IN THE MATTER OF:

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

-and-

KPMG LLP

JAMES MARSH

FORMAL COMPLAINT

INTRODUCTION

1. The Financial Reporting Council ("**the FRC**") is the independent disciplinary body for the accountancy and actuarial professions in the UK. The FRC's rules and procedures relating to accountants are set out in the Accountancy Scheme of 1 June 2014 ("**the Scheme**").

2. By paragraph 7(11) of the Scheme, if having reviewed any representations received for the purposes of paragraph 7(10) of the Scheme, the Executive Counsel to the FRC ("**Executive Counsel**") considers that there is a realistic prospect that a Tribunal will make an Adverse Finding against a Member or Member Firm and that a hearing is desirable in the public interest, then the Executive Counsel shall deliver a Formal Complaint against the Member or Member Firm to the Conduct Committee.

3. This is the Executive Counsel's Formal Complaint pursuant to paragraph 7(11) of the Scheme in respect of:

    - KPMG LLP ("**KPMG**"), a member firm[1] of the Institute of Chartered Accountants in England and Wales ("**ICAEW**"), and

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1 References to "Member Firm" and "Member" in this document relate to the definition as set out in paragraph 2(1) of the Scheme, references to 'member firm' and 'member' denote their membership of the ICAEW.

- James Marsh ("**Mr Marsh**"), a partner of KPMG and a member of the ICAEW,

together referred to herein as "**the Respondents**", in connection with the Respondents' conduct in relation to (i) the failure by Mr Marsh to dispose of the 651,559 shares ("**the Shares**") he owned in Cable & Wireless Worldwide PLC ("**CWW**"), a company of which he had formerly been Chief Executive Officer and which was an audit client of KPMG Audit Plc, prior to his appointment as a partner in KPMG on 3 October 2011; and (ii) the appointment of Mr Marsh as Chief Operating Officer for KPMG in the UK on 11 May 2012 less than two years after holding the position of Chief Executive Officer of CWW.

4. According to its website, as at December 2013, KPMG is a leading provider of accounting services in the UK and, as a wholly owned subsidiary of KPMG Europe LLP, is "*part of the largest integrated accounting firm in Europe*". KPMG in the UK has over 10,000 partners and staff working in 22 offices. KPMG reported UK fee income of £1,814m for 2013. KPMG identifies the existence of audit quality controls which include "*a tone at the top which emphasises quality, ethics and integrity*". KPMG has its own UK Ethics and Independence Manual ("**the KPMG Manual**") incorporating KPMG Europe LLP's Code of Conduct.

5. KPMG Audit Plc is a wholly owned subsidiary of KPMG LLP (held indirectly through intermediate holding companies) and its principal activity is statutory audits and related services.

6. Mr Marsh was admitted to membership of the ICAEW in 1991 and worked in KPMG's audit function until 1994 when he left to work at Boots the Chemist ("**Boots**") as a divisional director and then Head of Strategic planning. He left Boots in 1997 to return to KPMG as a partner in KPMG's consultancy practice and then joined Atos Consulting as Chief Operating Officer as part of the sale of KPMG's consultancy practice. He left Atos Consulting in 2004 to become business development director at Energis, which was subsequently acquired by CWW. He was appointed divisional Chief Executive Officer in 2005 and became (group) Chief Executive Officer of CWW on the demerger of Cable & Wireless Communications plc from Cable & Wireless plc in 2010. He resigned from that role on 28 June 2011. On 3 October 2011, Mr Marsh re-joined

KPMG as a partner with the role of Chief Operating Officer for the Financial Services sales team of KPMG. He was appointed Chief Operating Officer for KPMG on 11 May 2012 with immediate effect.

7. Mr Marsh has not been interviewed as a part of this investigation, but Mr Chris Hawes ("**Mr Hawes**"), an employee of KPMG working in its Ethics and Independence team, was interviewed on 30 July 2013 and a transcript of that interview has been produced.

