

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 71389 / January 24, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3530 / January 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15687

In the Matter of

KPMG LLP,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 4C AND 21C OF
THE SECURITIES EXCHANGE ACT OF
1934 AND RULE 102(e) OF THE
COMMISSION’S RULES OF PRACTICE,
MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C¹ and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) and Rule 102(e) of the Commission’s Rules of Practice against KPMG LLP (“KPMG” or “Respondent”).²

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to

¹ Section 4C provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct”

² Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . to have engaged in unethical or improper professional conduct.

which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below:

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

A. Summary

1. This matter concerns violations of the auditor independence rules by public accounting firm KPMG. The auditor independence rules are intended to ensure that auditors remain independent, both in fact and in appearance, from their Commission-registered audit clients ("SEC audit clients"). KPMG violated these rules concerning its relationships with and services provided to three of its public company audit clients or their affiliates. At various times from 2007 through the end of 2011, KPMG provided prohibited non-audit services to affiliates of three of its SEC audit clients: Company A, Company B and Company C. With regard to Company A, KPMG hired an employee who had recently retired from a senior position at Company A's affiliate, and then loaned him back to that affiliate to do the same work he had done as an employee of that affiliate. This engagement involved the loaned employee acting as a manager, employee and advocate for the affiliate, causing KPMG to violate Rule 2-01 of Regulation S-X of the Exchange Act. With regard to Company B, KPMG was its audit firm, but also provided various prohibited non-audit services, including restructuring, corporate finance, and expert services, to an affiliate of Company B. With regard to Company C, KPMG was its audit firm, but also provided prohibited non-audit services, including bookkeeping and payroll services, to affiliates of Company C. These non-audit services caused KPMG to violate the independence rules in relation to Company B and Company C. Finally, certain KPMG employees also owned stock in Company A and affiliates of Company B resulting in a further violation of the independence rules.

2. Despite this conduct, KPMG repeatedly represented that it was "independent" in audit reports issued on their financial statements, which were included or incorporated by reference in public filings with the Commission. By doing so, KPMG violated Rule 2-02(b) of Regulation S-X and Rule 10A-2 of the Exchange Act, and caused the three clients to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. KPMG's conduct also constituted improper professional conduct pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice.

B. Respondent

3. KPMG is a limited liability partnership registered in Delaware and headquartered in New York, NY. KPMG is registered with the Public Company Accounting Oversight Board (the "PCAOB"). KPMG is the U.S. member firm of KPMG International Cooperative ("KPMGI"). Pursuant to Rule 2-01 of Regulation S-X, KPMGI's foreign member

firms are included within the definition of “accountant,” which is defined to include associated entities.

C. Other Relevant Entities

4. Company A is a corporation located outside of the United States. Until September 2010, Company A’s common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange (“NYSE”) and one of KPMGI’s member firms served as Company A’s auditor. From August 2007 until June 2009, Company A held a minority interest in one of its U.S. affiliates. During the relevant time period, KPMG served as the U.S. affiliate’s auditor.

5. Company B is a Delaware limited partnership. Company B’s common limited partner units are registered with the Commission pursuant to Section 12(b) of the Exchange Act and trade on the NYSE. KPMG served as Company B’s auditor from 2005 until late 2011.

6. Company C is a Delaware corporation. Company C’s common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NYSE. KPMG has served as Company C’s auditor since 2008.

D. Legal Background

7. The purpose of Rule 2-01 of Regulation S-X is to ensure that auditors are qualified and independent of their SEC audit clients³ – both in fact and in appearance. The rule sets forth a non-exhaustive list of non-audit services which an auditor cannot provide to its audit clients and be considered independent. *See* 17 C.F.R. § 210-2.01(c)(4)(i)-(x). Among other things, it prohibits an auditor from providing bookkeeping services, payroll services, appraisal or valuation services, internal audit outsourcing services, legal services, expert services, and broker-dealer, investment adviser or investment bank services. *Id.* It also prohibits an auditor from designing and implementing financial information systems or performing human resources or management functions for its audit clients. *See* 17 C.F.R. § 210-2.01(c)(4)(ii), (vi) and (vii).

8. Pursuant to Rule 2-01(c)(4)(vi) of Regulation S-X, an auditor is specifically prohibited from “[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.” 17 C.F.R. § 210-2.01(c)(4)(vi). Similarly, Preliminary Note 2 to Rule 2-01 of Regulation S-X makes clear that, in applying the general standard of auditor independence set forth in Rule 2-01(b), the Commission considers, among three other principles, whether a relationship or service “results in the accountant acting as management or an employee of the audit client.” 17 C.F.R. § 210-2.01, Preliminary Note 2.

