



AUDIT INSPECTION UNIT

PUBLIC REPORT ON THE 2010/11 INSPECTION OF KPMG LLP AND KPMG AUDIT PLC

26 JULY 2011

Inspection between March 2010 to February 2011

1 Background information and key messages

1.1 Introduction

This report sets out the principal findings arising from the inspection of KPMG LLP and KPMG Audit Plc (“KPMG” or “the firm”) carried out by the Audit Inspection Unit (“the AIU”) of the Professional Oversight Board (“the Oversight Board”), part of the Financial Reporting Council (“the FRC”), in respect of the year to 31 March 2011 (“the 2010/11 inspection”). Our inspection was conducted in the period from March 2010 to February 2011 (referred to as “the time of our inspection”). 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 14 audit engagements undertaken by the firm in our 2010/11 inspection. These related to FTSE 100, FTSE 250, other listed and other major public interest entities, with financial year ends between September 2009 and February 2010. Our reviews were selected on a risk basis, utilising a risk model, and covered only selected aspects of the audits.

Each year we select a number of areas of particular focus. For 2010/11, these were: the fair value measurement of assets and liabilities, the impairment of assets (including goodwill and other intangible assets), revenue recognition and fraud risks, segmental reporting and the evaluation of going concern. Certain of our reviews were restricted to some or all of these areas.

In addition, we undertook two follow-up reviews to assess the extent to which our prior year findings on those audits had been addressed in the following year’s audit.

Our review of the firm’s policies and procedures supporting audit quality covered 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

The AIU estimates that the firm had 413 audit clients within the scope of independent inspection by the AIU as at the 2010/11 reference date of 26 February 2010. Of these audit clients, AIU records show that 171 had securities listed on the main market of the London Stock Exchange, including 22 FTSE 100 audit clients and 49 FTSE 250 audit clients.

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 our view, has appropriate policies and procedures in place for its size and the nature of its client base in the relevant areas which are subject to our review. Nevertheless, we have identified certain areas where improvements are required to those procedures, which are set out in this report.

Our principal findings, as set out in section 2, largely relate to the application, rather than the design, of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits.

1.4 Key messages

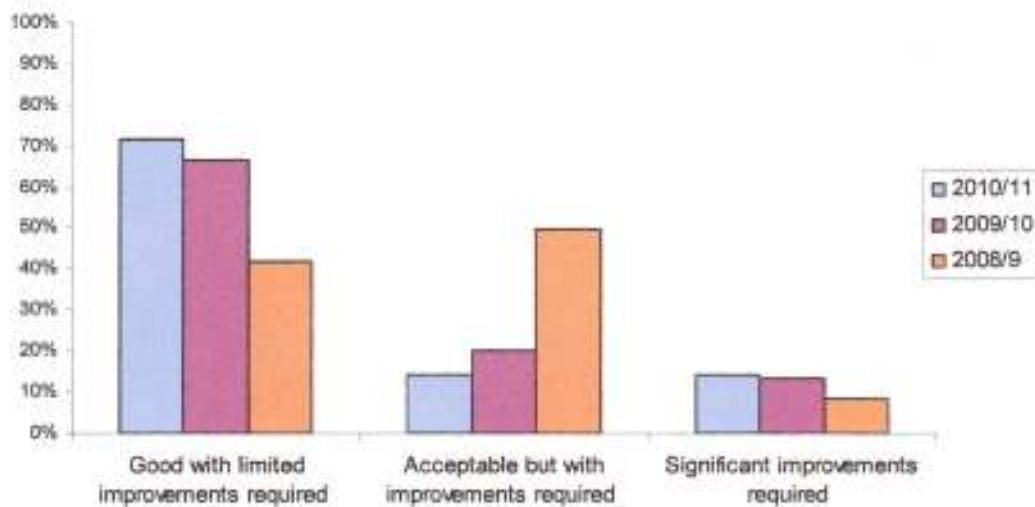
The firm should pay particular attention to the following areas in order to enhance audit quality:

- Ensure that audit teams apply appropriate professional scepticism to information prepared by the audited entity's staff that is significant to material amounts included in the financial statements (such as provisions or recognised revenue) and test its reliability.
- Consider the need for further action to improve the overall consistency of work performed on key judgment areas.
- Ensure that the improvements made to the partner appraisal system are also applied to audit managers, particularly in relation to selling non-audit services to entities which are audited by the firm.
- Readdress as a priority our recurring findings in relation to substantive analytical review where there are implications for the sufficiency of substantive testing and as a

result the overall audit evidence obtained. A focused initiative is required to eliminate the recurrence of issues in this area.

- Monitor more rigorously the application of finalisation policies and file assembly procedures.

The chart below shows the percentage of the audits we reviewed in 2010/11 by AIU grade with comparative figures for 2009/10 and 2008/9.



Due to the size of the samples involved, changes in performance from one year to the next are not necessarily indicative of an overall change in audit quality.

Findings in relation to audit evidence and judgments

The focus of our reviews has been on the audit evidence and related judgments for material areas of the financial statements and areas of significant risk. We reviewed a number of key audit judgments, paying particular attention to impairment of goodwill and other intangibles, the valuation of assets held at fair value, revenue recognition and fraud risks, segmental reporting and the going concern assessment.

We draw attention to the following findings which the firm should ensure are adequately addressed in future audits.

- Impairment of loans

Improvements were required in the audit of loan impairment in three audits we reviewed. Collective provisions were established in each case for impairments incurred by the end of the year but not yet reported. In each case we raised issues on the sufficiency of audit evidence supporting certain aspects of the techniques adopted by management to assess the level of collective provision required. Also, in one case, there was insufficient review of the work performed by overseas audit teams in relation to significant specific loan impairments incurred during the year.