FINANCIAL REPORTING COUNCIL:

Before the Disciplinary Tribunal;

HH Stephen Powles QC
Christopher Whittington
Paul Acres

Hearing on: 4th and 5th December 2014

IN THE MATTER OF A FORMAL COMPLAINT

B E T W E E N

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

- and -

KPMG LLP (1)

- and -

JAMES MARSH (2)

REPORT OF THE DISCIPLINARY TRIBUNAL

INTRODUCTION:

1. The case concerns the public interest in ensuring the independence and objectivity of auditors and compliance with ethical and other standards. The matters investigated by the FRC and leading to these proceedings, arose on Mr Marsh leaving Cable and Wireless Worldwide plc ("CWW") and joining KPMG LLP ("KPMG") whose wholly owned subsidiary KPMG AUDIT plc ("AUDIT") were the auditors of CWW, without disposing of all his shares in CWW for over 4 months and subsequently being appointed to a position potentially in the chain of command for the audit itself.

2. At the heart of the matter are standards introduced by the Audit Practices Board ("APB") APB Ethical Standard 1, para 2.7 to the effect that a partner should not hold shares in an audit client company and standard APB ES2 para 58, to the effect that no one should be engaged in a position to be able to influence an audit within 2 years of leaving the client company.

3. Ms Joanna Smith QC has appeared on behalf of the FRC and Mr Lomas of Freshfields Bruckhaus Deringer LLP on behalf of KPMG and Mr Marsh.

4. The Formal Complaint includes an introductory section followed by an analysis of the relevant standards leading to the formal allegations. In this case the facts set out are accepted as correct and the allegations are admitted by both Respondents.

5. The parties adopt this as an adequate and sufficient summary of the case and as the precise terms have been the subject of submission and they are reasonably succinct, there seems little purpose in the Tribunal seeking to paraphrase it. We set it out below:

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 of the Institute of Chartered Accountants in England and Wales ("**ICAEW**"), and
   - 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. 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.

11. 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.

12. 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[1] system from the date of joining. Mr Marsh was allocated his KICS account on 14 October and completed his KICS entry by 22 November.

13. 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).

14. 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

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

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

15. 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.

16. 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.

17. 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.

18. 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.

19. 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

20. 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 and his total pay distribution for FY12 was reduced by £60,000.

21. 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 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

22. 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.

23. 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.

24. 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.

25. 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.

26. 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..."*.

27. 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.

28. 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".*

29. 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".*

30. 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.

6. The Formal complaint is annexed to this report and may be referred to for the full text of the allegations and the particulars given as well as the terms of the various relevant standards.

7. The allegations against KPMG are fourfold in summary:

   (i) On Mr Marsh's first appointment: (1) the failure on the part of KPMG to require the immediate sale of the Shares upon Mr Marsh becoming a partner in KPMG, (2) the lack of sufficient or appropriate procedures within KPMG to prevent or identify the failure on the part of Mr Marsh to sell the Shares; and (3) the lack of an appropriate control environment within KPMG that placed adherence to ethical principles and compliance with APB Ethical Standards above commercial considerations.

   (ii) On Mr Marsh's subsequent appointment to Chief operating officer ("COO") there is one allegation in respect of this: namely (4) that KPMG appointed Mr Marsh to this role (a role in which he was able to influence the conduct and outcome of the CWW audit), at a time when CWW was a listed audit client of AUDIT and Mr Marsh had, less than 2 years previously, been in a position at CWW to exert significant influence over the financial statements of CWW.

8. There is one allegation against Mr Marsh, namely (5) his failure immediately to dispose of the Shares when he became a partner in KPMG;

9. In light of the admissions made and under paragraph 9(7)(i) of the Accountancy Scheme we find the allegations established and make adverse findings in respect of each formal allegation of misconduct.

10. The importance of ethical standards to ensure the independence, objectivity and integrity of auditors cannot be over stated. They are at the very heart of the public confidence in the audit process on which in turn the public confidence in capital markets and the conduct of public entities, depends.

11. Such is their importance that in 2003 the Government established the Auditing Practices Board to take over from the professions responsibility for standard setting in this area. This task is now assimilated within the FRC. There are different sources of standards in this case: those imposed by the APB and those required by the appropriate professional body.

12. The Tribunal accepts that Mr Matthews, who became Head of Quality and Risk Management on 1st January 2012 and Ethics Partner on 13th September 2013, is correct in stating the importance that is attached to compliance with the APB Ethical Standards by the audit profession and the importance that is attached to compliance with those Standards by the audit profession and the desirability of upholding compliance with them. The Tribunal also accepts (it has not been challenged) that since the events giving rise to these proceedings changes have been made within KPMG in systems, procedures and training to ensure that such an occurrence will not recur.

13. However, clear breaches of the standards occurred from the Autumn of 2010 which were picked up by the FRC on a compliance review and to the mind of this Tribunal reveal a state of affairs which fell short of what might be expected of any firm let alone one of the so called "big four" which trumpets amongst its objectives not only to dominate professional services in the UK but also to work to the highest standards of professionalism, to obtain the highest level of performance and to meet the profession's responsibilities to the public.

14. The Panel's powers of sanction derive from paragraph 9(8)(i) of the Scheme. It may make no order, or impose any of the sanctions set out in appendix 1 to the Scheme. These include reprimand, severe reprimand and a fine which may be imposed singly or in combination. In addition it may order a Respondent to pay costs.