³ With certain exceptions that are not relevant here, “audit client” is defined as “the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates, of the audit client.” 17 C.F.R. § 210-2.01(f)(6) (emphasis added). In turn, “affiliate” is defined to include “[a]n entity that has control over the audit client, over which the audit client has control, or which is under common control with the audit client, including the client’s parents and subsidiaries. . . .” 17 C.F.R. § 210-2.01(f)(4)(i).

9. Under the “financial relationships” provision of Rule 2-01 of Regulation S-X, “[a]n accountant is not independent if, at any point during the audit and professional engagement period, the accountant has a direct financial interest or a material indirect financial interest in the accountant’s audit client.” 17 C.F.R. § 210-2.01(c)(1). This provision is triggered when “[t]he accounting firm or any covered person in the firm, or any of his or her immediate family members, has any direct investment in an audit client, such as stocks, bonds, notes, options, or other securities.” 17 C.F.R. § 210-2.01(c)(1)(i)(A). As relevant here, “covered person” includes any partner in the “chain of command;” any “managerial employee . . . who has provided ten or more hours of non-audit services to the audit client;” and any partner “from an ‘office’ of the accounting firm in which the lead audit engagement partner principally practices in connection with the audit.” 17 C.F.R. § 210-2.01(f)(11).

E. Prohibited Services Provided to Affiliate of Company A

10. In or around April 2007, an affiliate of Company A offered early retirement packages to certain employees as part of the affiliate’s economic recovery plan. One employee who worked as Senior Tax Counsel in the affiliate’s Office of Tax Affairs’ Trade & Customs Group accepted an early retirement package effective August 31, 2007. Prior to retirement, this individual’s work involved senior-level tasks, including tax compliance planning for the affiliate and its subsidiaries, as well as international customs planning and advice. Among other things, this individual was involved in planning related to the affiliate’s international expansion efforts and responding to customs audits by international taxing authorities. This long-time employee’s retirement created an immediate need for someone to fill this role for the affiliate of Company A.

11. In November 2007, after discussions with the affiliate of Company A about its staffing needs in this regard, KPMG hired the former employee of the affiliate to be loaned back to the affiliate. This employee was hired by KPMG at the manager level and loaned back to the affiliate of Company A to perform essentially the same senior-level work that this individual had performed as Senior Tax Counsel for the affiliate. In fact, the KPMG engagement letter specified that this individual was expected to devote all professional time over a period of two years “to assisting [the affiliate of Company A] with such tax consulting matters as [the affiliate’s] management may specify related to global customs compliance matters.” The individual had no other duties at KPMG.

12. Over the course of this engagement, the Company A affiliate’s former employee performed a range of tax consulting work for the affiliate, all under the supervision of this individual’s former supervisor at the affiliate. This individual’s work was substantially the same as the work performed as an employee of the affiliate. It included responding to international customs audits and inquiries, as well as advocating on the affiliate’s behalf in dealings with customs officials. As part of this work, this individual gathered information responsive to customs officials’ inquiries and provided advice to the affiliate, based on prior experience at the affiliate, about how to present this information to these officials. During Fall/Winter of 2008, this individual also traveled with a team of the affiliate’s employees to various European countries to meet with government officials on the affiliate’s behalf. In addition, this individual took part in discussions regarding major operational and structural issues, including discussions regarding the structure of the affiliate’s European operations.

13. From November 2007 until December 2008 (when KPMG terminated the engagement pursuant to which it loaned the Company A affiliate's former employee to the affiliate of Company A), all of this individual's professional time was spent doing work for the affiliate. In total, KPMG provided 1,897 hours of services in connection with this engagement with Company A's affiliate.

14. This engagement violated the independence rules because the affiliate's former employee acted as both a manager and an employee of Company A's affiliate and provided advocacy services for the affiliate. In addition, this individual was allowed to hold stock in Company A while providing manager-level services to Company A's affiliate for over a year, in further violation of the independence rules.

F. Prohibited Services Provided to Affiliate of Company B

15. KPMG was Company B's outside audit firm from 2005 until December 2011. On September 1, 2006, Company B became an affiliate of a large financial services firm when one of the financial services firm's subsidiaries purchased all the issued and outstanding stock of a controlling affiliate of Company B. The transaction resulted in the financial services firm becoming the owner of Company B's General Partner, which owned and controlled Company B. As a result of this transaction, and because KPMG was Company B's auditor at the time, the financial services firm should have been identified for independence purposes by KPMG as an affiliate of Company B as of September 1, 2006.

16. The financial services firm was a non-audit client of KPMG from at least 2006 through the end of 2011. KPMG provided a variety of non-audit services to the financial services firm, described further below. These services were appropriate until such time that Company B and the financial services firm became affiliates, at which point the non-audit services provided to the financial services firm became prohibited under the auditor independence rules.

