Public Report

FRC Financial Reporting Council

May 2015

KPMG LLP and KPMG Audit Plc

Audit Quality Inspection

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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1 Background information and key messages

1.1 Introduction

This report sets out the principal findings arising from the 2014/15 inspection of KPMG LLP and KPMG Audit Plc (together referred to in this report as “KPMG” or “the firm”) carried out by the Audit Quality Review team of the Financial Reporting Council (“the FRC”). The inspection was conducted in the period from March to December 2014 (referred to as “the time of our inspection”). We inspect KPMG annually. The objectives of our work are set out in Appendix A.

Our inspection comprised reviews of individual audit engagements and a review of the firm’s policies and procedures supporting audit quality.

We reviewed 20 audit engagements undertaken by the firm, of which two were further reviews of audits reviewed in our last inspection. These related to FTSE 100, FTSE 250, other listed and other major public interest entities, with financial year ends between June 2013 and May 2014. Our reviews were selected on a risk basis, utilising a risk model; each review covered only selected aspects of the relevant audit. The further reviews included an assessment of the extent to which our previous findings on those audits had been addressed.

Our responsibility is to monitor and assess the quality of the audit work performed by the UK firm. Accordingly, our reviews of group audits covered the planning and control of the audit by the group engagement team, including their evaluation of the adequacy of the work performed by component auditors, and selected aspects of other work performed by the UK firm at group and/or component level. Our reviews did not cover audit work relating to components undertaken by other firms within or outside KPMG’s international network.

Our review of the firm’s policies and procedures supporting audit quality covered aspects of the following areas:

- Tone at the top and internal communications
- Transparency report
- Independence and ethics
- Performance evaluation and other human resource matters
- Audit methodology, training and guidance
- Client risk assessment and acceptance / continuance
- Consultation and review
- Audit quality monitoring
- Other firm-wide matters

We exercise judgment in determining which findings to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, both in the context of the individual inspection and in relation to any areas of particular focus in our overall inspection programme for the relevant year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.

Further information on the scope of our work and the basis on which we report is set out in Appendix A.

All findings requiring action set out in this report, together with the firm’s proposed action plan to address them, have been discussed with the firm. Appropriate action may have already been taken by the date of this report. The adequacy of the actions taken and planned will be reviewed during our next inspection.

The firm was invited to provide a response to this report for publication. The firm's response is set out in Appendix B.

We acknowledge the co-operation and assistance received from the partners and staff of KPMG in the conduct of our 2014/15 inspection.

1.2 Background information on the firm

KPMG LLP is incorporated as a limited liability partnership under the Limited Liability Partnerships Act 2000. KPMG Audit Plc, a public limited company registered in England and Wales, is wholly-owned (through two intermediate holding companies) by KPMG LLP. KPMG LLP, along with other KPMG member firms, is affiliated with KPMG International Cooperative ('KPMG International'), a legal entity which is formed under Swiss law and is legally separate to each member firm. Under agreements with KPMG International, member firms are required to comply with KPMG International's policies and regulations.

On 26 September 2014, KPMG LLP demerged from its former parent, KPMG Europe LLP, and, along with a number of KPMG member firms in Europe, transitioned back to a regional structure.

The UK Board and Executive Management team have responsibility for the firm's general and operational management. The KPMG office in Northern Ireland is part of the Irish member firm, and does not have any audits within our scope.

The UK firm has 23 offices and is organised into three lines of service, being Audit, Advisory and Taxation. All statutory audit work is performed within Audit which is divided into industry and geographical business units for operational purposes.

For the year ended 30 September 2014, the firm's turnover was £1,874 million, of which £495 million related to audit work and other assurance services. There was a total of 579 partners, of whom 145 were authorised to sign audit reports, and 103 employees (audit directors) who were authorised to sign audit reports[1].

We estimate that the firm audited 512 UK entities within the scope of independent inspection as at 31 December 2013. Of these entities, our records show that 195 had securities listed on the main market of the London Stock Exchange, including 23 FTSE 100 companies and 54 FTSE 250 companies.

The UK firm audits a number of entities incorporated in Jersey, Guernsey or the Isle of Man whose securities are traded on a regulated market in the European Economic Area. These are inspected by us under separate arrangements agreed with the relevant regulatory bodies in those jurisdictions. The results of these reviews are included in this report. Our records show that, at the time of our inspection, the firm had 11 such audits.