15. We are grateful to Counsel for the FRC for setting out the relevant provisions of the Scheme and of the Sanctions Guidance including paragraphs 9, 11, 13, 16 and onwards. These provisions are advisory only and are not binding on the Tribunal, however should we decide to depart from them we should explain why we are doing so.

16. All parties' submissions have focussed on the six stage approach set out in paragraph 16 of the guidance which for convenience is set out below:

"16. It follows, therefore, that the normal approach to determining the sanction to be imposed in a particular case should be to:

> i. Assess the nature and seriousness of the Misconduct found by the Tribunal (paragraphs 17 to 21);
>
> ii. Identify the sanction (including the range within which any fine might fall) or combination of sanctions that the Tribunal considers potentially appropriate having regard to the Misconduct identified in i above (paragraphs 22 to 47);
>
> iii. Consider any relevant aggravating or mitigating circumstances and how those circumstances affect the level of sanction under consideration (paragraph 48 to 54);

iv. Consider any further adjustment necessary to achieve the appropriate deterrent effect (see paragraphs 55 and 56);
v. Consider whether a discount for admissions or settlement is appropriate (paragraphs 57 to 61);
vi. Decide which sanction(s) to order and the level/duration of the sanction(s) where appropriate; and
vii. Give an explanation at each of the six stages above, sufficient to enable the parties and the public to understand the Tribunal's conclusions."

Stage 1; Nature and seriousness;

17. Ms Smith submits by reference to paragraph 18 of the guidance that

(a) In relation to allegations 1 – 3 (KPMG; non-sale of Marsh shares)

(i) the conduct complained of was unintentional

(ii) the failure to have proper procedures and controls was unintentional

(iii) junior staff within KPMG knew of the shares from the start but did not escalate the knowledge that they had not been disposed of. This was despite a procedure set out in their manual.

(iv) the standards are of fundamental importance

(v) no dishonest or reckless behaviour is involved

(vi) there is a breach of ISQC 1 and ES1.16, effective procedures were not in place, and internal procedures were not fully complied with;

(vii) KPMG has made changes to its policies and procedures, guidance and training programme

(b) In relation to allegation 4; KPMG appointing Mr Marsh to COO the same general points are made with the following modifications and additions:

(viii) KPMG ought to have resigned as auditors of CWW on Mr Marsh's appointment as chief operating officer, instead, and after some delay, it prepared a private, internal paper structure designed to exclude Mr Marsh from the chain of command.

(ix) the appointment was intentional and involved senior management

(x) the appointment was deliberate and reckless

(xi) even if Mr Marsh could not in fact influence the audit to 31 March 2012 there was a clear and continuing breach of ES2.58 until 27th June 2013, 2 years from his ceasing to be CEO of the client (had AUDIT's engagement not been terminated on 15th August)

(xii) there was a failure to carry out any proper process to ensure compliance with ES2.58

(xiii) no regard was shown for the public perception of such a state of affairs

(c) In relation to allegation 5 – Mr Marsh alone:

(i) Mr Marsh should have been aware of the content of the KPMG manual and had signed a new joiner form. Not disposing of the shares was at least reckless

18. Mr Lomas reminded us that the primary purpose of sanctions is not to punish but to protect the public and the wider public interest as provided in Paragraph 9 of the Guidance and submits, in summary;

(a) Allegation 1,2 & 3 (KPMG non-sale of shares)

(i) KPMG has made changes to its policies and procedures, guidance and training programme

(ii) Mr Marsh owned the shares through his remuneration package with CWW

(iii) he did not disclose the shares on the new joiner form prior to joining. It is accepted the form does not raise a specific question but asks a general one about compliance.

(iv) it is accepted the Ethics Team did not make clear the need to sell immediately

(v) during October Mr Marsh disclosed the shares to the ethics team

(vi) the KICS account was opened on 14th October when the first tranche was sold and completed by 22nd November

(vii) on 22nd November Mr Marsh disclosed the sale of two tranches of shares only but the matter was not then escalated.

(viii) the ethics team did not notify the audit partner

(ix) the final tranche of shares was sold on 31st January and recorded in KICS on 15th February 2012

(x) at no time was Mr Marsh formally warned that he was in breach

(xi) internal procedures to enforce a prompt sale did not operate effectively

(xii) while the standards are of fundamental importance not every breach is a serious one

(xiii) the conduct was not intentional, deliberate, dishonest or reckless

(xiv) Mr Marsh was not involved in audit practice and there was in fact no independence breach

(xv) there was no intention to derive financial benefit

(xvi) KPMG imposed upon Mr Marsh a £60,000 penalty, the largest imposed by KPMG for what they term a category 3 breach.

(xvii) Mr Marsh has completed mandatory partner training

(xviii) Mr Hawes has been sanctioned by reduction of £500 of his bonus

(xix) Internal procedures have been raised in importance and overhauled in an extensive way

(b) Allegation 4 (KPMG; appointment to COO)

(i) KPMG's recusal document was effective but the issue is not before the Tribunal

(ii) there is an admitted breach for the period from appointment until the recusal document 11th May to 2nd July. The document itself is senior management seeking to resolve an issue in good faith and cannot be taken otherwise. It should be seen as mitigation by responsible management and not a cynical circumvention of independence rules

(iii) the appointment of COO was due to occur in October but was accelerated to May creating a situation in which the point was overlooked

(iv) Mr Marsh was in the chain of command only because he might influence salary levels of auditors

(v) the audit of CWW was signed off on 23rd May (documents show 21st May), he could not have had any influence in fact.

