally is on-site although, in some instances, smaller engagements may have an initial off-site work-paper review but will always have an on-site interview and exit meeting with the engagement partner.

Some Member Firms supplement the QP program by performing In-Flight or In-Depth reviews, which usually take place partway through the engagement to assist the engagement team in evaluating the quality of the work performed and help to address potential issues. This type of program is not a global requirement for Audit. These additional local programs are not a substitute for QP reviews of completed engagements.

4. ***What are the prioritized elements or focused areas in quality monitoring (slide 27)***

When the annual QP questionnaire is updated each year, priority and focus is placed on:

- pervasive issues identified in the prior year's QP

- "hot topics" relating for example to new accounting standards or topical accounting issues, such as the credit crunch through targeted questions relating to valuations, going concern/liquidity risks (e.g., specific question added in 2008 Audit questionnaire relating to "exposure arising from unstable credit market conditions")
- significant accounting areas including judgments on key accounts, key audit judgment and documentation

Key drivers in Questionnaire design are as follows:

- Ensuring compliance with RMM-G and Functional Manuals
- Measuring quality of the work performed and the deliverable, with an emphasis on consistency across the KPMG network

The inclusion of these topics in the compliance programs (GCR, RCP and QP) is monitored and followed up by the GRM QP Team (QP/RCP) and the Global Compliance Group (GCR) with significant consultation with and input from the Global Services Centre (GSC), the International Standards Group (ISG), and the Regional Risk Management teams. Each of these groups is also consulted while preparing the Audit QP questionnaires to ensure that all appropriate topics are covered.

The Audit questionnaire is also sent out for review and comment to representatives from the US firm's Department of Professional Practice, and to the US Capital Markets Group.

5. *Does the quality control monitoring cover all network firms (slide 28)*

Yes

6. *How do the firms see their quality assurance policies and practices changing over the next two to three years as independent audit oversight continues to grow and mature - will that affect their global practice (slide 4)*

As previously noted, all Member Firms are subject to the same quality monitoring processes regardless of whether there is an external regulatory review. Our monitoring policies & processes and the scope and extent of our Quality Performance Program evolve continuously to ensure that our business objectives are met and these take account of the constantly changing regulatory environment.

7. *Are the firms able to share the work programs of the international quality control monitoring reviews (slide 39)*

All Member Firms should be able to share the International QP questionnaire with their national oversight body.

At a national level, the extent of sharing of QP review documentation and results with national regulators is determined by each Member Firm. Full access is given in some cases, limited access in others.

Individual regulators have asked Member Firms for a copy of the review questionnaire and where possible this request has been granted (e.g., US, UK).

▪ **Reporting**

1. How are the reviews graded by the quality monitoring division (slides 35 & 36)

Engagement ratings are determined by the QP reviewer, with review and validation by the Team Leader, Non-Local Lead Reviewer and Quality Performance Liaison Partner

Satisfactory (“1”) or Satisfactory with Comments (“2”)

For an engagement to be rated Satisfactory (“1”) or Satisfactory with Comments (“2”), the reviewer concludes that:

- Key judgments and conclusions regarding auditing, accounting and disclosure matters are appropriate;
- The engagement was performed and documented in a manner that was adequate to support the auditors’ report; and
- The engagement was performed and documented substantially in accordance with firm policy, professional standards, and applicable legal and regulatory requirements.

When the above are satisfied, the criteria for choosing between a “1” or “2” rating are as follows:

Satisfactory (“1”)

Engagements should only be rated “1” when judgments/conclusions are deemed appropriate and the reviewer has no significant comments regarding any omissions of required procedures/documentation or any deficiency with respect to the engagement deliverable.

If discussions with the engagement team are limited to minor clarifications to improve the reviewer’s understanding of the existing content of the work papers and there are no other negative answers which the reviewer considers lead to a significant issue, the engagement may be rated Satisfactory (“1”).

Satisfactory with Comments (“2”)

The engagement should be rated Satisfactory with Comments (“2”) if the criteria set out above as relating to “1” and “2” ratings are met and:

- there a few minor matters related to a significant area of the engagement for which documentation or procedures could be improved;
- there are minor omissions of required procedures or deficiencies with respect to the auditors' report or other deliverables
- clarifying edits or additions are required to the workpapers in areas not deemed to be significant to the engagement

- Non-substantial improvements are needed in the application of firm policy, professional standards, and applicable legal and regulatory requirements.

Less Than Satisfactory Performance

If the reviewer cannot conclude, based on the work papers (and, to a limited extent, discussions with the engagement team to clarify the contents of the existing work papers) that the engagement is "Satisfactory", with or without comments, then the reviewer should conclude that there is a performance deficiency.