KPMG supplies audit services to local authorities and the NHS (Local Public Audits - LPAs). Whilst we review LPAs undertaken by firms, this is done under separate arrangements agreed with the Audit Commission. The results of these reviews are not included in this report because the LPA inspections fulfil a different purpose to those considered in this report. These reviews of LPAs form

[1] As disclosed in the annual return to the ICAEW as at 31 May 2014.

part of the Audit Commission's assessment of the quality of contracted-out audits. The Audit Commission publishes its assessment both in overall terms and individually by firm. The most recent report can be found on its website.

1.3 Overview

We focus in this report on matters where we believe improvements are required to safeguard and enhance audit quality. We set out our key messages to the firm in this regard in section 1.4. While this report is not intended to provide a balanced scorecard, we highlight certain matters which we believe contribute to audit quality, including the actions taken by the firm to address findings arising from our prior year inspection.

The firm places considerable emphasis on its overall systems of quality control and, in most areas, has appropriate policies and procedures in place for its size and the nature of its client base. Nevertheless, we have identified certain areas where improvements are required to those policies and procedures. These are set out in this report.

Our findings relating to reviews of individual audits, as set out in section 2, largely relate to the application of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits. In general, our findings were diverse in nature and did not fall into common themes.

The firm took a number of steps in response to our prior year findings to achieve improvements in audit quality. This included enhanced guidance and audit training. However, we are concerned about the rate of progress in addressing our prior year findings relating to materiality. In addition, issues continued to arise in relation to the audit of goodwill and non-current assets, group auditing considerations and evidence of the involvement of the engagement quality control reviewer, as set out below. The firm should review the effectiveness of its actions in these areas.

1.4 Key messages

The firm should pay particular attention to the following areas in order to enhance audit quality and safeguard auditor independence:

- Take further action to ensure there is appropriate evidence of involvement by the engagement quality control reviewer on all relevant audits.

- Ensure audit teams use internal specialists where circumstances are complex or require particular expertise and that their work is more integrated into the audit process.

- Review and enhance the firm's policies for the timely disposal of financial interests once a breach of Ethical Standards or the firm's own requirements is identified.

- Take prompt action to review and revise the firm's guidance on materiality in the light of our findings, and the thematic review report issued by the FRC on this area in December 2013, and assess, on a timely basis, the sufficiency of those actions.

- Ensure that the firm's audit reports accurately describe the audit procedures performed to address the identified risks.

- Ensure adequate oversight of the internal monitoring procedures undertaken to assess offshore centres' compliance with the firm's policies and procedures.

2 Principal findings

The comments below are based on our reviews of individual audits and the firm's policies and procedures supporting audit quality.

