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**Report on**  
**2006 Inspection of KPMG LLP (Canada)**

**Issued by the**  
**Public Company Accounting Oversight Board**

**October 18, 2007**

**THIS IS A PUBLIC VERSION OF A PCAOB INSPECTION REPORT**

**PORTIONS OF THE COMPLETE REPORT ARE OMITTED  
FROM THIS DOCUMENT IN ORDER TO COMPLY WITH  
SECTIONS 104(g)(2) AND 105(b)(5)(A)  
OF THE SARBANES-OXLEY ACT OF 2002**

PCAOB RELEASE NO. 104-2007-128



### **Preface to Reports Concerning Annually Inspected Firms**

The Sarbanes-Oxley Act of 2002 requires the Public Company Accounting Oversight Board ("PCAOB" or "the Board") to conduct an annual inspection of each registered public accounting firm that regularly provides audit reports for more than 100 issuers. The Board's report on any such inspection includes this preface to provide context for information in the public portion of the report.

A Board inspection includes, among other things, a review of selected audits of financial statements. If the Board inspection team identifies deficiencies in those audits, it alerts the firm to the deficiencies during the inspection process. Deficiencies that exceed a certain significance threshold are also summarized in the public portion of the Board's inspection report. The Board encourages readers to bear in mind two points concerning those reported deficiencies.

First, inclusion in an inspection report does not mean that the deficiency remained unaddressed after the inspection team brought it to the firm's attention. Under PCAOB standards, a firm must take appropriate action to assess the importance of the deficiency to the firm's present ability to support its previously expressed audit opinions. Depending upon the circumstances, compliance with these standards may require the firm to perform additional audit procedures, or to inform a client of the need for changes to its financial statements, or to take steps to prevent reliance on previously expressed audit opinions. A Board inspection does not typically include review of a firm's actions to address deficiencies identified in that inspection, but the Board expects that firms are attempting to take appropriate action, and firms frequently represent that they have taken, are taking, or will take, action. If, through subsequent inspections or other processes, the Board determines that the firm failed to take appropriate action, that failure may be grounds for a Board disciplinary sanction.

Second, the Board cautions against drawing conclusions about the comparative merits of the annually inspected firms based on the number of reported deficiencies in any given year. The total number of audits reviewed is a small portion of the total audits performed by these firms, and the frequency of deficiencies identified does not necessarily represent the frequency of deficiencies throughout the firm's practice. Moreover, if the Board discovers a potential weakness during an inspection, the Board may revise its inspection plan to target additional audits that may be affected by that weakness, and this may increase the number of deficiencies reported for that firm in that year. Such weaknesses may emerge in varying degrees at different firms in different years.



### **Notes Concerning this Report**

1. Portions of this report may describe deficiencies or potential deficiencies in the systems, policies, procedures, practices, or conduct of the firm that is the subject of this report. The express inclusion of certain deficiencies and potential deficiencies, however, should not be construed to support any negative inference that any other aspect of the firm's systems, policies, procedures, practices, or conduct is approved or condoned by the Board or judged by the Board to comply with laws, rules, and professional standards.
2. Any references in this report to violations or potential violations of law, rules, or professional standards should be understood in the supervisory context in which this report was prepared. Any such references are not a result of an adversarial adjudicative process and do not constitute conclusive findings of fact or of violations for purposes of imposing legal liability. Similarly, any description herein of a firm's cooperation in addressing issues constructively should not be construed, and is not construed by the Board, as an admission, for purposes of potential legal liability, of any violation.
3. Board inspections encompass, among other things, whether the firm has failed to identify departures from U.S. Generally Accepted Accounting Principles ("GAAP") or Securities and Exchange Commission ("SEC" or "Commission") disclosure requirements in its audits of financial statements. This report's descriptions of any such auditing failures necessarily involve descriptions of the related GAAP or disclosure departures. The Board, however, has no authority to prescribe the form or content of an issuer's financial statements. That authority, and the authority to make binding determinations concerning an issuer's compliance with GAAP or Commission disclosure requirements, rests with the Commission. Any description, in this report, of perceived departures from GAAP or Commission disclosure requirements should not be understood as an indication that the Commission has considered or made any determination regarding these issues unless otherwise expressly stated.