Performance Improvement Necessary ("3")

Engagements that are rated Performance Improvement Necessary "3" are engagements where the auditors' report is supported by the work performed and the auditors' report is not materially deficient or inappropriate. However:

- The report includes weaknesses or deficiencies as compared to applicable laws, regulations or professional standards even though these do not mislead the user of the report.
- Significant oral explanations regarding the audit approach, its execution and conclusions were necessary to enable the reviewer to conclude that the auditors' report is supported by the work performed.
- The engagement team would need to add documentation to the work papers in order to clarify the procedures performed or conclusions reached in significant areas so that the work papers could "stand-alone".
- There are significant inconsistencies between the documented audit work and the conclusions reached.

Unsatisfactory ("4")

An engagement is rated "4" if one or more of the following five conditions are present:

- The financial statements do not conform with the specified generally accepted accounting principles in all material respects due to:
 - Material errors, including situations where the accounting policies adopted by the client are clearly inappropriate or incorrectly applied; and/or
 - The financial statement disclosures are materially deficient;
- The independent auditors' report is materially deficient or inappropriate in the circumstances;

- The deficiencies in work paper documentation on the engagement, prior to any remediation as a result of the QP review, are so extensive that the reviewer believes a “3” rating is inappropriate as the documentation does not support the auditors’ report on the financial statements, for example the engagement team is required to obtain additional audit evidence from the client and/or perform additional audit procedures for significant account balances or critical audit objectives; or
- The audit was not performed in all material respects in accordance with specified generally accepted auditing standards and with firm policy, professional standards, and applicable legal and regulatory requirements;

If the reviewer concludes that inadequacies in the work paper documentation indicate the omission of significant audit procedures or discussions with the engagement team cause the reviewer to conclude that the work performed is not adequate to support the auditors’ report in all material respects, or the auditors’ report is materially deficient or inappropriate, then the engagement must be rated a “4.”

Member Firm evaluations (Green, Yellow or Red) are determined by the Regional RMP, together with the Regional QPLP. In 2007, 83 Audit practices (operating in 118 countries) included in the QP Program were evaluated as:

- Green: 43
- Yellow: 38
- Red: 2

Note that for the purposes of understanding the above statistics, an Audit practice may operate in several countries.

Member Firm evaluations are assessed using the following definitions:

- **QP Green – substantial compliance with KPMG’s policies and procedures**
 - The results of QP reviews indicate that the Function is mainly compliant with KPMG’s policies and procedures.
 - Engagements are predominantly rated “1” or “2”. This means that “3” or “4,” engagement ratings are rare.
 - The issues identified from **all** engagement reviews are either:
 - minor, in that they have little or no impact on the overall quality of the engagements, or
 - for more significant issues, isolated and clearly non-pervasive.
 - Action plans resulting from prior years’ QP reviews have been implemented; there are only isolated cases of recurring issues.
 - Current year action plans are robust and may already have been partially implemented.
- **QP Yellow – substantial compliance with KPMG’s policies and procedures - action necessary**
 - The results of QP reviews indicate that the Function is mainly compliant with KPMG’s policies and procedures, however,

- Issues identified from engagement reviews are:
 - more than minor;
 - for more significant issues, these are not isolated;
 - more focus on applicable engagement methodology is needed (by either certain engagement teams or the Function as a whole) so that issues do not become pervasive throughout the practice.
- There are more than isolated cases of recurrence of prior year issues, but significant issues have been addressed.
- Current year action plans are adequate and the Function should be able to remediate the issues identified within a year.
- Action plans for issues recurring from the prior year reflect a revised or enhanced approach to remediation.
- **QP Red – serious deficiencies**
 - Issues identified from engagement reviews are significant and pervasive throughout the Function, and/or overall engagement quality has been impaired.
 - Engagements rated “3” or “4” indicate the existence of serious deficiencies within the Function that require immediate action.
 - Significant issues from prior years have not been addressed or the prior year action plans were either not robust enough or were not adequately and effectively implemented.
 - Execution of the current year's QP Program was inadequate or the presentation of the issues and root causes did not reflect the findings from engagement reviews.
 - Current year action plans are not adequate (i.e. timely, appropriate to address issues and root causes, have sufficient resources, etc.).
 - Monitoring and/or assistance may be needed from outside the Firm.

Other than the traffic light evaluation, no other ranking is determined and practices are not ranked in any order within each band of color evaluation.

2. *How are these grades presented (slides 38, 39 & 40)*

Results are presented first to Member Firm leadership, then to the Regional Board and finally at the international level (GRMSG, IET, International Board).

