



Bermuda Public Accountability Board (BPAB)
The Rosebank Building, 2nd floor
12 Bermudiana Road, Hamilton HM 11
Website: <http://bermudapab.com>

In the matter of KPMG Audit Limited (“KPMG” or the “Firm”) and Damion J Henderson CPA, CA

And in the matter of the Bermuda Public Accountability Act 2011 and the Bermuda Public Accountability (General) Rules 2015 (“the 2015 Rules”)

VIOLATION EVENT NOTICE

FINDINGS, REQUIREMENTS AND PENALTIES IMPOSED BY THE BPAB COMPLIANCE COMMITTEE

(To be published on the BPAB website *bermudapab.com* and notification given to the Public Company Accounting Oversight Board (‘PCAOB’) and CPA Bermuda)

Background

1. KPMG is a PIE public accountant and is licensed and regulated under the Bermuda Public Accountability Act 2011 (“the Act”). Under the Act, the BPAB Compliance Committee carries out periodic inspections of PIE public accountants including KPMG Bermuda. Where necessary, the Committee carries out investigations if it has reason to believe that a PIE public accountant may have committed a violation event which is an act or practice that is done in violation or breach of the Act.
2. KPMG is also regulated by other supervisory bodies, including the PCAOB which is a United States body. The PCAOB also conducts periodic inspections of firms that perform audit work on U.S. issuers and has enforcement and investigatory powers. This matter arises out of a 9 April 2019 Order of the PCAOB arising from an accepted Offer of Settlement.
3. In the fall of 2014, members of KPMG’s Ethics and Independence Department (“E&I”) misplaced certain independence confirmations, known internally as independence affidavits, that were previously executed by employees who were either starting or ending their employment with the Firm. These documents formed part of KPMG’s system of quality control and were subject to inspections. After recognizing that the confirmations were misplaced, E & I requested that the 27 affected employees re-execute their confirmations and back date the confirmations consistent with the dates they placed on the original confirmations. All but two employees complied with the Firm’s requests over a period of several months. Certain of the employees were told in follow up communications that it was imperative the documents needed to be on file as KPMG was preparing for a PCAOB inspection.

4. In May 2015, the PCAOB conducted a routine inspection of KPMG. Although the PCAOB inspectors requested to inspect a number of specific independence confirmations, the PCAOB's requests did not include the reproduced and re-executed confirmations. However, a few of the reproduced and re-executed confirmations were placed in a binder of documents created for the inspectors. The Firm did not disclose to the inspectors that the documents in question were reproductions of quality control documents that were previously misplaced, and the face of the documents did not otherwise disclose that these documents were reproductions. On their face the documents appeared to be originals produced and signed in July/August/September 2014 when in actual fact they were produced and executed months later.
5. In 2016, the PCAOB, having discovered that a number of independence affidavits were made available to its inspectors that appeared to be the originals when in fact they were reproductions, initiated an investigation into the matter. KPMG immediately retained outside counsel to carry out its own internal investigation into what had occurred and those results were shared with the PCAOB. Through the Firm's internal investigation, KPMG determined that multiple independence confirmations had been misplaced and subsequently reproduced and re-executed, not on the actual date that the documents were signed but using dates when the original documents were believed to have been signed. KPMG's investigation, however, also enabled KPMG to find the original misplaced confirmations and the Firm was able to confirm their original conclusions that (i) the reproduced and re-executed confirmations were substantially the same as the originals and (ii) no independence violations had been noted in either set of documents.
6. On 9 April 2019, the PCAOB, KPMG and Mr. Henderson, agreed to a settlement resulting in the issuance of a PCAOB order titled, "Order Making Findings and Imposing Sanctions." In summary, the PCAOB found (in findings that KPMG and Mr. Henderson neither admitted nor denied) that KPMG and Mr. Henderson had violated certain PCAOB rules and standards related to the Firm's system of quality control. In particular, the PCAOB found that *"the Firm failed to maintain appropriate documentation for a sufficient period of time, and multiple Firm personnel failed to understand that it was not permissible, based on Firm policies and professional standards, to re-execute and backdate missing Independence Affidavits and to present those quality control documents to the [PCAOB's] inspectors without disclosure that the documents were not originals."* Mr. Henderson's conduct was found to have directly and substantially contributed to the failure of the Firm's system of quality control and contributed to the Firm's quality control violations. At the time he was the Managing Director of the E & I Department.
7. Sanctions, including a censure, were imposed by the PCAOB and mandatory undertakings were implemented. To KPMG's credit, policies and procedures related to the undertakings described in the PCAOB Order were substantially put in place in 2016, and the Firm on its own accord voluntarily instituted a Firm policy that reinforced and strengthened existing policies and prohibited the activity of reproducing and re-executing records such as these in its entirety. The PCAOB Order can be found on its website at pcaobus.org. KPMG has been the subject of subsequent inspections by various regulators including the PCAOB and BPAB, and no significant quality control issues have been identified.
8. The PCAOB's investigation was confidential, and KPMG notified BPAB of the forthcoming PCAOB Order shortly before its publication in April 2019. Given KPMG's status as a licensed Bermuda PIE public accountant and the issuance of the PCAOB's Order, the BPAB Compliance Committee, in accordance with its oversight responsibilities under the Act commenced an inquiry and an investigation of its own into the matter to understand what occurred in 2014 and 2015, and to