(vi) KPMG's appointment as auditors of CWW was definitively terminated on 15th August 2013 because of a client take over and Mr Marsh was not able to influence salary levels until 2nd September

(vii) the recusal document did in fact protect the audit from any influence by Mr Marsh

(viii) there was no intention to conceal the situation from the regulator as demonstrated in the email record

(ix) the conduct was not intentional, deliberate, dishonest or reckless

(x) there was no financial benefit for anyone

(xi) the conduct was not capable of undermining confidence in the profession or in financial reporting

(c) Allegation 5 (Mr Marsh)

(i) the points already raised for KPMG can be made in respect of Mr Marsh also

(ii) it was a matter of oversight, his ownership of the shares was made clear from the start

(iii) a discussion with an individual in the compliance team led him to believe he could sell over a reasonable period in tranches

(iv) his oversight was not intentional, deliberate, dishonest or made in bad faith. He had not been involved in audit matters for over 15 years

(v) there was no breach of independence in fact because he started in a non audit role in financial services practice.

(vi) there was no loss, to anyone or denting of public confidence

(vii) he has already been sanctioned by a remuneration loss of £60,000

(viii) he has personally pushed for improvement within KPMG

<u>Stage 2;</u> Identify appropriate sanctions

19. Ms Smith submits that Repayment of fees, Preclusion, Exclusion or in light of the changes made a direction are not appropriate in these cases. This leaves Reprimand, Severe Reprimand and Fine in the frame.

20. She reminds us that under paragraph 15 of the Guidance ordinarily if the misconduct warrants a severe reprimand it will be appropriate for it to be ordered in conjunction with another sanction. A fine can be ordered in conjunction with any other sanction. She has drawn our attention to Paragaphs 22 – 25 in respect of Reprimands, and 29 to 36 in respect of fines. In particular that it is normally in the public interest for any conduct warranting the imposition of a fine to be accompanied by some degree of censure (a Reprimand or Severe Reprimand). She submits there is no suggestion of financial gain by KPMG or Marsh save in respect of allegation 4 where the audit fee was saved.

21. Invited by the tribunal to suggest a bracket within which any fine might lie and explain how it might derive from the financial information available, she suggested for KPMG at stage 1&2 (before mitigation) on the FRC's view of the facts and taking the 4 allegations together a range of £1m to £1.5m and for Mr Marsh £100k to £150k. The reasoning was based largely on the need for deterrence

22. Mr Lomas submits this is the first case before the FRC for breach of independence rules particularly where there has been no impact in fact on the independence they seek to protect. He referred us to ICEAW cases concerning BDO and KJ Pittalis in both of which a reprimand was given coupled with a fine in the Pittalis case. He submits that a Reprimand alone would be appropriate sanction both in respect of KPMG and of Mr Marsh. In Mr Marsh's case he points out the lasting damage a Reprimand will have to his reputation and career

23. In his oral submissions he said that KPMG's policy in relation to ethics was laudable and clear, that the organisation is huge on any view, it currently has 613 partners and 10,752 employees, and that it is inevitable that from time to time there will be instances of non compliance but these should not be seen otherwise than human failing which it is not realistically possible to avoid and should not be taken as an indication of some underlying malaise. Indeed the actions of KPMG in strengthening their system and themselves sanctioning defaulters should be encouraged and not lead to deterrent sanction.

<u>Stage 3;</u> Aggravating and Mitigating circumstances

24. By reference to paragraph 53 of the Guidance, Ms Smith has drawn our attention to the following;

(i) the misconduct only came to light through the work of the FRC's quality Review Team

(ii) senior management were aware of misconduct but took no step to resign as auditors; rather they were intent on keeping the fee and retaining the relationship with the client (allegation 4)

(iii) KPMG face further sanction for breach of ethical standards in the case of Watts to be heard on 5th December. The misconduct which occurred at much the same time is admitted.

(iv) Mr Marsh has a good compliance history and disciplinary record.

(v) full cooperation has been given

(vi) KPMG has changed its policies and strengthened guidance

(vii) Mr Marsh has suffered a reduction in his risk rating within KPMG and hence a reduction in his pay. We are told his total loss is £60,000

(viii) it is not contended Mr Marsh stood to gain or profit

(ix) regret has been expressed

25. Mr Lomas highlights that

(i) both KPMG and Mr Marsh have cooperated fully and have been open and transparent about what occurred

(ii) substantial steps have been taken to remedy matters

(iii) the breaches were isolated events unlikely to be repeated

(iv) there was no gain or loss and no bad faith

(v) KPMG have a good compliance history as does Mr Marsh

(vi) KPMG were unaware of the breach until it was drawn to their attention by the FRC

(vii) there was no actual impact on the independence of the audit

(viii) Mr Marsh has suffered financial loss through the sanction applied by his employers, KPMG

(ix) contrition demonstrated

(x) Since the events in the Formal Complaint, Mr Marsh has undertaken mandatory partner training on independence, as required for all partners, in 2012 and 2013.