Engagement results are presented in the Member Firm at a Debrief Meeting, led by the Non-local Lead Reviewer (NLLR) that is held upon completion of review fieldwork.

Engagement ratings and the nature and extent of issues are the key drivers of the evaluation process. Engagement ratings (non-nominative) are presented within each of the three geographic regions at Annual QP Wrap-Up meetings as part of the information used to finalize QP traffic light evaluations.

Each Member Firm is informed of its own practice evaluation by the relevant RRMP after the Regional QP Wrap-up meetings.

The results are monitored regionally and globally. It must be noted that the results of GCR, RCP and QP are treated confidentially and are handled by the Regional Risk Management Partners with caution and care. Aggregated and individual results, including the traffic light evaluations and, for QP, engagement ratings, are communicated to the Regional and International boards, the International Executive Team, and the International Management Council. Red practices are named at each of these meetings.

KPMG International, with the agreement of the Board and the respective Member Firms, provides the following information in relation to the results of QP and Compliance reviews:

- Lead Audit Engagement Partners on KPMG's Global Accounts are informed if their client has an affiliate which is included in the group audit scope in a practice with a Red evaluation.
- Lead Audit Engagement Partners on KPMG's Global Accounts and SEC filers are also informed of any engagement ratings of "3" or "4" on an affiliate of their client. LAEPs are encouraged to contact either the Member Firm RMP or the engagement partner to make additional enquiries and determine what action should be taken.

3. *Is there a ranking of the outcomes of the inspections (slides 38 & 39)*

No. Other than the traffic light evaluation, no other ranking is determined and practices are not listed in any order within each band of the color evaluation.

4. *To what extent are the results of the monitoring shared with other network members? (slides 38 & 39)*

The results of GCR, RCP and QP are treated confidentially and are handled by the Regional Risk Management Partners with caution and care. Aggregated and individual results, including the traffic light evaluations and, for QP, engagement ratings, are communicated to the Regional and International boards, the International Executive Team, and the International Management Council. Red practices are named at each of these meetings.

As each Regional RMP is a member of the GRMSG, he or she has access to all engagement ratings and traffic light evaluations and so is able to provide information, on request, to Lead Audit Engagement Partners in his or her Region.

KPMG International, with the agreement of the Board and the respective Member Firms, provides the following information in relation to the results of QP and Compliance reviews:

- Lead Audit Engagement Partners on KPMG's Global Accounts are informed if their client has an affiliate which is included in the group audit scope in a practice with a Red Audit Traffic Light.

- Lead Audit Engagement Partners on SEC filers and KPMG's Global Accounts are also informed of any engagement ratings of "3" or "4" on an affiliate of their client. No information is provided on what caused the rating, and LAEPs must contact either the Member Firm or the engagement partner to make additional enquiries and determine what action should be taken.

5. *Can work performed and results of monitoring reviews be shared with regulators, nationally and internationally (slide 37)*

At a national level, the extent of sharing of QP review documentation and results with national regulators is determined by each Member Firm. Full access is given in some cases, limited access in others.

For any communication of results outside of the Member Firm's jurisdiction, information can only be communicated if specific authorization has been obtained from each Member Firm involved.

- ***Restrictions***

1. *Is the quality monitoring review in certain cases impacted by confidentiality or data protection rules (slide 39)*

The main area of restriction is in the provision of nominative information. Most Member Firms are reluctant to include the names of clients in the Qubus answer-sets (software used to complete engagement quality reviews and collect results) or reports and each reviewer acknowledges that he or she will not mention the client name in any of the comments entered in the QP questionnaire. All QP questionnaires are anonymous and referred to by a computer generated number.

Most of the restrictions on nominative information relate to confidentiality or data privacy matters and can be waived on receipt of specific client authorization. However, a small number of Member Firms are unable to provide this information even with client consent due to legal restrictions.

There are, however, two key areas where KPMG International does make specific nominative QP results available to Member Firms in the interest of ensuring that engagement quality is monitored closely by the Lead Audit Engagement Partner. These are situations where 'Less than Satisfactory Performance' is encountered in the audits of an affiliate of a Global account or an SEC registrant or where a Member Firm's audit practice has been evaluated as "Red."

In rare cases, local confidentiality restrictions prevent the use of QP reviewers from another jurisdiction. In such cases it is deemed to be acceptable to appoint an overall monitor (Non-Local Lead Reviewer) from another KPMG firm, accepting that that person is not permitted to access engagement workpapers.

2. *Are there other restrictions to the quality monitoring reviews*

No.

3. *Are some Member Firms excluded from the quality monitoring program (slide 28)*

No.