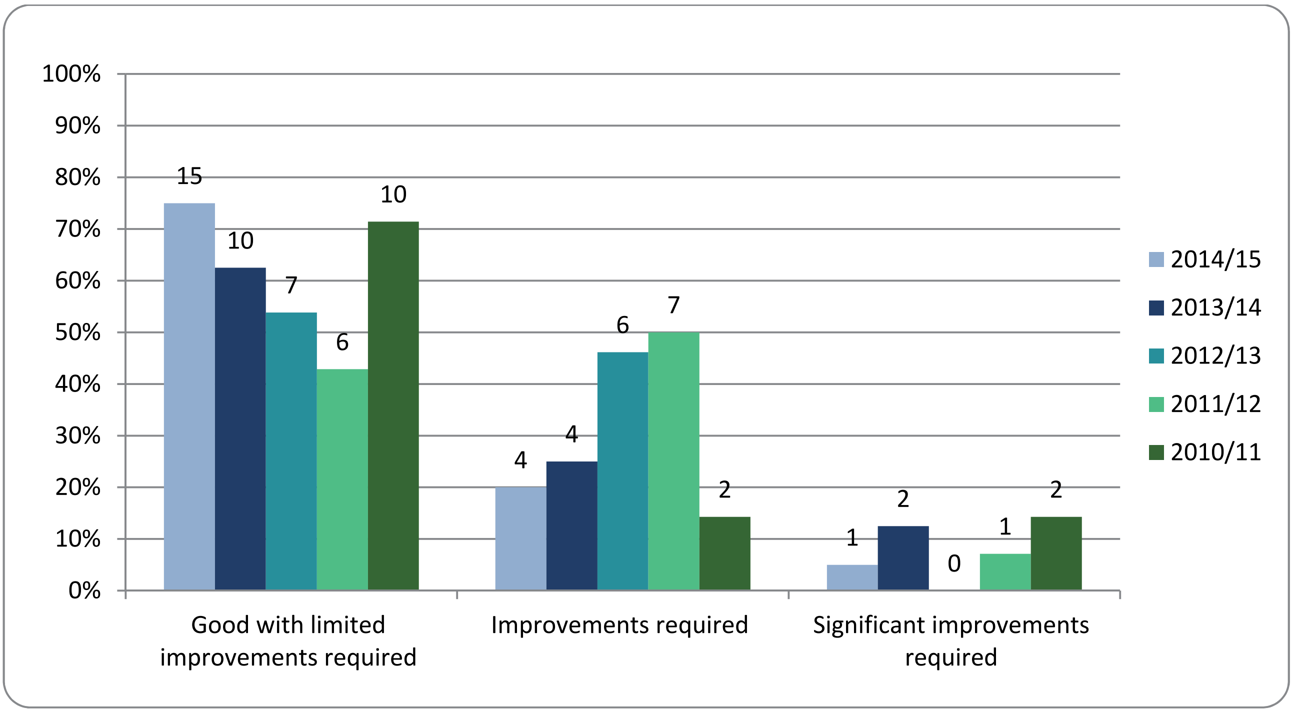
2.1 Reviews of individual audits

We reviewed and assessed the quality of selected aspects of 20 audits (2013/14: 17 audits), of which two were further reviews of audits reviewed in our last inspection which included an assessment of how findings previously raised had been addressed.

Of the audits we reviewed, 15 were performed to a good standard with limited improvements required and four audits required improvements. One audit required significant improvements, particularly in relation to the audit of inventories. Further details are set out later in this section.

An audit is assessed as requiring significant improvements if we had significant concerns in relation to the sufficiency or quality of audit evidence or the appropriateness of significant audit judgments in the areas reviewed or the implications of other matters are considered to be individually or collectively significant. This assessment does not necessarily imply that an inappropriate audit opinion was issued.

The bar chart below shows our assessment of the quality of the audits we reviewed in 2014/15, with comparatives for the previous four years. The number of audits within each category is shown at the top of each bar.



Changes to the proportion of audits reviewed falling within each category from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, movements from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

Findings in relation to audit evidence and judgments

Our reviews focused on the audit evidence and related judgments for material areas of the financial statements and areas of significant risk. We draw attention to the following findings which the firm should ensure are addressed appropriately in future audits.

The significance of these findings in the context of an individual audit reviewed, and therefore the implications for our assessment of the quality of that audit, will vary. However, whatever the implications for the specific audits reviewed, we nevertheless include the relevant findings in this report if we consider them important in the broader context of improving audit quality at the firm.

Audit of goodwill and other non-current assets

We reviewed the audit of goodwill and other intangible assets on eleven audits. In four audits there was insufficient testing of the reliability of forecast cash flows used within the impairment assessment of goodwill or the capitalisation of development costs. In one of those audits and one further audit, we identified related financial statement disclosures that were erroneous or potentially misleading. In another audit, we considered the level of challenge regarding the allocation of brand assets to cash generating units to be insufficient.

In one of those audits, there was also insufficient challenge of the assumptions used by management in the impairment assessment of investment property, including insufficient involvement of the firm’s property specialists in assessing the appropriateness of the land valuation. In another audit there was insufficient evidence of scepticism in the assessment of whether a loan receivable was recoverable.

Inventories

The audit of inventory was reviewed on five audits.

On all five audits we identified issues regarding the extent of the procedures performed relating to the valuation of inventory. On two of those audits, the issues related to the adequacy of analytical review procedures where the audit teams had either set no expectation for the outcome of the procedure or, in setting an expectation, had not obtained evidence to corroborate assumptions used therein. In two audits there was insufficient evaluation, by the audit team or through use of the firm’s internal specialists, of work performed by management experts on which reliance was placed by the audit team. On the fifth audit, there was insufficient challenge of management’s basis for determining a key estimate.

Audit of revenue

We assessed the quality of the firm’s audit work in relation to revenue on fifteen audits.

On four audits, insufficient substantive testing of contract revenues had been performed. On two of those audits, there was also inadequate evidence to support the appropriateness of certain accounting policies.