BACKGROUND

8. CWW was a global telecommunications company and was listed as a FTSE 250 company. Its Annual Report for 2010/11 shows that audit (and audit related) fees totalled £1.7 million for that year and identifies Mr Marsh as Chief Executive Officer and Executive Director. Its Annual Report for 2011/2012 shows audit (and audit related) fees of £1.6 million and identifies Mr Marsh as a former director. In each year, CWW's operations were predominantly in the UK. Peter Meehan of KPMG ("**Mr Meehan**") is identified in the 2010/2011 and the 2011/2012 Annual Report as the Senior Statutory Auditor. Each Annual Report records directors' shareholdings, including the Shares (which had been awarded to Mr Marsh as a normal part of the compulsory CWW incentive and remuneration schemes). These were Mr Marsh's only shareholdings in a publicly listed company.

9. At all material times in 2011 and 2012 (prior to its acquisition by Vodafone in 2012), CWW was a listed audit client of KPMG Audit Plc. Mr Meehan signed his independent auditor's report for the year ended 31 March 2012 on 23 May 2012.

Timing of Mr Marsh's disposal of his shares in CWW

10. When Mr Marsh became a partner in KPMG on 3 October 2011, he still owned the Shares. Mr Marsh subsequently disposed of the Shares in four tranches over a period of four months between October 2011 and January 2012, as set out below. The Shares were disposed of following discussions with KPMG's compliance function and before there was any involvement of any regulator in the issue. The Shares were sold at a loss by reference to their value on 3 October 2011.

11. In retaining the Shares after the date on which he became a partner in KPMG, Mr Marsh was in breach of section 3.3 of the KPMG Manual, in that he had a financial interest, in the form of shares in CWW, in an audit client of KPMG. KPMG did not take action to require a sale of the Shares prior to Mr Marsh becoming a partner.

12. Mr Marsh should have been aware of the content of the KPMG Manual, having signed the form entitled "Partner Ethics and Independence Confirmation on joining KPMG New Joiner Form" ("**the New Joiner Form**"), confirming his compliance with KPMG's requirements as set out in the KPMG Manual. However, Mr Marsh mistakenly believed that, not being involved in the audit practice and not having been informed to the contrary by KPMG's Ethics and Independence team, he was entitled to sell the Shares over a reasonable period.

13. The New Joiner Form did not include any requirement that Mr Marsh should disclose the Shares (although it did require the disclosure of any exceptions to compliance with the requirements of the KPMG Manual). However, the Shares were required to be disclosed in KPMG's KICS[2] system from the date of joining. Mr Marsh was allocated his KICS account on 14 October and completed his KICS entry by 22 November.

14. The requirements in the KPMG Manual reflect the requirements in the APB Ethical Standard 2 (revised) at ES2.7 (as more particularly set out below).

15. At some time in, as now can best be identified, October 2011, Mr Marsh telephoned Mr Hawes in the Ethics and Independence team and told him that he was in possession of the Shares. Mr Hawes understood Mr Marsh to tell him that he had agreed with someone else that he could sell the Shares in tranches, however Mr Hawes is not able to provide any specific details of this conversation. Mr Hawes made no record of this conversation and nor did he record, nor does he currently have any specific recollection of, any conversation that he might have had with a senior colleague during which the Shares and the plans for their disposal were discussed. Mr Marsh has a different recollection of the conversation with Mr Hawes: he does not believe that he told Mr Hawes he had received a prior authorisation to sell the Shares

2 The KPMG online tracking system designed to ensure compliance with KPMG Manual in particular the rule as to no holding investments in audit clients.

in tranches, since Mr Marsh does not believe that he had had a prior discussion for such a purpose.

16. On or about 22 November 2011, Mr Marsh telephoned the Ethics and Independence team and reported that he had sold two tranches of the Shares but that he still retained the remaining holding in the Shares which he intended to sell by the end of the quarter (as he recalls). This conversation was recorded in an email between Sara Ramirez, Mr Hawes and Christine Groom (which records the date for the sale to be the end of the month, not the quarter). No one on the Ethics and Independence team escalated the issue to senior management of KPMG.

