

**Report on**  
**2013 Inspection of Kesselman & Kesselman C.P.A.s**  
**(Headquartered in Tel-Aviv, State of Israel)**

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

**February 27, 2014**

**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**

## **2013 INSPECTION OF KESSELMAN & KESSELMAN C.P.A.s**

In 2013, the Public Company Accounting Oversight Board ("PCAOB" or "the Board") conducted an inspection of the registered public accounting firm Kesselman & Kesselman C.P.A.s<sup>1/</sup> ("the Firm"). The Board is issuing this report of that inspection in accordance with the requirements of the Sarbanes-Oxley Act of 2002 ("the Act").

The inspection process is designed, and inspections are performed, to provide a basis for assessing the degree of compliance by a firm with applicable requirements related to issuer audit engagements. The inspection process included reviews of aspects of selected issuer audit work completed by the inspected firm. The reviews were intended to identify whether such deficiencies existed in those aspects of the audit work, and whether such deficiencies indicated weaknesses or defects in the firm's system of quality control over issuer audit work. In addition, the inspection included reviews of policies and procedures related to certain quality control processes of the firm that could be expected to affect audit quality.

The issuer audit engagements and aspects of that work inspected were selected based on a number of risk-related and other factors. Due to the selection process, the deficiencies included in this report are not necessarily representative of the Firm's issuer audit engagement practice.

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>2/</sup>

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<sup>1/</sup> The Firm has issued audit reports under the name of Kesselman & Kesselman Certified Public Accountants (Isr.).

<sup>2/</sup> In its *Statement Concerning the Issuance of Inspection Reports*, PCAOB Release No. 104-2004-001 (August 26, 2004), the Board described its approach to making inspection-related information publicly available consistent with legal restrictions. As described there, if the nonpublic portions of any inspection report discuss criticisms of or potential defects in a firm's system of quality control, those discussions also could eventually be made public, but only to the extent a firm fails to address the criticisms to the Board's satisfaction within 12 months of the issuance of the report.

## PART I

### INSPECTION PROCEDURES AND CERTAIN OBSERVATIONS

Members of the Board's inspection staff ("the inspection team") conducted primary procedures for the inspection from June 17, 2013 to June 27, 2013. These procedures were tailored to the nature of the Firm, certain aspects of which the inspection team understood at the outset of the inspection to be as follows:

Number of offices	4 (Beer-Sheva, Haifa, Jerusalem, and Tel-Aviv, State of Israel)
Ownership structure	Partnership
Number of partners	56
Number of professional staff <sup>3/</sup>	829
Number of issuer audit clients <sup>4/</sup>	17
Number of other issuer audits in which the Firm plays a role <sup>5/</sup>	18

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<sup>3/</sup> "Professional staff" includes all personnel of the Firm, except partners or shareholders and administrative support personnel. The number of partners and professional staff is provided here as an indication of the size of the Firm, and does not necessarily represent the number of the Firm's professionals who participate in audits of issuers or are "associated persons" (as defined in the Act) of the Firm.

<sup>4/</sup> The number of issuer audit clients shown here is based on the Firm's self-reporting and the inspection team's review of certain information for inspection planning purposes. It does not reflect any Board determination concerning which, or how many, of the Firm's audit clients are "issuers" as defined in the Act. For information about audit reports issued by the Firm, see Item 4.1 of the Firm's annual reports on PCAOB Form 2, available at [www.pcaobus.org](http://www.pcaobus.org).

<sup>5/</sup> The number of other issuer audits encompasses audit work performed by the Firm in engagements for which the Firm was not the principal auditor, including

A. Review of Audit Engagements

The inspection procedures included a review of aspects of the Firm's auditing of financial statements of two issuers audit clients and the Firm's audit work on one other issuer audit engagement in which it played a role but was not the principal auditor. The inspection team identified what it considered to be audit deficiencies. The deficiencies identified in one of the audits performed by the Firm included deficiencies 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 appropriate audit evidence to support its opinion on the issuer's financial statements or internal control over financial reporting ("ICFR"). Those deficiencies were –

Issuer A

- (1) the failure, in an audit of ICFR, to perform sufficient procedures to test internal controls over the allocation of revenue and valuation of goodwill and other intangible assets;
- (2) the failure to perform sufficient procedures to test the valuation of intangibles assets; and
- (3) the failure, in testing the design and operating effectiveness of controls, to perform sufficient procedures regarding the use of the work of others.