determine if the 2014 to 2015 activity of reproducing, re-executing and backdating independence confirmations without highlighting that status constituted a violation event under the Act.

9. A similar inquiry was carried out by CPA Bermuda, as KPMG and Mr. Henderson are registered members of that professional body. CPA Bermuda found that KPMG and Mr. Henderson breached Rule 201 by failing to maintain the reputation of the profession and Rule 205 by producing documents that were capable of being misleading, contrary to the Institute's Rules of Professional Conduct.

A summary of the underlying salient facts are as follows:

10. The BPAB Compliance Committee conducted an extensive investigation, resulting in the findings put forth in this notice. KPMG and Mr. Henderson cooperated with the investigation and provided disclosure of all relevant documents in their possession and produced all of the testimony that was taken by the PCAOB and their communications with CPA Bermuda. While KPMG and Mr. Henderson have indicated that they do not intend to challenge the issuance of this Violation Event Notice, they adopt the position they did before the PCAOB and do so without admitting or denying any of the findings herein.
11. During 2014 and 2015, and in accordance with KPMG's quality control and business record policies (which policies are required under the Act), KPMG required employees to complete hard-copy independence confirmations at specified intervals to assess and confirm in writing whether they have any relationships or conflicts of interest which would affect their ability to carry out audits with independence and objectivity. After the independence confirmations were executed by the employees, they were first reviewed by the Senior Manager of E & I (who is no longer with KPMG), and then by Mr. Henderson. If they were satisfied with how the employee had completed the confirmation and that the confirmation raised no independence breach, they initialed and dated the document as evidence of their review. The Administrative Assistant of E & I (who is no longer with KPMG) then kept the completed confirmations in a hard-copy binder for future reference. Additionally, E & I maintained a log of each confirmation which included the date of completion and review of each confirmation, and also maintained emails between E & I and various Firm functional areas, including the HR department, evidencing the satisfactory completion and review of the employees' confirmations.
12. In the fall of 2014, the independence confirmations of 27 KPMG employees went missing due, in part, to hurricane damage to KPMG's offices. The Administrative Assistant of E & I contacted one set of the employees, in December 2014 and another set of former employees in February 2015 whose confirmations had been misplaced and requested that they re-execute the confirmations and backdate them as of the date they had originally signed the documents. The Administrative Assistant provided each of the employees who received emails in February 2015 with the date to be inserted (obtained from E & I records). When the reproductions were returned, Mr. Henderson and the Senior Manager of E & I initialed and backdated the confirmations to reflect the approximate dates they had previously initialed and dated the misplaced originals. The dates used were consistent with the E & I log and emails referred to in paragraph 11.
13. Over the course of a ten-month period (December 2014 through September 2015) all but two of the 27 employees and former employees complied with E & I's request to reproduce, re-execute and backdate the confirmations in question. Most employees who re-executed confirmations