17. On 13 February 2012, Mr Marsh confirmed that he had sold the last of the Shares and that sale was recorded on KPMG's KICS system on 15 February 2012.

18. At no time prior to 13 February 2012 was any formal action taken by KPMG to inform Mr Marsh that he was acting in breach of the KPMG Manual or to require immediate compliance with its requirements. Mr Hawes said in interview that he would have told Mr Marsh to sell the Shares but it is unclear what time frame was required and it seems that neither Mr Marsh nor KPMG took any action to ensure that an immediate sale took place. Mr Marsh does not accept that he was told by Mr Hawes, or anyone else at KPMG, that immediate sale of the Shares was required.

19. The breach was not notified to the audit engagement partner, Mr Meehan. KPMG accept that it would have been appropriate to notify the audit engagement partner of any known possible independence issues.

20. In the event, Mr Marsh disposed of the Shares as follows:

Disposal Dates	**No. of Shares**	**Sale price (p)**	**Proceeds (£)**
14 October 2011	180000	27.9	50,220
14 November 2011	137900	30.0	41,370

22 November 2011	200000	29.4	58,800
31 January 2012	133659	17.01	22,735

21. KPMG subsequently concluded that Mr Marsh's conduct, although without intention to deceive or mislead, was "*against the letter and spirit of our compliance rules and the UK regulator's ethical standards*". In a letter to Mr Marsh dated 14 December 2012, Simon Collins, KPMG Chairman and Senior Partner, explained that KPMG had concluded that Mr Marsh's conduct constituted a "*Category III breach of our rules*". Mr Marsh's name was entered in the Ethics Register[3] and his total pay distribution for FY12 was reduced by £60,000.

22. KPMG has also recognised that it failed to identify, and to act to ensure the disposal of, Mr Marsh's holding of the Shares at the appropriate stage through its internal procedures. It has now taken certain other actions and also steps to improve its procedures. In particular:

    (i) Mr Hawes has been criticised in his appraisal for not having properly documented the discussions he was involved in and the actions he took in or about November 2011;

    (ii) KPMG has made changes to the format of the New Joiner Form so as to ensure that all future direct entry partners will be required formally to schedule their various financial and other relationships irrespective of the KICS disclosure requirement;

    (iii) The completed New Joiner Form (and supporting documentation provided) is reviewed by a member of the Ethics and Independence Team and then by a senior member of the team;

    (iv) All individuals joining KPMG as partners (direct entry partners) are then interviewed by a senior member of the Ethics and Independence Team prior to joining so that the independence requirements can be explained fully to them, an action plan can be

3 The official record of breaches of KPMG independence policy as required for practice compliance and disciplinary purposes.

agreed for any matters that are required to be addressed as identified from the review of their New Joiner Form and this discussion and the individual can raise any questions or concerns with the member of the Ethics and Independence Team;

(v) A review of all new partners' financial and other relationships for compliance with independence requirements is performed prior to joining and again within approximately 12 months after joining;

(vi) KPMG amended its systems so that all KICS accounts for future direct entry partners are opened manually either on the day that the partner commences work or at the latest on the following day, and the online KICS account is now opened normally within a week of the individual joining the firm. The partner is required to enter all applicable investments into the account within 14 days of the account becoming opened;

(vii) A member of the Ethics and Independence team checks through examination of the KICS account that the individual has addressed any conditions as to the individual's investments which were made prior to the individual joining the firm (i.e. as arising from the discussion with the senior member of the Ethics and Independence Team);

(viii) KPMG has developed a new database or call log in which all calls made by and to the Ethics and Independence team are logged together with essential details and all such logs are reviewed on a weekly basis; and

(ix) KPMG is preparing guidelines for members of the Ethics and Independence team reinforcing the need to be observant and sceptical and to escalate any matter which gives cause for concern.

