AGENDA
A Financial Times Service

KPMG Accountants Charged With Stealing PCAOB Info

Article published on January 26, 2018
By Lindsay Frost

Earlier this week, the **SEC** charged six accountants at **KPMG** with participating in a scheme to misappropriate and use confidential information relating to the planned **Public Company Accounting Oversight Board**'s inspections of the audit firm. Two of those charged are former staffers at the PCAOB. The accountants are also currently facing criminal charges in the Southern District of New York for the incident.

Boards should look to the incident as a reminder of how important it is to oversee auditor independence and work with external auditors to maintain a high-quality audit, sources say.

"This type of fraud could happen anytime and during any given rotation," **Matteo Tonello**, managing director of corporate leadership at the **Conference Board**, writes in an e-mail. "Audit committees should therefore continue to be vigilant about any circumstance surrounding the external auditor's team, including the background and role performed by individual members, and be reassured that none of these relevant circumstances can jeopardize the independence of the team or individual professionals on the team."

The KPMG incident should remind audit committees how "elusive" auditor independence is, Tonello says, even though they are expected to regularly evaluate it. He says practices such as auditor rotation can help curb egregious cases of strained independence resulting from long-standing relationships between audit firms and companies, but can't prevent a case like this.

In general, audit committees have been disclosing more about their oversight of their external auditors to reassure investors they have the right firm. According to **EY**, 56% of 75 Fortune 100 audit committees disclosed factors used in their assessment of the external auditor qualifications and work quality in proxy statements last year.

Consequences of the Misconduct

According to the SEC, between 2015 and 2017, three former PCOAB officials, **Brian Sweet**, **Cynthia Holder** and **Jeffrey Wada**, provided "unauthorized disclosures of PCAOB plans for inspections of KPMG audits, enabling the former KPMG partners to analyze and revise audit workpapers in an effort to avoid negative findings by the PCAOB." Sweet and Holder, who eventually went on to work for KPMG, obtained the information while preparing for employment at KPMG, and Wada leaked information while seeking employment at the firm. The others charged were already employed by KPMG at a high level.

During that time, KPMG faced concerns over the number of deficiencies in its inspections. For example, in 2014 it received twice as many comments as the average for its competitors, according to PCAOB inspection results, and in 2015, 40% of the audits inspected contained deficiencies. Its 2016 inspection results have not been released yet, and the PCAOB noted that it has adjusted its inspection procedures and reselected the KPMG audits it would be inspecting, according to a statement provided to *The Wall Street Journal.* In its yearly inspection of audit firms, the PCAOB assesses compliance with laws, rules and professional standards in connection with a firm's audit work for public companies. According to a preview of its 2016 inspections, which as of November included more than 780 audits, the most frequent audit deficiencies identified fell under assessing and responding to risks of material misstatement, auditing internal controls over financial reporting and auditing accounting estimates, including fair value measurements.

"The new PCAOB Board will conduct an ongoing review of the organization's information technology and security controls, as well as its compliance and ethics protocols, to assess their effectiveness," PCAOB chairman **William Duhnke III** wrote in a statement this week.

"Obviously [with] any inspection process there needs to be a certain degree of confidentiality because you would need to have the ability to select the engagements you are going to inspect without having afforded enough notice [to the audit firm] to have any opportunity to risk the quality of that inspection or to risk it being compromised," says **Richard Chambers**, president and CEO of the **Institute of Internal Auditors**.

The scheme began in 2015 and lasted until February 2017. According to a statement from KPMG obtained by *Accounting Today*, the firm promptly notified authorities and has been cooperating with the government. The firm says it took "swift and decisive action" including engaging outside legal counsel to conduct a detailed investigation. Also in response to the incident, the firm replaced its top auditor last April.

Experts say the incident calls into question the revolving-door issue, i.e., people going from service at a regulator to a company overseen by that regulator, and vice versa. Tonello writes in an e-mail that KPMG should be recognized for its no-tolerance response and the decision to immediately terminate the employees, but this approach should start early in the onboarding process.

"Auditors, as well as other professional services firms, regularly hire former government agency staffers to benefit from the direct experience and insights gained in those public roles," Tonello says. "[But] consulting firms should recognize the unique risks to which the independence of new employees hired from government agencies is subject, and expect them to undergo induction programs specifically designed in collaboration with the firm's compliance department to set clear behavioral and independence standards expected by the firm."

Tonello, who also serves as a member of **Deutsche Telekom**'s advisory board on compliance culture, says tailor-made compliance programs should be used to discuss past or future interactions between the new employee and the former public employers, conducted with the employee acknowledging the firm's written policy as a part of its "tone at the top" approach.

However, Chambers says accountants can gain valuable insight from working as a regulator as long as there are safeguards built in, such as not being able to participate in inspections and regulatory matters involving the company.

The incident is another black eye for the Big Four, which has seen several scandals over the past few years. Some experts are also concerned with the Big Four's pervasive control over public company audits. According to **Audit Analytics**, as of last spring, EY accounted for 14.7% of public company audits; **PwC** accounted for 10.8%; KPMG, for 10.3%; and **Deloitte**, for 9.9%. Combined with six other audit firms, they account for more than 61% of all public company audits.

Other recent events have some observers questioning the audit quality at the Big Four. For example, just yesterday, **General Electric** announced that the SEC is investigating how the company recognized revenue from long-term service contracts. GE's auditor is KPMG. KPMG was also the audit firm at the time of the **Wells Fargo** accounts scandal and was questioned by regulators. Earlier this month, PwC was ruled negligent in connection with violating audit rules by not detecting signs of the fraud that led to the downfall of Colonial Bank.

Chambers says codes of conduct and ethics imbue the culture of any audit firm or organization, and those companies and regulators should always be diligent in fostering that culture. However, it's difficult to stop an individual who chooses to act against that culture, though it should be the organization's mission to detect bad actors.

According to the SEC, the audit opinions of the financial statements KPMG audited during the time of misconduct still stand, though the investigation is ongoing.

"I don't know that a company's risk of having had an [audit] engagement that was not properly conducted is necessarily increased by the engagement having been compromised," Chambers says. "If the engagement was done correctly, it was done correctly."