Stage 4: Adjustments for deterrence

26. We have been reminded of paragraphs 55 and 56 of the Guidance by Ms Smith. Mr Lomas says there is no case here for any increase in sanctions to provide deterrence in the light of the full cooperation and remedial steps taken

Stage 5: Discount for admissions or settlement

27. Ms Smith suggests that regard might be had by analogy to the guidance in relation to settlements set out in paragraph 59 of the Guidance. She also drew attention to paragraph 20 and said by analogy we should disregard the fact that Mr Marsh had suffered a fine from KPMG of £60k

28. Mr Lomas said that there is no basis for a financial penalty but if the Tribunal thinks otherwise it should be at the bottom end of the scale and any adjustment should be discounted by 35% in light of the early and complete co-operation.

Discussion

The parties' approach to the hearings

29. It is important to appreciate that the facts set out in the Formal Complaint have been the subject of discussion and revision which resulted in an agreed set of facts on which the Tribunal could come to its conclusion on sanction. Such an approach is to be commended and the parties congratulated on its achievement. A great saving in cost and time has doubtless resulted. Furthermore the parties have prepared an extremely helpful agreed chronology.

30. The parties were free to draw attention to any document that might bear on sanction and to call evidence of matters going to sanction whether directly referred to in the Sanctions Guidance or not.

31. The FRC did not call any evidence but relied on the agreement. However by reference to documents, they mounted a case that Mr Marsh had in fact been reckless in not selling his shares and KPMG reckless about his appointment to COO. That case first appeared in written submissions on 27th October 2014.

32. Mr Lomas responded in his written submission for KPMG by expressing surprise and suggesting that such an allegation was quite inappropriate in relation to share issues. In respect of the COO appointment he met the fresh allegation head on with detailed submissions as to why it should be rejected.

33. It would appear to the Tribunal that if an allegation is to be made that anyone had been reckless in their conduct of professional affairs, that allegation should be made clearly within the allegation itself. Where a regulation does not specify recklessness amongst the different ways a breach might occur then the fact of recklessness, if relied on, should be included in the particulars. It was not.

34. Where an agreement is reached but there are matters that are to be left to a Tribunal to decide they should be identified clearly and flagged up for possible directions as to evidence and mode of decision at the first opportunity. This was not done.

35. Mr Lomas did not apply at the hearing for consideration as to whether the FRC should be precluded from raising this matter and the case has proceeded on the basis that if recklessness can be shown it would have a material effect on sanction.

36. Mr Lomas made another strategic decision which was not to call either Mr Marsh or Mr Matthews to affirm their witness statements or to give evidence about the recent recklessness suggestion. Ms Smith confirmed earlier indications that she did not wish to cross examine anyway. The Tribunal had identified a number of matters which might with advantage have been ventilated but in the somewhat unusual circumstances that had developed of the parties own choosing, thought it better to leave each side with the evidence they wanted considered without further intervention by the Tribunal, save to warn that evidence untested by or offered for cross examination would carry less weight.

The relevance of evidence in the Watts case.

37. It is apparent from the submissions filed on behalf of Executive Counsel in this case and the case of Watts which follows immediately that the FRC wishes the Tribunal to take account of the evidence in both cases when deciding the facts and sanctions in either. If

this was thought appropriate application should have been made for the two cases to have been heard together. Consideration would then have been given as to whether the links between them justified such a course and if not whether it was appropriate for the same Tribunal Members to hear both cases. On the face of it, since one involved KPMG and the other KPMG AUDIT, with different individuals and circumstances occurring at different times, joinder was not an immediately obvious requirement. Mr Lomas has not formally objected but has submitted that no account should be taken of one case in the other save and except that by the time we come to consider the Watts case a formal adverse finding will have been made in the Marsh case which may become relevant to sanction.

38. As will become evident, we do not find that evidence from the Watts case makes a difference to the conclusions we would otherwise make in this case and it is unnecessary to address this problem further.

Culpability - Recklessness or isolated events

39. In paragraph 12 of the formal complaint it is stated "*Mr Marsh mistakenly believed that not being involved in the audit practice and not having been informed to the contrary by [KPMG], he was entitled to sell the shares over a reasonable time*" Mr Lomas submits that recklessness does not involve a mistake but is concerned with taking identified risks. Ms Smith responds by saying the mistaken belief is only about the fact that he can sell over a period, not about the fact that he has to sell in the first place.

40. It seems to the Tribunal that those propositions are not mutually exclusive and that both can be right. The Tribunal agrees with Mr Lomas that the agreement is unqualified and without reservation and sees no basis for exploring materials that might show different recollections on different occasions and potentially conflicting assertions about what happened because at the end of the day there is agreement that this was a mistake. Even were this to be wrong the FRC would need to support a serious allegation such as this with good evidence and while the documents we have been shown raise questions to be asked of Mr Marsh, he was not asked to submit himself for cross examination and such questions were not asked.

41. Mr Marsh had resigned from CWW on 28th June 2011 and joined KPMG as Chief Operating Officer for the Financial Services sales team on 3rd October 2011. At some stage which is unclear, it was decided to appoint him as COO of KPMG with effect

from 1st October 2012. Meanwhile on 25th April 2012 Mr Marsh met Peter Meehan, the senior statutory Auditor of CWW for KPMG, at which time a potential conflict, where a former CEO of CWW in the year to 31st March 2012, then under audit, moves to the 'chain of command' of its auditor, was identified but potential ES2 points and the 2 year rule were not identified at this stage and Mr Marsh was able to reassure Mr Meehan that he was not to take up his appointment until October by which time the audit in question would have been completed.