## 2006 INSPECTION OF KPMG LLP (Canada)

In 2006, the Board conducted an inspection of KPMG LLP (Canada) ("KPMG" or "the Firm"). The Board is today issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The Board is making portions of the report publicly available. Specifically, the Board is releasing to the public Part I of the report and portions of Part IV of the report. Part IV of the report consists of the Firm's comments, if any, on a draft of the report.<sup>1/</sup>

The Board has elsewhere described in detail its approach to making inspection-related information publicly available consistent with legal restrictions.<sup>2/</sup> A substantial portion of the Board's criticisms of a firm (specifically criticisms of the firm's quality control system), and the Board's dialogue with the firm about those criticisms, occurs out of public view, unless the firm fails to make progress to the Board's satisfaction in addressing those criticisms. In addition, the Board generally does not disclose otherwise nonpublic information, learned through inspections, about the firm or its clients. Accordingly, information in those categories generally does not appear in the publicly available portion of an inspection report.

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<sup>1/</sup> The Board does not make public any of a firm's comments that address a nonpublic portion of the report. In addition, pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(b), if a firm requests, and the Board grants, confidential treatment for any of the firm's comments on a draft report, the Board does not include those comments in the final report at all. The Board routinely grants confidential treatment, if requested, for any portion of a firm's response that addresses any point in the draft that the Board omits from, or any inaccurate statement in the draft that the Board corrects in, the final report.

<sup>2/</sup> See Statement Concerning the Issuance of Inspection Reports, PCAOB Release No. 104-2004-001 (August 26, 2004).

## **PART I**

### **INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS**

Members of the Board's inspection staff ("the inspection team") performed an inspection of the Firm from April 2006 to September 2006.<sup>3/</sup> The inspection team performed field work at the Firm's national office in Toronto ("National Office") and at five of its 34 practice offices.

Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.<sup>4/</sup> To achieve that goal, Board inspections include reviews of certain aspects of selected audits performed by the firm and reviews of other matters related to the firm's quality control system.

In the course of reviewing aspects of selected audits, an inspection may identify ways in which a particular audit is deficient, including failures by the firm to identify, or to address appropriately, respects in which an issuer's financial statements do not present fairly the financial position, results of operations, or cash flows of the issuer in conformity with GAAP.<sup>5/</sup> It is not the purpose of an inspection, however, to review all of a firm's audits or to identify every respect in which a reviewed audit is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer clients' financial statements, are free of any deficiencies not specifically described in an inspection report.

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<sup>3/</sup> The Board's inspection was conducted in cooperation with the Canadian Public Accountability Board.

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

<sup>5/</sup> When the Board becomes aware that an issuer's financial statements appear not to present fairly, in a material respect, the financial position, results of operations, or cash flows of the issuer in conformity with GAAP, the Board's practice is to report that information to the SEC, which has jurisdiction to determine proper accounting in issuers' financial statements.

A. Review of Audit Engagements

The scope of the inspection procedures performed included reviews of aspects of selected audits of financial statements performed by the Firm. Those audits and aspects were selected according to the Board's criteria, and the Firm was not allowed an opportunity to limit or influence the selection process.

In reviewing the audits, the inspection team identified matters that it considered to be audit deficiencies.<sup>6/</sup> Those deficiencies included failures by the Firm to perform, or to perform sufficiently, certain necessary audit procedures.

In some cases, the conclusion that the Firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if the Firm claims to have performed the procedure. With respect to those audits required to comply with PCAOB auditing standards,<sup>7/</sup> Auditing Standard No. 3, *Audit Documentation* ("AS No. 3") provides that, in various circumstances including PCAOB inspections, a firm that has not adequately documented that it performed a procedure, obtained evidence, or reached an appropriate conclusion must demonstrate with persuasive other evidence that it did so, and that oral assertions and explanations alone do not constitute persuasive other evidence.<sup>8/</sup> For purposes of the inspection, an observation that the Firm did not perform a procedure, obtain evidence, or reach an appropriate conclusion may be based on the absence of such documentation and the absence of persuasive other evidence.