17. From September 1, 2006 forward, Company B disclosed its relationship to the financial services firm in every annual report it filed with the Commission and also included a visual depiction of the relationship in these filings. Despite these public disclosures, the KPMG audit engagement teams for the Company B audits did not recognize the financial services firm as a controlling affiliate for independence purposes until late 2011. As a result, from September 1, 2006 until late 2011, KPMG provided a range of prohibited non-audit services to the financial services firm, including 67 instances of management functions, 20 instances of restructuring services, 13 instances of loaned staff services (involving KPMG employees providing services such as bookkeeping and expert services), six instances of corporate finance services and three other instances of expert services. KPMG also received contingent fees for services provided to the financial services firm in 26 instances, which was prohibited by Rule 2-01(c)(5). *See* 17 C.F.R. § 210-2.01(c)(5).

18. In late 2011, KPMG realized that the financial services firm should have been identified as an affiliate of Company B. In early December 2011, KPMG reported this fact to the Audit Committee of Company B's General Partner. On December 15, 2011, the Audit Committee terminated KPMG as Company B's auditor.

19. In addition, six partners in the KPMG chain of command and two partners in the KPMG office that conducted Company B's audits owned stock in the financial services firm, in further violation of the independence rules.

G. Prohibited Services Provided to Affiliates of Company C

20. During December 2007, KPMG was notified that Company C was requesting proposals from three firms, including KPMG, to perform the 2008 audit and quarterly reviews of its consolidated financial statements. During the ensuing client acceptance process for Company C's audit engagement, the KPMG audit engagement team learned that KPMG had been providing certain non-audit services to affiliates of Company C that KPMG would be prohibited from providing if it became Company C's independent auditor. These services included bookkeeping and payroll services provided to affiliates of Company C in eleven different countries. On February 22, 2008, Company C provided KPMG with a "Transition Plan" that identified these services, the countries in which the services were being provided, and actions being taken to transition the services to other providers. The Transition Plan specified that all such services would end by July 1, 2008.

21. On February 27, 2008, the KPMG audit engagement team – in consultation with the firm's Independence Group – concluded that, based on the perceived immateriality of the locations and services being provided, the Transition Plan was reasonable and KPMG's overall independence would not be impaired if it became the auditor for Company C but also continued providing the non-audit services to Company C's affiliates through July 1, 2008. On February 28, 2008, KPMG was appointed Company C's auditor and confirmed by letter to Company C that it was independent "with respect to [Company C] and its related entities under applicable SEC and PCAOB independence requirements." In the letter, KPMG acknowledged it was currently providing certain non-audit services to Company C's affiliates, but concluded that, "[b]ased on the nature of the matters identified and their planned timely resolution we do not believe these matters compromise the firm's independence."

22. In fact, from February 28, 2008 through June 2008, the non-audit services that KPMG continued to provide to Company C's affiliates, including bookkeeping and payroll services, constituted prohibited services in violation of the auditor independence rules (which do not provide for limited duration transition periods or include any exceptions based on the nature of the services provided).

H. Violations

23. As a result of the conduct described above, KPMG violated Rule 2-02(b) of Regulation S-X, which requires that each accountant's report state whether the audit was made in accordance with generally accepted auditing standards ("GAAS") (which standards require that auditors maintain strict independence from SEC audit clients). *See* PCAOB

Auditing Standards, *Independence*, AU § 220.03.⁴ A violation occurred each time that KPMG issued an audit report for the three audit clients (or issued a consent for the filing of an audit report in later filings) that incorrectly stated that the audits were performed in accordance with the independence requirements of GAAS, where either the period covered by the audit, or the period of the audit work, or both, overlapped with prohibited conduct.

24. As a result of the conduct described above, KPMG violated Rule 10A-2 of the Exchange Act each time that it provided non-audit services that are prohibited under Rule 2-01(c)(4) of Regulation S-X to the three audit clients. Rule 10A-2 of the Exchange Act makes it unlawful for an auditor to fail to be independent of its audit clients under Rule 2-01(c)(4) of Regulation S-X.

25. As a result of the conduct described above, KPMG caused the three audit clients to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder, which require that financial statements included in annual reports filed with the Commission be audited by an independent accountant. KPMG knew, or should have known, that its conduct would cause the audit clients to violate these reporting provisions.

26. As a result of the conduct described above, KPMG also engaged in improper professional conduct, as defined in Exchange Act Section 4C and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

I. Undertakings

Respondent has undertaken to:

Implement internal changes (the "proposed changes") to enhance KPMG's ability to educate and monitor compliance by its personnel with respect to the independence requirements under PCAOB standards and applicable Commission rules concerning the provision of non-audit services to SEC audit clients by achieving the following goals: (a) increasing personnel and expertise within KPMG's Independence Group, (b) improving KPMG's review procedures for both new service offerings and engagement-specific requests for non-audit services, (c) improving KPMG's independence policies, guidance, and training, and (d) improving KPMG's clearance and compliance procedures related to the independence rules.