Mr Marsh's appointment as Chief Operating Officer for KPMG

23. On 11 May 2012, some 12 days prior to the CWW independent auditor's report for the year ended 31 March 2012 being issued, Mr Marsh was appointed Chief Operating Officer for KPMG. Although this appointment had originally been intended to take effect in October 2012, for internal reasons, it was accelerated to have immediate effect.

24. Upon his appointment as Chief Operating Officer for KPMG, Mr Marsh became part of KPMG's ten person Executive Leadership team and his role was listed second in the composition of that team on KPMG's website. His role was internally facing and he had no responsibility for audit activities and no involvement in the CWW audit. However, as Chief Operating Officer, he was ultimately in a position to have some influence on the remuneration of all partners including the partner responsible for the CWW audit, when that remuneration process came around (usually commencing in September). Accordingly, Mr Marsh was theoretically able to influence the performance evaluation and remuneration of the audit partner for the CWW audit and was, therefore, in the relevant chain of command for the CWW audit. This was despite the fact that, by 11 May 2012, (i) final papers had been issued by the auditor to the audit committee and all substantive work on the CWW audit was completed, (ii) the audit report was signed on 23 May 2012, (iii) by 18 June 2012, CWW's shareholders accepted a take-over bid such that the audit was likely to be lost, (iv) the acquisition was completed on 27 July 2012 and (v) Mr Marsh's involvement in the process for determining partner remuneration did not commence until 2 September 2012.

25. Prior to, and at the time of, Mr Marsh's appointment as Chief Operating Officer for KPMG, no one involved in the decision to accelerate the appointment at KPMG identified that because he had departed from CWW less than one year previously his appointment would fall foul of APB Ethical Standard 2 (revised), at ES2.58 (as more particularly set out below) if Mr Marsh were in the chain of command.

26. In an email dated 16 May 2012, Mr Meehan recognised that, although the reality was very different and he did not consider that, in fact, there was an issue: "*I am very conscious that in the position of COO there may be the perception that he is in a position to influence the audit, being within my 'chain of command'. He, and we, would of course have a potential conflict of interest in that case, having been part of the client management team*". He noted that he had raised this potential conflict at the CWW audit committee meeting on 15 May 2012 and that the audit committee had concluded that no real conflict existed and that appropriate measures had been put in place to address any perception issue.

27. However, in an email dated 7 June 2012 to Mr Meehan, Chris Jenkins of KPMG expressly pointed to the requirements of ES2.58 noting that "*Clearly [Mr*

Marsh] influenced the prep of the March 2011 financial statements or was in a position to do so as CEO (so the fact that as you say he wasn't able to influence the 2012 financial statements/audit is not I think decisive under this rule)" and that "*...the question would be whether his position of UK COO of KPMG means he is "able to influence" etc. This would seem to turn on the wide-ranging definition of this concept in ES1* and the Glossary to the ES...".

28. In an e-mail of 14 June 2012, Mr Meehan confirmed that the issue as he had identified it in his earlier email of May 2012 had been that "*[Mr Marsh] had been CEO of [CWW] to July 2011...and on becoming COO he was now in my chain of Command*". Mr Meehan said that he had met Mr Marsh on 25 April 2012 "*to explain [the] issue*" but was told by him that his appointment would not take effect until 1 October 2012.

29. In the event, announcement of the appointment was made on 11 May 2012 (and accelerated to have immediate effect). Mr Meehan accepted that his email of 16 May 2012 (and also apparently his conversation with Mr Marsh) "*[did] not really address the ES2 points and particularly the 2 year rule, under which the firm would have a potential issue even if it had happened on 1 Oct as originally envisaged*". In conclusion he identified that "*there is one issue here of getting CWW's audit documentation right, but there is also clearly a broader firm issue here which will perhaps need some documentation*".