42. As far as the audit team was concerned at that stage all would have been well on the current audit had it not been decided to bring forward Mr Marsh's appointment to COO to 11th May 2012. No-one involved in that decision identified the 2 year rule prohibiting Mr Marsh from taking a position from which he was potentially in the 'chain of command' and thus able to influence the conduct and outcome of the audit.

43. Mr Meehan was immediately concerned, not that there was a conflict in fact but that there might be a perception of conflict and he raised the matter with the CWW audit committee on 15th May. He records that that committee concluded that there was no real conflict in fact. This seems to have been largely based on the stage the audit had reached.

44. On 21st or 23rd May (documents seem to vary) Mr Meehan signed the audit for the year ending 31st March 2012. Although the audit for that year was now finished AUDIT remained statutory auditors to CWW. This appointment was short lived because on 18th June CWW shareholders accepted a bid from Vodafone who acquired the company on 27th July 2012 and on 15th August 2012 the auditors appointment was terminated. Whether or not any party had early knowledge of this takeover is not relevant to the case.

45. Senior management within KPMG did not become aware of the problem posed by the 2 year rule until Mr Meehan drew it to their attention in an email dated 14th June 2012. On 2nd July, now 7 weeks after his appointment, a document was produced called the "Recusal document" prohibiting Mr Marsh from having a direct supervisory management or other oversight responsibility over either any audit partner of the CWW audit team or over conduct of the CWW audit until the earlier of KPMG's resignation from the audit or the second anniversary of Mr Marsh's departure from CWW.

46. Ms Smith argues that the Recusal document was not effective and furthermore it did nothing to disabuse a reasonably informed third party of a perception that KPMG's objectivity had been impaired or was likely to be impaired. According to her the only acceptable step having made the appointment was for AUDIT to have resigned as

auditors and their failure to do so was deliberate and motivated by a desire to save the audit fees.

47. Mr Lomas pointed out that Mr Meehan had gone back to CWW on 15th May and told them about Mr Marsh's appointment and that they accepted that no conflicts existed because there had not been nor could there be any involvement by Mr Marsh with the audit in question. No one realised at that stage that ES2 para 58 was engaged and so there cannot have been a deliberate taking of a risk. It is not necessary for the Tribunal to decide whether the recusal document is effective; it is not part of any allegation or its particulars and from a mitigation perspective what matters is whether the document was bona fide. If it was then KPMG cannot have intended to take a risk.

48. Whether or not the recusal document or one like it in these or other circumstances can be valid (given the FRC's view that it cannot) may become the subject of a decision in which it arises directly. For our part the arguments we have had on what is potentially a most important point for the profession have been necessarily limited and we cannot see that the sanction we impose is going to be significantly different whether the breach ended on 2nd July or on 15th August when the audit appointment was terminated. The more so when no significant event occurred in the meantime. We agree with Mr Lomas that it is at least persuasively arguable that the recusal document was valid and we have no evidence to support the contention that it was other than a bona fide step to rectify an admitted breach.

49. While it is a proper matter for comment that KPMG did not succeed in avoiding the difficulties it got itself into there is no evidence that KPMG its partners or staff were engaged in intentional risk taking. The matters we have been asked to consider are little more than speculation and there is an explanation for every one. We have no hesitation in rejecting the attempt to prove otherwise.

50. However, we would agree with Ms Smith that the implications of appointing Mr Marsh COO were not properly thought through nor the problems identified in a timely fashion within KPMG. Ethics have much to do with perception as is made clear in the rules and regulations. For example;

    (i) ES1 para 13 "Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired……"
    (ii) ES1 para 14 “"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 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"

(iii) ES1 para 15 "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. As a result of the influence that the Board of directors and management have over the appointment and remuneration of the auditor absolute independence cannot be achieved or maintained. The audit engagement partner considers the application of safeguards where there are threats to auditor independence (both actual and perceived)".

51. The following matters are capable of giving rise to an inference, however well intentioned the manual may be and however good it is in an effort to ensure compliance with ethical standards, that the message it conveys of the importance of such standards had not fully registered in the minds of those who had dealings with the "on boarding" of Mr Marsh and in his appointment to the position of COO;

(i) There is no evidence that anyone in the joiner team mentioned to him that he would have to sell the shares, as they should have realised he was likely to have acquired them during his time with CWW

(ii) There is no evidence that ethical compliance had formed any part of the consideration into whether Mr Marsh should be engaged or not or whether his engagement would present problems in any areas.

(iii) Mr Marsh is presented with a new joiner form to sign sent by email at 11.09 on Wednesday 28th September just 2 working days (plus a weekend) before he was due to start on Monday 3rd October 2012. The email attached electronic versions of the manual and other documents comprising some 87 pages of relatively dense text and although an offer was made to send hard copy this may have been unrealistic given the time scale. There is no evidence about Mr Marsh's commitments in that short interval however he seemingly accomplished the task as he signed the form on Friday 30th September.

(iv) Contact between Mr Marsh, who was joining in a very senior position, and the ethics team is left to a very junior employee, Mr Hawes

(v) After joining, it is 12 days before his KICS account is opened.