Retain, within sixty (60) days after the entry of this Order, an independent consultant (the "Independent Consultant"), not unacceptable to the staff of the Commission. The Independent Consultant's role will be to review and evaluate whether the proposed changes have been designed and implemented in a manner reasonably sufficient to achieve the goals stated above concerning the provision of non-audit services to SEC audit clients. KPMG shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to its

⁴ Pursuant to Commission Release 33-8422, GAAS, as used in Regulation S-X, means "the standards of the PCAOB plus any applicable Commission rules." Audit reports dated on or after May 24, 2004 – the effective date of PCAOB Auditing Standard 1 – are required to state they were performed in accordance with PCAOB standards. PCAOB rules and standards require auditors to be independent from their audit clients. *See, e.g.*, PCAOB Rule 3520, PCAOB Rule 3600T, and PCAOB AU § 220.

own files, books, records, and personnel as reasonably requested for the review. The Independent Consultant shall disclose to the staff of the Commission in the event that KPMG or any of its employees, agents, consultants, contractors, or anyone else acting on its behalf refuses to provide information necessary for the performance of the Independent Consultant's responsibilities. KPMG agrees that it will not take any action to retaliate against the Independent Consultant for such disclosures.

Require that the Independent Consultant issue a report, within six (6) months of being retained, summarizing his or her review and reporting on whether the proposed changes have been designed and implemented in a manner reasonably sufficient to achieve the goals stated above concerning the provision of non-audit services to SEC audit clients. Simultaneously with providing that report to KPMG, the Independent Consultant shall transmit a copy to LeeAnn Gaunt, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110. In the event that the Independent Consultant reports that the proposed changes have in some way failed to be designed and implemented in a manner reasonably sufficient to achieve the goals stated above concerning the provision of non-audit services to SEC audit clients, the report will include recommendations of procedures reasonably designed to do so.

Adopt all additional recommendations in the report of the Independent Consultant; provided, however, that, within sixty (60) days after the Independent Consultant serves the report, KPMG shall advise the Independent Consultant and the Commission, in writing of any recommendations that it considers unnecessary, unduly burdensome, impractical or costly. With respect to any recommendation that KPMG considers unnecessary, unduly burdensome, impractical or costly, KPMG need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any recommendation on which KPMG and the Independent Consultant do not agree, such parties shall attempt in good faith to reach an agreement within sixty (60) days after KPMG serves the written advice. In the event that KPMG and the Independent Consultant are unable to agree on an alternative proposal, KPMG will abide by the determinations of the Independent Consultant.

Require the Independent Consultant to enter into an agreement with KPMG that provides that, for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with KPMG, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he or she is affiliated or of which he or she is a member, and any person engaged to assist the Independent Consultant in performance of his or her duties under this Order shall not, without prior written consent of the Securities and Exchange Commission's Division of Enforcement, enter into any employment, consultant, attorney-client, auditing, or other professional relationship with KPMG, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years from completion of the engagement.

Certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn Gaunt, Assistant Director, Division of Enforcement at the address provided above, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

These undertakings shall be binding upon any acquirer or successor-in-interest to KPMG's, or substantially all of KPMG's, audit practice for SEC audit clients.

For good cause shown, the Commission staff may extend any of the procedural dates set forth above.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 4C and 21C of the Exchange Act and Section 102(e) of the Commission's Rules of Practice, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Rule 2-02 of Regulation S-X, Rule 10A-2 of the Exchange Act, and Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

B. Respondent is censured.

C. Respondent shall, within fourteen (14) days of the entry of this Order, pay disgorgement of \$5,266,347, prejudgment interest of \$1,185,002, and a civil money penalty in the amount of \$1,775,000, for a total of \$8,226,349, to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;⁵
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may make payment by certified check, bank cashier's check, or United States postal money order, payable to the Securities and Exchange Commission and hand-delivered or mailed to:

⁵ On December 31, 2012, the minimum threshold for transmission of payment electronically was increased to \$1,000,000. For amounts below the threshold, Respondent must make payments pursuant to option (2) or (3) above.

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order shall be accompanied by a cover letter identifying KPMG as the Respondent and including the file number of these proceedings. A copy of the letter and check or money order must be sent to LeeAnn Gaunt, Assistant Director, Division of Enforcement at the address provided above.

D. Respondent shall comply with the undertakings enumerated in Section III.I above.

By the Commission.

Elizabeth M. Murphy
Secretary