B. Auditing Standards

Each of the deficiencies described in Part I.A of this report represents circumstances in which it appeared to the inspection team that the Firm failed to comply with the requirement to obtain sufficient appropriate audit evidence to support its opinion that the financial statements were presented fairly, in all material respects, in accordance with applicable accounting principles, and for its opinion concerning whether the issuer maintained, in all material respects, effective ICFR. Each deficiency relates to several applicable standards that govern the conduct of audit work.

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audits, if any, in which the Firm plays a substantial role as defined in PCAOB Rule 1001(p)(ii).

AU 230, *Due Professional Care in the Performance of Work* ("AU 230"), requires the independent auditor to plan and perform his or her work with due professional care. AU 230 and PCAOB Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement* ("AS No. 13"), specify that due professional care includes the exercise of professional skepticism. This is an attitude that includes a questioning mind and a critical assessment of the appropriateness and sufficiency of audit evidence.

AS No. 13 requires the auditor to design and implement audit responses that address the identified risks of material misstatement, and PCAOB Auditing Standard No. 15, *Audit Evidence* ("AS No. 15"), requires the auditor to plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for the audit opinion. Sufficiency is the measure of the quantity of audit evidence, and the quantity needed is affected by the risk of material misstatement and the quality of the audit evidence obtained. The appropriateness of evidence is measured by its quality; to be appropriate, evidence must be both relevant and reliable in support of the related conclusions.

PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* ("AS No. 5"), and AS No. 13 establish requirements regarding testing and evaluating ICFR. In an audit of ICFR in an integrated audit, AS No. 5 requires the auditor to plan and perform the audit to obtain appropriate evidence that is sufficient to support the auditor's opinion on ICFR as of the date of that opinion. AS No. 13 requires that, if the auditor plans to assess control risk at less than the maximum and to base the nature, timing, and extent of substantive procedures on that lower assessment, the auditor must obtain evidence that the controls tested were designed and operating effectively during the entire period for which the auditor plans to rely on controls to modify the substantive procedures.

Each deficiency described in Part I.A of this report involves, in the inspection team's view, a failure to comply with the provisions cited above and also a failure to perform, or perform sufficiently, certain specific audit procedures that are required by other applicable auditing standards. The table below lists the other specific auditing standards that are primarily implicated by the deficiencies identified in Part I.A of this report.<sup>6/</sup>

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<sup>6/</sup> This table does not necessarily include reference to every auditing standard that may have been implicated by the deficiencies included in Part I.A.

PCAOB Auditing Standards	Issuer
<i>AU 328, Auditing Fair Value Measurements and Disclosures</i>	A
<i>AU 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</i>	A

C. Review of Quality Control System

In addition to evaluating the quality of the audit work performed, 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 foreign affiliates. 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.

D. General Information Concerning PCAOB Inspections

Board inspections are designed to identify whether weaknesses and deficiencies exist related to how a firm conducts audit work and address any such weaknesses and deficiencies. To achieve that goal, Board inspections include reviews of certain aspects of selected audit work performed by the firm and reviews of other matters related to the firm's quality control system. The scope of the inspection procedures is determined according to the Board's criteria, and the firm is not allowed an opportunity to limit or influence the scope. The focus on weaknesses and deficiencies 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. Further, the inclusion in an inspection report of certain deficiencies and potential deficiencies should not be construed as an indication that the Board has made any determination about other aspects of the firm's systems, policies, procedures, practices, or conduct not included within the report.