30. At the beginning of July 2012, KPMG prepared a document entitled "Cable and Wireless Worldwide: Arrangements to secure compliance with Ethical Standard 2 - paragraph 58" ("**the Recusal Document**"). Amongst other things, the Recusal Document identified that the "*COO is generally considered to be in the Chain of Command for all audit clients of the firm and therefore assumed to be able to influence the conduct and outcome of all audits for the purposes of ES2, paragraph 58*". That document sought to explain why Mr Marsh had not in fact been in a position to influence the signing of the audit report for CWW on 23 May 2012. However, it also identified specific arrangements to be put in place until the earlier of KPMG's resignation from the audit, or 28 June 2013, being the second anniversary of Mr Marsh's departure from CWW with the intention of ensuring that Mr Marsh was not, as a matter of fact, in the chain of command. These arrangements were to the following effect: "*[Mr Marsh] shall not have a direct supervisory, management or other oversight responsibility over either any audit partner of the CWW audit team or over the conduct of the CWW audit work*".

31. The Recusal Document did not address the issue of whether ES2.58 is an absolute requirement such that it is not capable of mitigation or remedy by safeguards. On any view, however, ES2.58 was breached between 11 May and either 2 July (when the Recusal Document was adopted) or 15 August when KPMG was definitively terminated as auditor.

THE RELEVANT STANDARDS

The Relevant Standards of Conduct

32. The standards of conduct reasonably to be expected of the Respondents (and current at the relevant time) included those set out in:

  (i) APB Ethical Standard 1: Integrity, objectivity and independence;

  (ii) APB Ethical Standard 2 (Revised): Financial, business, employment and personal relationships;

  (iii) ISQC (UK and Ireland) 1: Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements.

33. Executive Counsel will refer to and rely upon the applicable standards. These standards are made in the public interest and they are designed to maintain a high standard of integrity, objectivity and independence. Key provisions upon which Executive Counsel intends to rely are set out in paragraphs 34-37 below.

34. APB Ethical Standard 1 includes, inter alia, the following requirements:

  (i) "*The audit firm shall establish policies and procedures, appropriately documented and communicated, designed to ensure that, in relation to each audit engagement, the audit firm, and all those who are in a position to influence the conduct and outcome of the audit, act with integrity, objectivity and independence.*" (paragraph 16);

  (ii) "*The leadership of the audit firm shall take responsibility for establishing a control environment within the firm that places adherence to ethical principles and compliance with APB Ethical Standards above commercial considerations.*" (paragraph 19).

35. In addition, APB Ethical Standard 1 includes, inter alia, the following guidance:

> "*The need for independence arises because, in most cases, users of the financial statements and other third parties do not have all the information necessary for judging whether the auditor is, in fact, objective. Although the auditor may be satisfied that the auditor's objectivity is not impaired by a particular situation, a third party may reach a different conclusion. For example, if a third party were aware that the auditor had certain financial, employment, business or personal relationships with the audited entity, that individual might reasonably conclude that the auditor could be subject to undue influence from the directors or would not be impartial or unbiased. Public confidence in the auditor's objectivity could therefore suffer as a result of this perception, irrespective of whether there is any actual impairment.*

Accordingly, in evaluating the likely consequences of such situations and relationships, the test to be applied is not whether the auditor considers that the auditor's objectivity is impaired but whether it is probable that a reasonable and informed third party would conclude that the auditor's objectivity either is impaired or is likely to be impaired" (paragraphs 14 and 15).

36. APB Ethical Standard 2 (Revised) includes, inter alia, the following requirements:

    (i) "*Save where the circumstances contemplated in paragraphs 9, 10, 12, 19 or 21 apply, the audit firm, any partner in the audit firm, a person in a position to influence the conduct and outcome of the audit or an immediate family member of such person shall not hold: (a) any direct financial interest in an audited entity or an affiliate of an audited entity...*" (paragraph 7);

    (ii) "*Where a former director or a former employee of an audited entity, who was in a position to exert significant influence over the preparation of the financial statements, joins the audit firm, that individual shall not be assigned to a position in which he or she is able to influence the conduct and outcome of the audit for that entity or its affiliates for a period of two years following the date of leaving the audited entity.*" (paragraph 58).