Audit of loan loss provisions

We reviewed the audit of loan loss provisions on three audits. While significant improvements have been made in the audit work in this area, we identified some limited issues in all three audits in relation to the level of audit evidence obtained.

In particular, on two audits, our review of the evidence obtained relating to loan loss provisions for a sample of loans identified that there was insufficient challenge of management or insufficient audit evidence in relation to certain key inputs and assumptions used. We also identified some issues on all three audits related to the sufficiency of testing of certain controls identified as relevant to the audit.

General IT controls

We reviewed the testing of the operational effectiveness of IT controls on eight audits.

Actions taken by the firm in response to our 2013/14 findings included making enhancements to the firm's audit software to improve the evidencing of how identified IT concerns were addressed.

On five audits, performed prior to these enhancements, there was insufficient evidence that the audit team had responded appropriately to IT deficiencies identified. On three of those audits the lead IT specialist was insufficiently senior given the planned reliance on IT controls and the complexity of the systems. On one further audit, reliance had been placed on certain IT application controls when the operating effectiveness of general IT controls had not been tested in the current year.

In one audit, there was inadequate analysis and testing of mitigating controls identified in relation to potential segregation of duties issues. Management's actions in response to those potential issues were also not adequately evaluated.

Group audit considerations

We reviewed group audit considerations on 14 audits, including the scoping of the work, the extent of involvement in the work of component audits and how matters reported by component auditors were followed-up and resolved.

On five audits, there was insufficient evidence of appropriate evaluation and challenge of the work of component auditors by the group audit team. In two further audits, insufficient procedures were performed to ensure that audit evidence reported as outstanding by component auditors had been obtained before signing the group audit report.

Materiality

On six audits, we raised concerns in respect of the materiality levels set. In three of these audits, we considered that the overall materiality levels set were inappropriately high. On two further audits, materiality for work at component level had been set at the same level as overall materiality for the group financial statements, contrary to Auditing Standards. In another audit it was unclear why materiality had not been reduced at the completion stage, given that reported profits were lower than forecast.

Journals

We reviewed the testing of journals on sixteen audits. A number of these audits were performed prior to enhanced guidance on this area being issued to audit teams in December 2013.

On eight audits there was insufficient evidence supporting the journals selected for testing by the audit team. Other weaknesses in this area included insufficient procedures to ensure the completeness of the population of journals (three audits) and insufficient testing in relation to certain risk characteristics (two audits).

Substantive analytical review

Substantive analytical review procedures involve the investigation of differences between recorded amounts and expected values above a predetermined threshold. On two audits the threshold set for further investigation exceeded the materiality level set for audit testing purposes. On a third audit, the audit team accepted, without adequate investigation, a difference higher than the materiality level set for audit testing purposes. The firm should review its methodology in this area and how it is applied in practice.

Use of internal specialists

In three audits (including one audit referred to in the "*Audit of goodwill and other assets"* section and one audit referred to in the "*inventories*" section above) we considered there to be insufficient use of KPMG valuation or insurance experts when assessing matters that required detailed knowledge in a field other than auditing and accounting.

Other findings

Independence and ethics - non-audit services

On two audits there was insufficient evidence that the audit team had given appropriate consideration to independence threats, and related safeguards, arising from the provision of non-audit services. There was insufficient written communication to the Audit Committee of independence threats and the related safeguards applied on these audits and a further four audits.

On three audits, it was unclear why certain engagement partners responsible for the audit of significant components or certain specialist partners had not been identified as key partners involved in the audit for partner rotation purposes. One of these partners had been involved in the audit for longer than seven years, thereby increasing the risk of an actual or perceived loss of independence.

Auditor's report

UK auditing standards introduced a requirement for extended auditor reports for listed and certain other entities[2] with effect from September 2013 year-ends. The audit report is now required to include a description of those assessed risks of material misstatement which had the greatest effect on the audit, an explanation of how the concept of materiality was applied and an overview of the scope of the audit. The firm introduced detailed guidance and additional quality control procedures in this area.

Most of the audits we reviewed were affected by these new requirements. In four audits, the audit report, in certain respects, did not accurately describe the procedures performed by the audit team.

In another audit, the materiality level disclosed in the audit report had been inappropriately rounded up by management during the final stage of publishing the audited financial statements and this amendment was not identified by the audit team.

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[2] Entities which apply the UK Corporate Governance Code.