In the course of reviewing aspects of selected audit work, an inspection may identify ways in which particular audit work is deficient, including failures by the firm to identify, or to address appropriately, departures from U.S. Generally Accepted Accounting Principles ("GAAP"), or, as applicable, International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").<sup>7/</sup> It is not the purpose of an inspection, however, to review all of a firm's audit work or to identify every respect in which an audit performed by the firm, or in which the firm played a role, is deficient. Accordingly, a Board inspection report should not be understood to provide any assurance that the firm's audits, or its issuer's clients' financial statements or reporting on internal control, are free of any deficiencies not specifically described in an inspection report.

In some cases, an inspection team's observation that a firm failed to perform a procedure may be based on the absence of documentation and the absence of persuasive other evidence, even if a firm claims to have performed the procedure. PCAOB 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. See AS No. 3, paragraph 9 and Appendix A to AS No. 3, paragraph A28.

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<sup>7/</sup> When it comes to the Board's attention 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 or IFRS, the Board's practice is to report that information to the Securities and Exchange Commission ("SEC" or "Commission"), which has jurisdiction to determine proper accounting in issuers financial statements. Any description in this report of financial statement misstatements or failures to comply with SEC disclosure requirements should not be understood as an indication that the SEC has considered or made any determination regarding these issues unless otherwise expressly stated.

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.

Inclusion of a deficiency 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, when audit deficiencies are discovered after the date of the audit report, a firm must take appropriate action to assess the importance of the deficiencies to the firm's present ability to support its previously expressed audit opinions.<sup>8/</sup> Depending upon the circumstances, compliance with these standards may require the firm to perform additional procedures, or to inform a client of the need for changes to its financial statements or reporting on internal control, or to take steps to prevent reliance on previously expressed audit opinions. A firm also should consider whether there are actions the firm should take to alert another auditor that has expressed an opinion on financial statements or ICFR that the firm played a role in auditing. 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.

END OF PART I

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<sup>8/</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), and AS No. 5, paragraph 98.





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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>9/</sup>

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<sup>9/</sup> The Board does not make public any of a firm's comments that address a nonpublic portion of the report unless a firm specifically requests otherwise. In some cases, the result may be that none of a firm's response is made publicly available. 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.



January 16, 2014

Ms. Helen A. Munter  
Director  
Division of Registration and Inspections  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006

Dear Ms. Munter,

**Re: Response to Draft Report on 2013 Inspection of Kesselman & Kesselman**

We are pleased to provide our response to Part I - Inspection Procedures and Certain Observations of the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") Draft Report on the 2013 Inspection of our firm dated December 18, 2013 (the "Report").

We support the PCAOB's inspection process and we value the insights provided by it. We are committed to addressing the issues identified in the Report in a thorough and thoughtful manner.

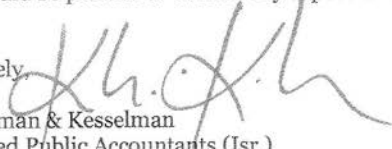
We have evaluated the observations set forth in Part I and taken appropriate actions under both PCAOB standards and our policies. Our evaluation included those steps that we considered necessary to comply with AU 390, Consideration of Omitted Procedures After the Report Date, and where applicable, AU 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report.

We believe that as with any audit process, judgments are necessarily involved in the inspection process and professionals can reach different conclusions about the adequacy of audit evidence in a particular circumstance. In those instances where such differences exist related to the inspection observations detailed in this Report, they generally related to the significance of the observation in relation to the audit evidence taken as a whole rather than the specific nature of the observation. So, while we may disagree with the significance of inspection observations in certain cases, we have taken all of the Board's observations into account in formulating our plan to continuously improve audit quality.

We continue to be committed to performing high-quality audits, and in doing so, meeting the needs and expectations of our stakeholders, including the PCAOB. This is the top priority of our partners. We look forward to continue working with the PCAOB in support of our continuous efforts to improve audit quality.

We would be pleased to discuss any aspect of our response or any further questions you may have.

Sincerely,

  
Kesselman & Kesselman  
Certified Public Accountants (Isr.)  
PwC Israel

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