37. ISQC (UK and Ireland) 1 includes, inter alia, the following requirements:

(i) "*The Firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements. (ref: Para A7-A10)*" (paragraph 20);

(ii) "*The firm shall establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements...maintain independence where required by relevant ethical requirements...*" (paragraph 21);

(iii) "*The firm shall establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations*" (paragraph 23).

38. In addition, Executive Counsel will rely upon the KPMG Manual, and in particular section 3.3 of the KPMG Manual "Financial Relationships with Audit Clients", which sets out rules that KPMG is "*required to follow when contemplating financial relationships with audit clients*". Amongst other things, section 3.3 includes the following:

(i) "*You are personally responsible for making appropriate enquiries to ensure you and your immediate family do not have financial interests which are prohibited*" (paragraph 3.3.1);

(ii) "*Financial interests comprise (a) shares and other securities...Financial interests can be held directly or indirectly. Direct financial interests are those held directly by you...*"(paragraph 3.3.2);

(iii) "*Partners and their immediate family members are prohibited from holding direct or material indirect financial interests comprising shares and securities of any audit client of KPMG worldwide*" (paragraph 3.3.2).

The Respondents' Misconduct

39. Paragraph 2(1) of the Scheme provides that an Adverse Finding, (referred to at paragraph 2 above) is a finding by a Disciplinary Tribunal that a Member or Member Firm has committed "Misconduct", that is defined as: "*an act or*

omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession."

40. As set out more particularly below, the allegations of Misconduct relate to failures on the part of KPMG and Mr Marsh to comply with the required standards of integrity, objectivity and independence in connection with:

(i) the timing of the sale of Mr Marsh's shares in CWW (both KPMG and Mr Marsh); and

(ii) the appointment of Mr Marsh as Chief Operating Officer for KPMG on 11 May 2012 (KPMG only).

ALLEGATIONS AGAINST KPMG

ALLEGATION 1: The Timing of the Disposal of Mr Marsh's shares in CWW

From 3 October 2011, KPMG knew that Mr Marsh was holding a direct financial interest in an audited entity, namely CWW, contrary to the requirements of ES2.7, and also the requirements of section 3.3 of the KPMG Manual, but failed to take action to preclude him from doing so such that its conduct fell significantly short of the standards reasonably to be expected of a Member Firm in that KPMG failed to require Mr Marsh to sell the Shares immediately upon taking up his appointment as a partner.

Particulars of Allegation 1:

Upon the details of Mr Marsh's shareholding in CWW being made known to KPMG at or relatively soon after the time of his appointment, KPMG did not require the immediate sale of the Shares and did not seek to stop Mr Marsh from selling the Shares over time.

ALLEGATION 2:

Between 28 September 2011 and 15 February 2012, when CWW was an audit client of KPMG, KPMG failed to have sufficient or appropriate procedures as required by ES1.16 and/or ISQC (UK and Ireland) 1, paragraphs 20, 21 and 23, appropriately documented and communicated, to ensure that, in relation to each audit engagement, KPMG acted with integrity, objectivity and independence and thereby the conduct of KPMG fell significantly short of the standards reasonably to be expected of a Member Firm in that:

2.1 KPMG failed to ensure that its procedures were effective to require a joining partner to disclose, prior to joining, his direct financial interests, including his ownership of shares in companies who were audit clients of KPMG on the New Joiner Form;

2.2 KPMG failed to ensure that its procedures were effective to require the completion (whether manually or otherwise) of a record of share ownership from the date of a new partner joining the firm;

2.3 KPMG failed to ensure that its policies and procedures required all calls to and from the Ethics and Independence team to be logged and maintained

and thereafter monitored to ensure compliance and/or failed to ensure that the policies that it had as to recording information were adhered to;

2.4 **KPMG failed to ensure that its procedures required a breach that had been identified by a junior employee immediately to be reported to a more senior employee, whatever the circumstances, and/or failed to ensure that the policies it had as to reporting up the chain of command were adhered to; and**