(vi) After Mr Marsh has entered his shares on the KICS account he is not told he must sell and Mr Hawes does not escalate that failure.

(vii) Although in April the audit partner on the CWW audit raised concerns about the appointment to COO this did not trigger any wider thinking about Ethical standards and the 2 year rule which would have been breached even if the original start date of 1st October 2012 had been adhered to.

(viii) There is no evidence that any consideration at all was given, when bringing the date forward for his appointment as COO to 11th May 2012, to the fact that the audit for the year ending 31st March 2012 had not yet been signed off and included a period during which he had been CEO of the client, CWW.

(ix) Although the breach was finally identified on 7th June nothing was done until 2nd July which was 7 weeks after the appointment.

(x) When looking at the case of Watts there can be added that in the autumn of 2010 the problems inherent in continuing with an audit when a partner who arguably had been in the chain of command for the audit joins the board of the client did not come into the minds of responsible persons until after the event and the audit partner not did see fit to include anything about it in his independence letter in February 2011.

(xi) the remedies that have been put in place for new joiners once these two cases came to light include; an interview with a senior member of the ethics team; training throughout the organisation; a formal hand over from the appointment to ethics team;

52. Mr Lomas seeks to persuade us that the allegations all relate to isolated events and should be seen in the context of a substantial organisation with a well developed set of procedures which realistically cannot be expected to be able prevent all human frailty and failure. From time to time, as problems arise what matters is that the system is re-examined and strengthened to minimise the risk of recurrence. He says there is no evidence that these events show anything untoward beyond themselves and had it been

intended to show a poor culture within the firm a great deal more evidence should have been called by the FRC. He invites us to draw no inference.

53. We agree with Ms Smith that the matters listed above do show a certain lack of attention to the implementation of their own ethics policy by those who should know better. We have already rejected her contention that they show recklessness. It is noted that save for passing reference in the context of subsequent events, KPMG has not called any evidence about the period prior to the matters in the formal complaint on for example; training programmes and the frequency with which all members are refreshed on ethical standards in general or specifically with reference to those involved in these allegations; internal compliance audits; enforcement procedures to mention only a few.

54. In the result (whether or not account is take of the evidence in the Watts case) we do draw the inference set out above and reject Mr Lomas' submission that these can be seen as isolated events. They may be the route by which a poor state of affairs is discovered but it is that state of affairs which attracts the stronger sanction. For how long and how deeply entrenched this state of affairs may have become is difficult to say and we should not go beyond what may properly be inferred from the circumstances. Not knowing about training schedules and the frequency of retraining complicates matters but the situation did not develop overnight; rather it is likely to have been present for many months perhaps years.

55. As far as Mr Marsh is concerned, while we agree for the reasons set out above that the importance of ethical considerations was not given prominence by KPMG, nonetheless Mr Marsh should have been aware from the company positions he had held that ethics are a core requirement of a financial organisation such as KPMG. If he did not have enough time to consider the papers sent to him (he has not said so) he should have asked for more time or not signed the form as he did. If he needed help he should have asked for it. While we have rejected the contention that he was reckless, his performance (or lack of it) in making disclosure and signing the form was well below what might be expected.

The law as it impinges on sanction

56. We do not shrink from saying that we have found arriving at an appropriate sanction difficult. Although there is useful material in the sanctions guidance it is mostly concerned with promoting a clear and fair procedure and identifying matters to take into

account. What it does not do is offer any guidance on what the result should be in any particular set of circumstances. There is no anchor point such as a maximum fine or example of sanctions delivered by other tribunals of the FRC in the area of ethics. We are told our decision will be taken as a precedent but for our part consider that most of these cases are decided on their own special facts and circumstances and should we offer any words of general import they deserve no more weight that the views of the tribunal considering another case.

57. That is not to say that the question of how to arrive at a fine for breach of statutory regulation is free of judicial authority.

58. Following the Hatfield rail crash on 17th October 2000, Balfour Beatty Rail Infrastructure Services Ltd were prosecuted under the Health and Safety Legislation and fined £10 million. On appeal the fine was reduced to £7.5 million. The decision is reported under *R v Balfour Beatty* [2006] EWCA Crim 1586. In the course of their judgements the Court of Appeal approved the Judge's summary of thirteen principles he had derived from *R v Howe & Co (Engineers) Ltd* [1999] 2 Cr App 37 for sentencing those who break both public and private regulatory duties.

59. Those principles were adopted by the Accountancy and Actuarial Discipline Board (a forerunner of the FRC) in a decision dated 6th December 2011 on a complaint against Price Waterhouse Coopers LLP over their audit of JP Morgan Securities Limited, of failing to detect the transfer of client monies into a non-segregated account. It was shown that over a period of some 7 years the average amount of client money that had become desegregated was US$8.55 billion. The FSA fined JP Morgan £33.32 million. PWC who had several opportunities to discover what was occurring, were sanctioned to a severe reprimand and a fine of £1.4 million.