Engagement quality control reviews

There was insufficient evidence of involvement by the engagement quality control reviewer ("EQCR") on 11 audits. Our findings included insufficient evidence of review of certain audit work performed for significant risk areas and failure to follow up how the audit team had addressed matters which the EQCR had raised. On one further audit where we considered that the appointment of an EQCR would have been appropriate, no EQCR was appointed.

Communications with the Audit Committee

We considered the quality and timeliness of the firm's communications with the Audit Committee on all the audits we reviewed. This was generally of a good standard. However, the reporting of identified significant risks to Audit Committees required improvement on two audits. In both cases, and on a further three audits, the risk of management override of controls and/or the risk of fraud in revenue recognition, presumed to be areas of significant risk under Auditing Standards, were not adequately communicated. It was unclear on some audits why control deficiencies (three audits) and disclosure errors or omissions (two audits) identified by the audit team had not been reported to the Audit Committee.

Review of financial statements

The firm's processes for review of the financial statements did not result in certain disclosure deficiencies being identified on four audits reviewed. These deficiencies included those relating to intangible assets referred to in the "*Audit of goodwill and other assets"* section above.

2.2 Review of the firm's policies and procedures

The firm's policies and procedures are developed globally and the UK firm puts significant resources into its central support functions, such as risk management, audit and accounting technical, independence compliance and HR.

Improvements made during the year

Significant improvements were made during the year to the firm's policies, procedures and guidance in relation to independence and ethics and the approach to bank audits. Further details are set out later in this section.

Enhancements were also made in respect of the approach to the audit of general IT controls. This included a significant increase in the number of IT audit specialists, improvements to the firm's audit system in this area and new guidance for all audit staff.

In response to our focus on letterbox companies in the prior year, the firm significantly enhanced its guidance and training in this area. In particular, the firm agreed with various overseas network firms a new approach to evidencing the audit of letterbox companies such that one audit file is prepared for the audit, irrespective of the network firm undertaking the work. We consider this a positive development to ensure the audit engagement partner can fully evidence their involvement in all necessary aspects of these audits.

The firm significantly enhanced its internal monitoring of firm-wide policies and procedures in the prior year, including tests being undertaken throughout the year and setting up a team dedicated to internal monitoring. The enhanced procedures are designed to ensure that issues identified are addressed on a timely basis and we consider the effort taken by the firm in this area to be of particular benefit to the firm's quality control environment.

Prior year findings not adequately addressed

The following prior year findings had not been adequately addressed by the firm at the time of our inspection.

Independence and ethics – Financial interests in audited entities

The firm has made significant changes to its processes and procedures relating to partners holding financial interests in audited entities in response to concerns we raised in the prior year. The improvements include enhanced training and guidance; strengthening central teams with responsibility for independence and ethics; additional procedures to be performed by all partners including consultation with the central team prior to all investments; and increased monitoring of compliance with the firm's procedures.

A number of prohibited investments in audited entities have continued to be identified by the firm. These cases have been considered by the firm's (recently established) Ethics Committee and the partners concerned have been fined by the firm in all but two cases.

However, the length of time between the identification and sale of prohibited investments was in four cases longer than is appropriate and, in one of these cases, was more than a month.

Pre-issuance reviews of financial statements

We recommended in prior years that the firm introduce a requirement for its technical department to review the clearance of any significant matters it raises in a pre-issuance technical review of the financial statements prior to the audit report being signed. The firm continues to take the view that the engagement partner, together with the EQCR, is responsible for deciding how such matters should be addressed. However, in January 2015 the firm issued new requirements for further consultation on significant matters arising from a pre-issuance review. These requirements took effect for 31 December 2014 year-ends for FTSE 100 audited entities and are effective from later year-end dates for other audited entities. We will consider the effectiveness of these changes in our future inspections.

Audit methodology – Materiality

In our prior year report we raised concerns in respect of the overall materiality levels set on a number of the audits reviewed and recommended that the firm should review and enhance its guidance on materiality. We were informed that revised guidance was being prepared globally but it had not yet been finalised and issued. While interim consultation requirements were introduced by the firm where proposed materiality levels were towards the higher end of KPMG's allowable ranges or based on a revenue benchmark, we continue to raise findings in relation to materiality levels set. It is important that the firm takes prompt action to address our findings in this area and assesses, on a timely basis, the sufficiency of those actions.