2.5 **KPMG failed to ensure that its procedures were sufficient to prevent, and/or to identify, the failure on the part of Mr Marsh to dispose of his shares prior to joining KPMG as a partner.**

Particulars of Allegation 2:

The KICS Record

Although KPMG maintain a KICS account for all partners which is designed to track their investments, the KICS account for Mr Marsh was not created until 14 October 2011, some 11 days after he joined KPMG and further there was no requirement that he complete the KICS account prior to becoming a partner. Indeed, KPMG's procedures in place at the time would not have made this possible. In fact, Mr Marsh did not input details of his shareholding in CWW onto his KICS account until, at the latest, 22 November 2011. KPMG had no adequate procedure that was documented or communicated, which could address the late provision of information.

Contact with the Ethics and Independence team

Mr Marsh made a number of calls to the Ethics and Independence team, including the call he made to Mr Hawes, none of which was properly recorded or logged for future reference. The Ethics and Independence team says that it tried to call Mr Marsh on a number of occasions, but there is no evidence of these calls either. Further, there is no evidence of the conversation that Mr Hawes believes he would have had with Mr Walker during which he reported on the telephone discussion that he had had with Mr Marsh.

Escalation of breaches

Mr Hawes became aware of the breach on the part of Mr Marsh in not selling his Shares during a telephone conversation he had with him at some time in, as best can be identified, October 2011. Thereafter, other, junior members of the Ethics and

Independence team also became aware of this breach, in particular, Sara Ramirez, Christine Groom and (possibly) Jodie Clement. However, none of these junior employees reported the breach to their superiors, despite an escalation route being specified in the KPMG Manual (even if escalation was not then formally required).

Failure of Procedures

KPMG failed to have procedures sufficient to ensure that Mr Marsh's continuing ownership of the Shares was identified and addressed immediately upon his joining the firm. On the contrary, Mr Marsh was able to sell his Shares in four tranches over a period of time without adverse comment or action of any kind being taken by KPMG. This was contrary to the requirement for KPMG to act with integrity, objectivity and independence.

ALLEGATION 3:

Between 28 September 2011 and 15 February 2012, when CWW was an audit client of KPMG, KPMG's leadership failed to take responsibility for establishing a control environment within the firm as required by ES1.19, that placed adherence to ethical principles and compliance with APB Ethical Standards above commercial considerations and thereby the conduct of KPMG fell significantly short of the standards reasonably to be expected of a Member Firm in that:

3.1 KPMG failed to take sufficient steps to ensure the importance of complete compliance with APB Ethical Standards;

3.2 KPMG failed to establish procedures that ensured complete compliance with the APB Ethical Standards; and

3.3 KPMG failed to ensure prompt communication of the breach by Mr Marsh of the requirement that he should have no direct financial interest in an audit client to the relevant audit engagement partner.

Particulars of Allegation 3:

Emphasis on the importance of compliance with the APB Ethical Standards

Upon Mr Marsh joining KPMG as a partner, KPMG did not act to require the immediate sale of the Shares (despite Mr Marsh's continuing ownership of the Shares having come to their attention) and did not therefore act to emphasise the importance of such compliance.

Failure to establish policies and procedures

KPMG did not establish sufficient procedures to ensure complete compliance with APB Ethical Standards. The deficiencies in the KPMG procedures as identified in Allegation 2 above are repeated. In particular, KPMG failed to establish procedures to ensure that:

(i) a joining partner would disclose, prior to joining, his direct financial interests, including his ownership of shares in companies who were audit clients of KPMG on the New Joiner Form;

(ii) a joining partner would complete (whether manually or otherwise) a record of share ownership from the date of joining the firm;

(iii) all calls to and from the Ethics and Independence team were logged and maintained and thereafter monitored to ensure compliance;

(iv) a breach that had been identified by a junior employee would be reported immediately to a more senior employee whatever the circumstances; and

(v) the failure on the part of Mr Marsh to dispose of his shares prior to joining KPMG as a partner would immediately be identified and addressed.