60. Both Ms Smith and Mr Lomas submit that the Balfour Beatty case as applied in that of PWC offers useful guidance to us as to principle although caution should be exercised as the regulatory regimes are different. Many of the principles are already enshrined in the Sanctions Guidance (which is advisory only but which we intend to follow) but we draw from the helpful summary in paragraph 29 of the decision; it is not possible to say that a fine should stand in any specific relationship with a turnover or net profit of a firm; consistency of fines between one case and another and proportionality may be difficult to achieve and so consistency may not be a primary aim of sentencing in this area; the

fact that a risk has by good fortune not eventuated is a relevant factor and we do not take paragraph 13 of the Sanctions Guidance to say otherwise.

61. We were referred to the case of *Fuglers LLP v Solicitors Regulatory Authority* [2014] EWHC 179 (admin) where a firm of solicitors, knowing Portsmouth Football Club was close to insolvency had permitted their own client account to be used as a bank account for the club. Popplewell J. upheld a fine of £50,000 levied on the 2 partner firm and in doing so referred to observations made by Sir Thomas Bingham MR as he then was in the case of *Bolton v The Law Society* [1994] 1WLR 512 about the purpose of sanction.

62. In *Bolton* the Master of the Rolls referred to the importance that solicitors should discharge their professional duties with integrity, probity and complete trustworthiness and that any solicitor failing to do so must expect severe sanctions to be imposed. He said that the most fundamental purpose of sanction was to maintain the reputation of the profession as one which every member of whatever standing could be trusted to the ends of the earth so the public might have full confidence in any solicitor they might instruct. The case was one in which the solicitor had not been guilty of dishonesty but was found to have been naïve and foolish in distributing completion monies prior to completion which then did not take place. The 2 year suspension from practice was upheld.

63. Two other cases cited to us by Mr Lomas were in informal reports one where BDO was reprimanded and fined £5,750 for permitting a partner who was not involved in the audit of a client to hold 45,453 shares in that client until he had held them 3 years to qualify for EIS relief, thereby saving himself £6000; the other a small firm called Pittalis & Co audited the principal's own family company in which he held a direct financial interest of 6.87%. The firm was reprimanded and fined £7000.

64. It is difficult to discern any particular tone in the sanction given in these cases of ethical breach beyond the seriousness with which ethical standards must be taken, a point which is advanced forcibly by Ms Smith but every breach of an important and serious standard is not necessarily a serious breach as Mr Lomas reminds us.

The Sanctions

Stage 1 – nature and seriousness of misconduct

65. Of the factors listed in paragraph 18 we considered the following to be of particular relevance: there was no financial benefit and all breaches occurred unintentionally; all

breaches of ethical standards have the potential to undermine public confidence in some respects KPMG are fortunate that the facts of this case have come to light because it has given them an opportunity to correct a state of affairs that uncorrected may have led to a more serious breach; the state of affairs in KPMG which permitted these breaches to occur has been addressed; Mr Marsh was not solely responsible for his failure to identify the need for immediate sale, it is the Tribunals view that greater culpability lies at the door of KPMG.

Stage 2 – identify sanction range

66. Looking at the totality of breach across all allegations a reprimand is obviously appropriate but in light of our rejection of the case that the breaches can be looked at as isolated incidents severe reprimand should also be considered.

67. Considerations of the size of a fine engage paragraphs 29 to 36 of the Sanctions Guidance. The revenue and operating profit for KPMG and AUDIT combined for 2013, are £446m and £60m respectively. The fee income generated by the CWW audit was in the region of £1.6m. The income Mr Marsh derived from his appointment to KPMG is known to the Tribunal and to the FRC but is commercially sensitive. We see no overriding need to recite the figures here.

68. Before moving to consider further mitigation and deterrence, which come in later stages an accompanying fine might be appropriate for KPMG in the range £250k to £500k and for Mr Marsh in the range £60k to £120k. In reaching this bracket we have no reason to think that the fine imposed in the PWC case for a far more serious breach with highly damaging consequences is either too high or too low but that we should endeavour to ensure that our sanction retains an element of consistency with this case and is proportionate to the harm actually done. The fines levied on BDO and Pittalis are very small and the reports do not explain the full circumstances or thinking behind the fine. As we have already said nearly every decision will be sensitive to its own particular facts and we do not find these two cases very helpful.

69. While not directly relevant to our consideration at this stage, it is noted that Mr Marsh suffered a penalty imposed by KPMG of £60,000 which is said to be the largest ever amount within the firm for a category 3 breach and which was imposed as a result of his senior position. It seems to us that the figure is a useful cross check on our bracket and is the same order of magnitude.

Stage 3 – aggravation and mitigation

70. We have already rejected the contention that the breaches occurred recklessly and found them to be unintentional. Of the examples of aggravating conduct in paragraph 53 of the Guidance while it can be said that neither KPMG nor Mr Marsh brought these matters to the attention of FRC this was because they were not aware that a breach had occurred. It is the case that Mr Marsh was in a senior position and KPMG are one of the so called "big four" of the accounting world.

71. As far as mitigation features are concerned, of the list in paragraph 54 the following are clearly relevant: Mr Marsh and KPMG have cooperated fully with the FRC in the investigation and in the preparation and presentation of the proceedings (cooperation in the proceedings by timely admissions comes later); as soon as senior management were aware of the matters comprised in allegation 4 they took steps to remedy the situation; the undoubted overhaul of the system to remedy the exposed weakness has already been taken into account in fixing the bracket at stage 2; as has the absence of gain or loss; both KPMG and Mr Marsh have taken the allegations seriously and expressed contrition; Mr Marsh has taken a personal interest in the overhaul of the procedures in an effort to ensure that repetition will not occur; Mr Marsh has suffered a loss of income at the hands of KPMG of £60,000.