When deficiencies are identified after the date of the audit report with respect to an audit conducted in accordance with PCAOB auditing standards, PCAOB standards require a firm to take appropriate actions to assess the importance of the deficiencies to

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<sup>6/</sup> The discussion in this report of any deficiency observed in a particular audit reflects information reported to the Board by the inspection team and does not reflect any determination by the Board as to whether the Firm has engaged in any conduct for which it could be sanctioned through the Board's disciplinary process.

<sup>7/</sup> Some of the Firm's issuer audit clients file reports with the Commission under the multijurisdictional disclosure system, which, as implemented, permits the filing of financial statements that have been audited in accordance with Canadian generally accepted auditing standards rather than PCAOB auditing standards.

<sup>8/</sup> See AS No. 3, paragraph 9; Appendix A to AS No. 3, paragraph A28.

the firm's present ability to support its previously expressed opinions,<sup>9/</sup> and failure to take such actions could be a basis for Board disciplinary sanctions. In response to the inspection team's identification of deficiencies, the Firm, in some cases, performed additional procedures or supplemented its work papers.<sup>10/</sup>

In some cases, the deficiencies identified were of such significance that it appeared to the inspection team that the Firm, at the time it issued its audit report, had not obtained sufficient competent evidential matter to support its opinion on the issuer's financial statements. The deficiencies that reached this degree of significance are described below, on an audit-by-audit basis.

#### Issuer A

The issuer engaged the services of an outside specialist to appraise three investment properties where indicators of impairment were identified. The specialist's work indicated that the investment properties' fair market value was approximately 53 percent of their carrying value. The issuer disagreed with certain key assumptions that the specialist had used and prepared a revised analysis for two of the properties, which resulted in an increase of 16 percent in the total appraised values. This difference represented approximately ten percent of the issuer's income before taxes.

The Firm accepted the issuer's conclusion that certain key assumptions used in two of the property appraisal reports were unreasonable, and the Firm recalculated the values using the issuer's assumptions. Other than making inquiries of management, however, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had performed any procedures to evaluate the appropriateness of the issuer's assumptions. For example, the Firm did not contact the specialist to ascertain the specialist's perspective on the issuer's changes to the underlying assumptions or on the issuer's characterization of the specialist's assumptions.

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<sup>9/</sup> See AU 390, *Consideration of Omitted Procedures After the Report Date* and AU 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (both included among the PCAOB's interim auditing standards, pursuant to PCAOB Rule 3200T).

<sup>10/</sup> The Board inspection process generally did not include review of such additional procedures or documentation, although future Board inspections of the Firm may, as appropriate, include further review of these matters.

#### Issuer B

In this audit, the Firm failed to adequately test the existence of inventory produced by the issuer's precious metal mining operations. For finished goods, the Firm obtained its audit assurance primarily through an analytical procedure that involved comparing the year-end balance to the ending balance for the preceding year and obtaining management's explanation for the difference. The analytical procedure did not qualify as a substantive analytical procedure because the Firm failed to develop an expectation of the ending balance and failed to obtain corroboration of management's explanation for the difference. For work-in-process, there was no evidence in the audit documentation, and no persuasive other evidence, that the Firm had tested certain of the data (other than by comparing them to untested reports) and no such evidence that the Firm had tested a significant assumption that the issuer had used to estimate the balance.

#### Issuer C

The issuer received duplicate payments from many of its customers and recorded such overpayments as income 90 days after receipt unless the customer requested a refund or credit. The issuer did not record an estimated liability for the potential reimbursement of the overpayments beyond the 90-day period. The issuer did not disclose this business practice and the related accounting treatment in its financial statements or regulatory filings. The Firm failed to test the amount of overpayments, or obtain corroboration, beyond inquiry of management, of the issuer's assertion that customers rarely request reimbursement after the 90 days. The Firm concurred with the issuer's decision to account for the overpayments as operating income and failed to evaluate whether the overpayments should instead have been treated as liabilities and/or whether the business practice and related accounting treatment should have been disclosed.