Failure to communicate

KPMG did not inform Mr Meehan, or anyone else in the audit team dealing with the CWW audit, of Mr Marsh's breach of the requirement that he should not have a direct financial interest in an audit client.

Escalation of breaches

Mr Hawes became aware of the breach on the part of Mr Marsh in not selling his Shares during a telephone conversation he had with him at some time in, as best can be identified, October 2011. Thereaf0ter, other, junior members of the Ethics and Independence team also became aware of this breach, in particular, Sara Ramirez, Christine Groom and (possibly) Jodie Clement. However, none of these junior employees reported the breach to their superiors, despite an escalation route being specified in the KPMG Manual (even if escalation was not then formally required).

ALLEGATION 4: The Appointment of Mr Marsh as Chief Operating Officer

Between 3 October 2011 and 11 May 2012, when CWW was an audit client of KPMG and less than 2 years previously Mr Marsh had been in a position at CWW to exert significant influence over the financial statements of CWW, KPMG took the decision to appoint Mr Marsh to the role of Chief Operating Officer of KPMG (and did appoint him to that role on 11 May 2012), a role in which he was able to influence the conduct and outcome of the CWW audit, contrary to ES2.58, such that the conduct of KPMG fell significantly short of the standards reasonably to be expected of a Member Firm in that:

4.1 KPMG failed to take sufficient account of Mr Marsh's employment history with an existing Audit Client prior to appointing him to the role of Chief Operating Officer;

4.2 KPMG failed to consider properly whether in appointing Mr Marsh there were any grounds for concern at the existence of a conflict of interest and/or a threat to the firm's objectivity and independence, including grounds for concern over whether a reasonable and informed third party would conclude that KPMG's objectivity and independence had been impaired or was likely to be impaired;

4.3 KPMG appointed Mr Marsh despite not having carried out any or any proper process and procedure to ensure compliance with ES2.58; and

4.4 KPMG appointed Mr Marsh without having given any consideration to the question of compliance with ES2.58.

Particulars of Allegation 4:

Prior to, and at the time of, Mr Marsh's appointment, KPMG did not sufficiently consider his role with CWW or the fact that in that role Mr Marsh had had power to exert significant influence over the financial statements. KPMG did not apparently identify that the CWW audit opinion for the year ended 31 March 2012 had not yet been issued and that, even if there was no scope for actual influence on the part of Mr Marsh over the conduct and outcome of the CWW audit, there was nevertheless a clear breach of ES2.58 and indeed that, assuming that CWW remained an audit client and Mr Marsh continued to be in the chain of command, there would be a continuing breach of ES2.58 until 27 June 2013, namely 2 years after Mr Marsh had ceased to be Chief Executive Officer of CWW. Furthermore, KPMG failed to attach any importance to the impression that Mr Marsh's appointment was likely to give to the reasonable and informed third party; namely that KPMG's objectivity had been impaired or was likely to be impaired.

ALLEGATION AGAINST MR MARSH

ALLEGATION 5: The Timing of the Disposal of Mr Marsh's Shares in CWW

Between 3 October 2011 and 31 January 2012, Mr Marsh held a direct financial interest in an audited entity, namely CWW, contrary to the requirements of ES2.7, and also the requirements of section 3.3 of the KPMG Manual and thereby the conduct of Mr Marsh fell significantly short of the standards reasonably to be expected of a Member in that:

5.1 Mr Marsh did not sell all of the Shares prior to taking up his appointment as a partner at KPMG; and

5.2 Although Mr Marsh sold his Shares on his own initiative and at a loss to the 3 October 2011 price, he did so in tranches over the period October 2011 to January 2012 rather than immediately.

Particulars of Allegation 5:

Prior to becoming a partner in KPMG, Mr Marsh held 651,559 shares in CWW, a company which he knew to be an audit client of KPMG. He did not sell the Shares on becoming a partner, but instead sold the Shares in four tranches over the period October 2011 to January 2012.

Signed:

GARETH REES QC
EXECUTIVE COUNSEL

Date: 9th July 2014.