Use of offshore centres

Audit engagement teams have sole responsibility for determining the extent of use of offshore centres and the level of usage is significant and has continued to rise. Our prior year report recommended that the firm ensures that audit work is undertaken by staff with a sufficiently detailed working knowledge of the audited entity. In the current year, we remain concerned by some of the procedures performed by offshore staff. In particular, out of eight engagements sampled, we identified offshore staff performing procedures related to aspects of journal entry testing (four audits), reviewing board and executive meeting minutes (one audit) and completion of an industry-specific disclosure checklist (one audit).

Compliance with the firm's policies and procedures by offshore centres is monitored by KPMG India, who report significant findings to the UK firm. The reporting by KPMG India was, however, insufficiently detailed in relation to both the monitoring procedures undertaken and the findings identified and any actions taken or planned in response.

Monitoring of gifts and entertainment

The firm has maximum limits set for gifts and entertaining provided to audited entities by partners and staff. An issue was identified in the prior year relating to the firm's inability to monitor cumulative spend on individuals. This issue had not been addressed at the time of our inspection, although we were informed that a new system would be operational from May 2015.

Current year findings

We identified certain further areas where improvements to the firm's policies and procedures are required, as set out below.

Audit tenders

We reviewed a sample of five audit tender documents issued by the firm. In two instances we identified inappropriate and potentially misleading references to AQR inspection findings. In one of those tender documents the firm, as the existing auditor, stated that "the audit has satisfactorily been through a recent regulatory review" when in fact we reported that improvements were required in relation to aspects of the audit. The second tender document stated that the AQR inspection "focused on two areas that needed improvement." The areas selected for inclusion in the tender document were not a fair reflection of our findings.

In one of these two tender documents, KPMG had a senior manager seconded to the entity as the "Outsourced Head of Internal Audit" at the time of the external audit tender. The tender document identified the same individual as a proposed external audit senior manager. Had the proposal been successful, it is unclear how the individual could have performed this role without there being an actual or perceived lack of independence.

Audit quality monitoring – Review of financial services engagements

The firm has a senior UK partner as the financial services team leader for internal quality monitoring reviews. While all financial services reviews are undertaken by reviewers with relevant experience, this individual does not have a financial services background and, therefore, may not have appropriate experience to undertake all aspects of the role effectively.

Audit quality monitoring – Scope of review

Significant UK component audits were not consistently covered in the scope of the internal monitoring of group audits. Our review of one audit, which had also been reviewed as part of the firm's practice review, identified findings concerning the audit of contract revenues and related claims in relation to significant components (overseas and UK) of the group. The firm's review of this group audit did not identify these matters as it did not cover those significant components.

Other matters

Banking thematic review

In December 2013, the FRC announced that, during 2014, it would perform a thematic review of the quality of bank and building society audits, focusing on the audit of loan loss provisions and related IT controls. The thematic review sought to identify why progress in improving audit quality in these areas had been slow and what further action was needed to achieve the necessary improvements. As part of the thematic review, we reviewed the policies and procedures applied by the firm in conducting bank and building society audits.

The firm has made significant improvements in addressing concerns raised previously, through the introduction of additional initiatives and increased leadership focus on loan loss provisioning and related IT controls. This includes the enhanced use of benchmarking procedures; knowledge sharing and peer review of audit strategies amongst teams; and the increased use of data analytics. The quality of interaction with IT specialists has further improved and the use of other internal specialists has increased, although they need to be better integrated with the audit team.

The FRC published a report in December 2014 setting out the principal findings of the thematic review and identifying key messages arising for both auditors and audit committees.

Transparency report

We reviewed the firm's transparency report for the year to 30 September 2014, which was published in December 2014, to assess whether the information in the report was consistent with our understanding of the firm's quality control and independence procedures. We did not identify any inconsistencies with our understanding of the firm's quality control and independence procedures.

In common with certain other major audit firms, the transparency report was enhanced to identify factors which contribute to audit quality, in particular a summary and metrics relating to the firm's internal monitoring processes. We believe this is a positive development.

Andrew Jones

Director

Audit Quality Review

FRC Conduct Division

29 May 2015

Appendix A – Objectives, scope and basis of reporting

Scope and objectives

The overall objective of our work is to monitor and promote improvements in the quality of auditing. As part of our work, we monitor compliance with the regulatory framework for auditing, including the Auditing Standards, Ethical Standards and Quality Control Standards for auditors issued by the FRC and other requirements under the Audit Regulations issued by the relevant professional bodies. The standards referred to in this report are those effective at the time of our inspection or, in relation to our reviews of individual audits, those effective at the time the relevant audit was undertaken.