#### B. Review of Quality Control System

In addition to evaluating the quality of the audit work performed on specific audits, the inspection included review of certain of the Firm's practices, policies, and procedures related to audit quality. This review addressed practices, policies, and procedures concerning audit performance and the following eight functional areas: (1) tone at the top; (2) practices for partner evaluation, compensation, admission, assignment of responsibilities, and disciplinary actions; (3) independence implications of non-audit services; business ventures, alliances, and arrangements; personal financial interests; and commissions and contingent fees; (4) practices for client acceptance and

retention; (5) practices for consultations on accounting, auditing, and SEC matters; (6) the Firm's internal inspection program; (7) practices for establishment and communication of audit policies, procedures, and methodologies, including training; and (8) the supervision by the Firm's audit engagement teams of the work performed by non-Canadian affiliates on non-Canadian operations of the Firm's issuer audit clients. Any defects in, or criticisms of, the Firm's quality control system are discussed in the nonpublic portion of this report and will remain nonpublic unless the Firm fails to address them to the Board's satisfaction within 12 months of the date of this report.

END OF PART I



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Inspection of KPMG LLP (Canada)  
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PARTS II AND III OF THIS REPORT ARE NONPUBLIC  
AND ARE OMITTED FROM THIS PUBLIC DOCUMENT

**PART IV**

**RESPONSE OF THE FIRM TO DRAFT INSPECTION REPORT**

Pursuant to section 104(f) of the Act, 15 U.S.C. § 7214(f), and PCAOB Rule 4007(a), the Firm provided a written response to a draft of this report. Pursuant to section 104(f) of the Act and PCAOB Rule 4007(b), the Firm's response, minus any portion granted confidential treatment, is attached hereto and made part of this final inspection report.<sup>11/</sup>

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<sup>11/</sup> In any version of an inspection report that the Board makes publicly available, any portions of a firm's response that address nonpublic portions of the report are omitted. In some cases, the result may be that none of a firm's response is made publicly available.



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Mr. George H. Diacont  
Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street N.W.  
Washington, DC 20006

September 26, 2007

Dear Mr. Diacont:

**Re: Public Response to Part I of Public Company Accounting Oversight Board (PCAOB)  
Draft Report on 2006 Inspection (2006 PCAOB Report) of KPMG LLP (KPMG  
Canada)**

We are pleased to respond to Part I of the 2006 PCAOB Report.

KPMG Canada is committed to conducting the highest quality audits and to prompt and effective response to constructive observations and recommendations. We have made and will continue to make improvements in our audit methodology, quality control processes and engagement execution and will maintain our full cooperation with the PCAOB as it continues its ongoing inspection process.

Just as auditors use their judgment to determine auditing procedures to be performed, the PCAOB inspection staff's observations are based upon their judgments regarding audit risk assessments and financial statement materiality. While we may have differing views as to the nature and extent of necessary audit procedures, resulting conclusions, and/or required documentation in specific circumstances, we recognize that judgments are involved in both the performance of an audit and the subsequent inspection process, and we view the PCAOB's comments as very helpful and give each careful and thoughtful consideration.

KPMG Canada has over 100 SEC registrant audit clients and is therefore subject to an annual inspection by the PCAOB. In Canada, the Canadian Public Accountability Board (CPAB) was formed in 2003 to carry out inspections of Canadian accounting firms. All major accounting firms in Canada, including KPMG Canada, have been subject to annual CPAB inspections, starting in 2004. The 2006 PCAOB inspection of KPMG Canada was carried out in conjunction with CPAB's



2006 inspection. Generally the matters raised in the 2006 PCAOB Report are matters that were also raised and responded to by KPMG Canada in the CPAB 2006 report.

With respect to the findings identified in Part I of the 2006 PCAOB Report, we have addressed each of the matters identified by the PCAOB by performing additional audit procedures, improving audit documentation or concluding that no additional actions were necessary. In all instances, our original audit conclusions remained unchanged.

We appreciate the professionalism of the PCAOB inspection staff and the role the PCAOB plays in improving audit quality. While the requirement to have two separate inspections invariably leads to some duplication of effort, we recognize the efforts of both the PCAOB and CPAB towards performing their inspections in a coordinated manner. We also want to recognize the professionalism and diligence displayed by the partners and employees of KPMG Canada as they continuously strive to execute high quality audits.

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KPMG Canada is committed to continually improving our firm and the profession and working constructively with the PCAOB and CPAB to improve audit quality. Thank you for your assistance in this effort.

Very truly yours,

KPMG LLP