72. The account to be taken of the fact that Mr Marsh has already been sanctioned £60k by KPMG on precisely the same facts and for the same conduct was the subject of brief submissions. Ms Smith drew our attention to paragraph 20 of the Guidance which advises we should disregard fines imposed by another regulator or authority but take account of it only when considering a respondents financial position. It is clear law, never mind paragraph 20, that someone who has infringed the law cannot expect to have losses suffered in consequence of their behaviour deducted from a fine. Account could be taken in a general way especially if an ability to pay the proper fine has been compromised.

73. It is our view paragraph 20 is looking at something a little different. A given piece of conduct can breach the requirements of a number of different regulators with different provisions seeking to achieve different objectives. In those circumstances each should impose the appropriate sanction but taking account of a respondent's financial position as it stands after the previous fines.

74. This case however seems to us to be somewhat different. It is important for the encouragement of compliance that employers should through internal systems be able to sanction defaulters. We see little reason to treat this payment as if it were the same as the type of loss he has suffered by holding onto the shares. On the contrary it is a penalty for the very conduct for which we are presently asked to sanction him. To refuse to reduce the fine on account of it would be unjust and do nothing to promote the primary objects of the scheme which is to protect the public, maintain public confidence in the accountancy profession and uphold standards of conduct. Indeed such aims are supported by encouraging internal policing and sanction by accountancy firms themselves.

75. It is a little curious that the £60k on this occasion went back into the profits of KPMG. However we are told that the scheme has been changed and these payments now go into the KPMG charitable foundation and are used to support community projects.

76. In the result the Tribunal has taken the fact of this deduction into account in a general way and the fine is consequently less than it would have been.

77. Putting all the factors into our consideration and before discount for admissions we find the fine should be for KPMG £350k and for Mr Marsh £60k and both should be reprimanded. The difference reflects KPMG's greater responsibility for the non-sale of shares and the fact they are solely concerned with allegations 1 to 3.

Stage 4 – adjustment for deterrence

78. It is this Tribunals view that neither KPMG nor Mr Marsh need any further deterrence. They clearly recognise the importance of ethical considerations and have demonstrated a determination to lead in the quest for compliance. As far as other firms are concerned if we have achieved the correct level of sanction there would be no warrant to increase what we consider to be proper sanction on this account by increasing the strength of reprimand or of the fine. In our view, the overall sanction will send a proper message to other members of the profession.

Stage 5 – discount for admissions

79. Both Mr Marsh and KPMG are entitled to (and deserve) a deduction of 35%. This reduces the fines to £227,500 for KPMG and £39,000 for Mr Marsh.

Decision

80. We made adverse findings on all allegations in the course of the proceedings. We have followed the Sanctions Guidance in determining the appropriate type and level of sanction as set out above. We are satisfied that these fines are proportionate to the breach and the financial circumstances of the respondents.

81. KPMG is reprimanded and will pay a fine of £227,500; Mr Marsh is reprimanded and will pay a fine of £39,000

Costs

82. After the hearing the parties handed to the Tribunal Secretary a signed document whereby KPMG agreed to pay the costs of the proceedings in the sum of £43,895.78 in 28 days. It invited the Tribunal to make such deduction from that figure as it thought proper in the light of its findings on the issues of recklessness and intent based only on the submissions it had already received.

83. There is no doubt that the proceedings have been more protracted and costly as a result of such allegation and the way that it came before the Tribunal. The time estimate had been half day only but which the court had extended to 1 day in an effort to ensure the Tribunal would have time to discuss its conclusions. In the event all that time was taken and a further hour and a half the following day.

84. Mr Lomas is not asking for his own costs in respect of that time just a reduction in the cost to be paid to the FRC. This is not a case where it can be said that KPMG brought the allegation on itself, on the contrary it has been totally cooperative. The question was not reserved from the agreement in respect of the Formal Complaint and having listened to the evidence and submissions the Tribunal finds that it would have been better not raised. It would of course only be the additional costs of the extra time and we have little information to guide us. Doing the best we can there will be a deduction of £5,000 from the costs otherwise agreed to be paid.

85. It subsequently transpired that the figure for costs had omitted the Tribunal Members' and Secretary's time based fees for preparatory work, both before and after the hearing as well as expenses and disbursements.

86. The Tribunal has been informed via the Secretary that these additional costs are agreed to be paid by KPMG.

87. The totality of these costs will not be known until after the Report has been published. In the circumstances a proper order would seem to be that KPMG LLP should (1) pay the FRC the agreed sum of £43,895.78 less £5000 within 28 days (2) pay the FRC such further sums as are not included in the above sum but which are paid to the Tribunal Members and Secretary together with any expenses or disbursements in connection with the hearing within 14 days of being notified of the total thereof by the FRC (3) in the event of any dispute as to the amount of the additional sum the matter is to be referred to a costs judge for determination (4) Liberty to apply to the Tribunal Chairman (a) for reconsideration of this order within 14 days of it being notified to the parties and (b) for further directions if needed.

88. The Tribunal were unanimous in the above decisions.

....

HH Stephen Powles QC

(Tribunal Chairman)

Dated 26 January 2015