Our reviews of individual audit engagements and the firm's policies and procedures supporting audit quality cover, but are not restricted to, the firm's compliance with the requirements of relevant standards and other aspects of the regulatory framework. Our reviews place emphasis on the appropriateness of key audit judgments made in reaching the audit opinion together with the sufficiency and appropriateness of the audit evidence obtained. We also assess the extent to which the firm has addressed the findings arising from our previous inspection.

We seek to identify areas where improvements are, in our view, needed in order to safeguard audit quality and/or comply with regulatory requirements and to agree an action plan with the firm designed to achieve these improvements. Accordingly, our reports place greater emphasis on weaknesses identified which require action by the firm than areas of strength and are not intended to be a balanced scorecard or rating tool.

Our inspection was not designed to identify all weaknesses which may exist in the design and/or implementation of the firm's policies and procedures supporting audit quality or in relation to the performance of the individual audit engagements selected for review and cannot be relied upon for this purpose.

The professional accountancy bodies in the UK register firms to conduct audit work. Their monitoring units are responsible for monitoring the quality of audit engagements falling outside the scope of independent inspection but within the scope of audit regulation in the UK. Their work, which is overseen by the FRC, covers audits of UK incorporated companies and certain other entities which do not have any securities listed on the main market of the London Stock Exchange and whose financial condition is not otherwise considered to be of major public interest. All matters raised in this report are based solely on the work which we carried out for the purposes of our inspection.

Basis of reporting

We exercise judgment in determining those findings which it is appropriate to include in our public report on each inspection, taking into account their relative significance in relation to audit quality, in the context of both the individual inspection and any areas of particular focus in our overall inspection programme for the year. Where appropriate, we have commented on themes arising or issues of a similar nature identified across more than one audit.

While our public reports seek to provide useful information for interested parties, they do not provide a comprehensive basis for assessing the comparative merits of individual firms. The findings reported for each firm in any one year reflect a wide range of factors, including the number, size and complexity of the individual audits selected for review which, in turn, reflects the firm's client base. An issue reported in relation to a particular firm may therefore apply equally to other firms without having arisen in the course of our inspection fieldwork at those other firms in the relevant year. Also, only a small sample of audits are selected for review at each firm and the findings may therefore not be representative of the overall quality of each firm's audit work.

The fieldwork at each firm is completed at different times during the year and rigorous quality control procedures are applied. These procedures include a peer review process at staff level and a final review by independent non-executives who approve the issue of all reports. These processes are designed to ensure both a high quality of reporting and that a consistent approach is adopted across all inspections.

We also issue confidential reports on individual audits reviewed during an inspection. While these reports are addressed to the relevant audit engagement partner or director, they are copied to the chair of the relevant entity's audit committee (or equivalent body).

Purpose of this report

This report has been prepared for general information only. The information in this report does not constitute professional advice and should not be acted upon without obtaining specific professional advice.

To the full extent permitted by law, the FRC and its employees and agents accept no liability and disclaim all responsibility for the consequences of anyone acting or refraining from acting in reliance on the information contained in this report or for any decision based on it.

Appendix B – Firm's response

The firm's response is on the following page

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13 May 2015

Dear Sirs

Audit Quality Inspection report 2014/15

We thank you for the opportunity to respond to the above Audit Quality Inspection report.

We are pleased with the positive impact of improvements we have made from implementing previous action plans but are not complacent and continue to enhance internal policies and procedures to deliver ongoing improvements to audit quality.

We recognise the fundamental importance of audit quality to our reputation and the public interest role of auditors at large. We remain fully committed to continuous improvement in audit quality and independence processes and invest significant time and resources in developing and implementing our response to internal and external inspection findings. We consider the root cause behind each of the FRC's findings and reflect on these as our action plan is developed. Many of our actions are well advanced as we respond as issues are identified during the course of the inspection process.

We would like to thank the inspection team for the constructive way reviews are performed and their time and efforts in working with us to achieve a common goal of audit quality improvement.

Further information about our approach to delivering audit quality is set out in our Transparency Report available at

http://www.kpmg.com/uk/en/about/aboutkpmg/pages/transparencyreport.aspx .

Yours faithfully

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