did so at the request and at times the persistence of the E & I Administrative Assistant. During this time management in the E&I Department did not adequately monitor her communications or her exercise of any delegated authority. Two former employees who were not responsive to the Assistant's requests were contacted by E & I management. This included a certain former employee whom Mr. Henderson in early May 2015 telephoned, which resulted in the reproduction being submitted for and during the week of the PCAOB inspection. It also included a certain employee who twice voiced discomfort with backdating a document but was encouraged by the Senior Manager of E & I to submit the document because it was needed for the May 2015 PCAOB inspection. The encouragement resulted in the production of the document. All of the returned independence confirmations were -subsequently initialed and backdated by Mr. Henderson and the Senior Manager – again to reflect the approximate dates they initialed and dated the misplaced originals. Management in the E & I Department failed to disclose to the PCAOB or to the senior management of KPMG that 27 independence confirmations went missing or how the Department had attempted to address the matter.

14. These independence confirmations were part of KPMG's quality control system designed to provide reasonable assurance that KPMG and its personnel maintain their independence under appropriate professional standards. The failure to maintain the 27 misplaced confirmations resulted in a deficiency in KPMG's system of quality control as it related to the maintenance of these documents. That deficiency was remediated in 2016 when KPMG implemented an electronic independence confirmation process to replace its prior manual process.
15. The more serious quality control issue, in the view of the BPAB Compliance Committee, was not disclosing to the inspectors that the firm had produced and secured reproductions from compliant current and former employees and maintaining in KPMG's quality control records those documents as if they were the originals. It is this aspect of the matter that has resulted in the BPAB Compliance Committee issuing this Violation Event Notice. To any regulatory inspector reviewing the adequacy of KPMG Bermuda's quality control records, the event of misplacing 27 independence confirmations would have been unobservable as the independence confirmations on file and particularly those included in the binder of documents made available to the inspectors would be taken at face value to be the originals. Since the PCAOB investigation, KPMG to their credit has supplemented existing policies with a zero-tolerance policy which prohibits what occurred in 2014/2015.
16. The provenance of a document can be and often is just as important as the contents of the document, particularly to inspectors. Inspectors have an expectation that any document placed before them is the original or a true copy of the original and that a document affixed with a date existed on the stated date and that if it is signed or initialed that the person affixed their signature or mark on or about the date indicated. Absent appropriate disclosure, conduct that runs counter to this expectation constitutes a serious violation event under the Act.
17. The investigations into this matter and the adverse findings could have been avoided had the E & I Department made it apparent on the face of each document that this document is being made on [z] date to replace a lost document that was made on or about [x] date which loss occurred on or about [y] date. Alternatively, guidance could have been sought from the regulatory authority. Either route would have allowed the regulator to assess the adequacy of any replacement document and determine whether the reason for the lost or misplaced documents was excusable (e.g. hurricane damage) or indicative of a quality control problem.

18. Although KPMG is to be commended for co-operating with the investigations and quickly addressing and prohibiting the activity of recreating or backdating documents, PIE public accountants must at all times maintain their quality control and business records in a manner that is in keeping with the professional standards set out in the Act and the Rules. KPMG's E & I Department failed in this regard. It is for this reason that the BPAB Compliance Committee now imposes upon KPMG the Requirements and Penalties set out below. In arriving at these Requirements and Penalties, the Committee has taken into account KPMG's good regulatory record, Mr. Henderson's previously unblemished professional record; their cooperation in this matter; the fact that the conduct at issue did not involve the audit process or implicate any issues of auditor independence; the fact that KPMG did not seek in any way to influence or modify the answers given by the employees in their confirmations; and the fact that four years have passed since the conduct came to light. Since that time KPMG has been the subject of routine regulatory inspections by both the PCAOB and the BPAB Compliance Committee, the results of which have been positive. The most recent inspection by BPAB was in December 2019.

