**Called to Account**

# The auditor of Citi, Credit Suisse and Deutsche Bank was tipped off before regulatory inspection

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By Francine McKenna

**Court filings: KPMG employees would receive bonuses if their engagements received no comments from inspectors**

C -0.63% ▼ CS -0.28% ▼ DB +0.90% ▲ BANC +3.17% ▲ BBVA -0.43% ▼ AMBC -2.40% ▼

CORRECTION *Fixes story to reflect that Air Products and Chemical was not one of the issuers involved.*


Former KPMG executives are on trial for obtaining confidential information about audit inspections.
REUTERS

The auditor of some of the world's largest banks including Citigroup, Credit Suisse and Deutsche Bank was tipped off before a regulator inspected them.

It's been previously reported that KPMG executives were able to extract from the regulator, the Public Company Accounting Oversight Board, confidential information ahead of inspections, and use that information to correct their work and at least in one instance, withdrawn an opinion. But MarketWatch now has court documents that, for the first time, names the audit clients caught up in the scandal.

The Justice Department in January brought criminal charges against five former KPMG executives and one former regulator for allegedly taking advantage of advance notice of regulator inspections. Court filings made June 8 by lawyers for two of the KPMG partner defendants spells out the audit clients caught up in the scandal. They're mostly financial companies: Citigroup **C, -0.63%** , Credit Suisse **CS, -0.28%** , Deutsche Bank **DB, +0.90%** , Banc of California **BANC, +3.17%** , BBVA **BBVA, -0.43%** , Chemical Financial Corp. US:CHFC , Ambac **AMBC, -2.40%** , Phoenix Life, and NewStar Financial as well as C&J Energy Services US:CJ.

Neither the Justice Department nor the Securities and Exchange Commission, who filed similar charges in a civil cases, have ever identified the KPMG clients.

It should be stressed that there's no indication that any of these banks or companies were aware of the tip off, and typically, they would have little to no involvement in auditor inspections. None of the issuers have announced a restatement of financials since the Jan. 6. indictment. KPMG, the auditor, has not been accused of wrongdoing.

The SEC moreover said in January that the KPMG audits of these companies should continue to be relied upon.

After the charges were filed in January, SEC Chairman Jay Clayton issued a statement intended to assuage fears that KPMG audits may have to be withdrawn based on the illegal early warnings about inspections.

"Based on discussions with the SEC staff," Clayton wrote on Jan. 22, "I do not believe that today's actions against these six individuals will adversely affect the ability of SEC registrants to continue to use audit reports issued by KPMG in filings with the Commission or for investors to rely upon those required reports."

A spokesman for KPMG provided the following statement to MarketWatch via email:

"It is important to note that the inexcusable actions of the individuals who were separated from KPMG over a year ago were designed to subvert the PCAOB's inspection process, and had no effect whatsoever on any of the firm's audit opinions or clients' financial statements. Our commitment to audit quality and integrity remains unwavering. In addition, we have taken steps to reinforce our values and culture, and to enhance our governance."

The firm has said it promptly notified authorities when it discovered the issue in 2017 and has been fully cooperating with the government.

The Department of Justice, the SEC and the PCAOB each declined comment.

Corporate governance expert Nell Minow, the vice chair of ValueEdge Advisors, said investors shouldn't be satisfied with the SEC's statement. "The breadth and seriousness of the charges and the importance to the financial markets of the companies affected should require a through internal investigation with results made public. If the SEC or KPMG do not insist on it, investors and clients should."

Lynn Turner, a former chief accountant for the SEC, was even more emphatic. "I believe Chairman Clayton misled investors when he said they could rely on the audits report issued by KPMG," Turner told MarketWatch. "In my opinion, the information that has come to light raises a serious question with respect to the integrity, objectivity and professionalism of the audits."

Banc of California, BBVA, Citigroup, Credit Suisse and Deutsche Bank representatives declined comment.

Spokespersons for Phoenix Life, NewStar Financial, and C&J Energy did not respond to an emailed request for comment.


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## Bonuses for clean reports

Civil and criminal charges against David Middendorf, KPMG's then-national managing partner for audit quality and professional practice, Thomas Whittle, KPMG's then-national partner-in-charge for inspections and David Britt, KPMG's banking and capital markets group co-leader say they allegedly lured three PCAOB employees — Brian Sweet, Cynthia Holder and Jeffrey Wada, all certified public accountants — into the conspiracy with promises of jobs at the accounting firm in exchange for stolen information.

Spokespersons for the attorneys for defendants Middendorf, Britt and Sweet declined comment on the case. Attorneys for Whittle, Holder, and Wada did not respond to an emailed request for comment.

Sweet and Holder were later hired by KPMG. Wada remained at the PCAOB. Once at KPMG, Sweet's and Holder's jobs were then threatened if they did not continue to provide information, according to the indictments. The conspiracy to steal the regulatory inspection data lasted from 2015 and 2017, according to the charges.

Sweet, the PCAOB's KPMG inspection team lead, was recruited by KPMG to allegedly bring over confidential regulatory data. He pleaded guilty on Jan. 5 to conspiracy and wire fraud and is cooperating with the authorities. The cases against the others are still pending.

Sweet and Holder were on the job on Dec. 18, 2015, when Scott Marcello, the vice chair of audit, sent an email to KPMG personnel announcing an audit quality bonus program, according to details in the new court filing that expand on a brief mention in the original indictment. KPMG employees would receive financial bonuses if their engagements received no comments from PCAOB inspectors.

Scott Marcello was fired by KPMG in April with the other four partners but was not named in any of the charges. A spokesman for Marcello said he had no comment.

The new court document confirms a MarketWatch story that concluded "Issuer-2" in the indictment was almost certainly Ambac Financial and the former KPMG executives' actions did have a significant impact on its 2015 financial statements. The court document confirms that KPMG discovered an error in its audit of Ambac based on its alleged illegal early receipt of the PCAOB's list of audits to be inspected in 2016.

At the time the error was discovered, KPMG had already issued its Ambac's financial statements and the annual report had already been issued. As a result of discovering the error, KPMG withdrew its opinion on Ambac's internal controls. Shortly after the decision to withdraw its opinion, KPMG was formally notified by the PCAOB that Ambac would be inspected.

During a call about the 2016 list, Middendorf emphasized that the top priority was protecting KPMG's monitoring programs. This was because, according to the document, "while any failed inspection of a particular audit would be bad, a failed inspection for an audit subject to a monitoring program would demonstrate that the monitoring programs were not working and would represent a systemic failure."

The court document also says that in May and June 2015, when Sweet shared confidential information about that year's inspection list with Middendorf, Whittle and Britt, among others, the audits selected for re-review in 2015 were already past the documentation period and the work papers had been archived. This gave the engagement partners extra time to prepare for the inspections of their audits, including preparing for their leadoff presentations to the PCAOB.

Britt sent an email to 35 engagement teams with engagements in the "allowance for loan and lease losses" or ALLL Monitoring system, telling them Sweet, Holder and several others must be given access to the electronic audit files of their engagements in order "to gather information," according to the court document.

According to the SEC complaint against Sweet, KPMG created the monitoring program in 2015 as a show of action in response to the numerous violations of auditing standards that the PCAOB had identified in this area. "The success of the ALLL monitoring program was especially important to KPMG because the firm had promoted it as proof of the seriousness with which it was working to improve its audit quality," according to the SEC complaint against Sweet.

Jane Fonda, promoting her movie '80 for Brady,' suggests that 'There'd be no climate crisis if it wasn't for racism.'

**Francine McKenna**

Francine McKenna is a MarketWatch reporter based in Washington, covering financial regulation and legislation from a transparency perspective. She has written about accounting, audit, fraud and corporate governance for publications including Forbes, the Financial Times, Accountancy and the American Banker. McKenna had 30 years of experience at banks and professional-services firms, including at PwC and KPMG, before becoming a full-time writer.