Breaches

19. The BPAB Compliance Committee has determined that KPMG and Mr. Henderson's 2014/2015 conduct constituted violation events under the Act. In particular, the BPAB Compliance Committee has found that the following provisions of the Act and Rules were breached:

- (i) Section 25 (2) of the Act as read with Rules 11(4) and 11(5) of the 2015 Rules that requires all PIE public accountants to comply with a system of quality control in accordance with the pronouncements and rules on all professional matters and ethics issued by the BPAB. The Rule (which adopts the standards of CPA Canada) requires appropriate monitoring of quality controls, appropriate reporting of and responses to identified deficiencies and it prohibits the production of and reliance upon documents that are misleading or capable of misleading.
- (ii) Section 27 (1) (a) of the Act which requires a PIE public accountant to ensure that the business operations relating to the business of the PIE public accountant are managed in accordance with rules on professional conduct of CPA Bermuda with regard to the highest standards of accountability, transparency, fairness and responsibility. The CPA Bermuda Rules require its members to maintain the good reputation of the profession and they prohibit the production or use of misleading documents or documents that are capable of misleading.

Requirements and Penalties imposed on KPMG by the BPAB Compliance Committee

20. Pursuant to Rule 24 (1) (i) of the 2015 Rules, a penalty of public censure is imposed upon KPMG and Mr. Henderson. Publication of the Violation Event Notice by the Committee on the BPAB website shall serve as the notice. The Committee will send a copy of the Violation Event Notice to CPA Bermuda and to the PCAOB.

21. Pursuant to Rule 24 (1) (a) of the 2015 Rules, KPMG shall develop an educational module to be provided to all of its designated professionals (within 30 days of it being approved by the BPAB Compliance Committee) on the issues associated with reproducing, re-executing and backdating documents and the potential professional and regulatory consequences of encouraging or engaging in such conduct. Such module may be provided either separately or as part of annual or other periodic training.

22. Pursuant to Rule 24 (1) (b) of the 2015 Rules KPMG Bermuda is required to enhance their business record and quality control policies by:

- a. enhancing existing delegation policies to ensure any act of delegation that engages applicable professional rules of conduct considerations is appropriately supervised by the delegator, and the delegator supervise the delegated actions to provide reasonable assurance that any actions taken are rule compliant.
- b. ensuring that persons who are appointed or work in the E & I Department have a good grounding in the applicable Rules of the BPAB, CPA Bermuda and CPA Canada and that they use their positions to advance those rules.
- c. ensuring any internal discovery of a material deficiency in its business records is promptly reported to the head of the particular department and that person in turn reports the matter to the Chairman/CEO of the Firm with a recommendation on how the deficiency ought to be addressed. A record of the report and how it was dealt with should be maintained.

23. KPMG shall undertake:

- (i) to promptly report in writing to the BPAB Compliance Committee any allegation of improper document alterations in connection with (i) the Firm's system of quality control, (ii) any audit subject to the BPAB's jurisdiction, or (iii) any BPAB Compliance Committee inspection or investigation.
- (ii) if permitted by law, to promptly report in writing to the BPAB Compliance Committee any formal investigations or proceedings brought by any regulatory body, supervisory body or professional body against KPMG or one of its employees.

24. Pursuant to Paragraph 3(e) of the KPMG Participation Agreement, KPMG shall pay BPAB/BPAB Compliance Committee investigation costs.

25. Unless otherwise provided for, the requirements set out above shall be carried out or implemented by KPMG within 30 days of the date of this document.

Issued by the BPAB Compliance Committee this 13th day of November 2020



Peter F. Watson
Chairperson
BPAB Compliance Committee