

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 63987 / February 28, 2011

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 3248 / February 28, 2011

ADMINISTRATIVE PROCEEDING

File No. 3-14276

In the Matter of

KPMG AUSTRALIA,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C¹ and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii)² of the Commission's Rules of Practice against KPMG Australia ("Respondent" or "KPMG Australia").

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

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

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

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission’s Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds³ that:

A. OVERVIEW

This matter stems from the provision of non-audit services by KPMG Australia and certain other KPMG member firms to two audit clients of KPMG Australia, Companies A and B, both of which provided financial services in Australia and other jurisdictions and were audit clients with a class of securities registered with the Commission during the relevant period, in violation of the auditor independence requirements imposed by the Commission’s rules and by generally accepted auditing standards in the United States of America (“U.S. GAAS”), or, with respect to one financial reporting period relating to Company B, the standards of the Public Company Accounting Oversight Board (“PCAOB”). The violative services were rendered during fiscal years 2001 and 2002 in the case of Company A, and during fiscal years 2001 through 2004 in the case of Company B. Several distinct categories of non-audit services were rendered that violated Rule 2-01 of Commission Regulation S-X and therefore impaired independence. First, KPMG Australia and at least one other KPMG member firm outside Australia seconded non-tax professional staff to work at each client’s premises, under the supervision and direction of each client, doing the same types of work that each client’s own employees or managers ordinarily would perform, in violation of the prohibition under Rule 2-01(c)(4)(vi) against “[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client.” Second, KPMG Australia received trailing commissions from an acquired subsidiary of Company B in exchange for KPMG Australia’s earlier promotion of the subsidiary’s products prior to the subsidiary’s acquisition by Company B. These services violated the prohibition under Rule 2-01(c)(3) against direct business relationships with an audit client. Third, certain overseas subsidiaries of Company B retained a legal practice associated with another KPMG member firm to provide litigation services in violation of the prohibition under Rule 2-01 against acting as an advocate for an audit client.

³ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

The provision of these prohibited services came about in substantial part as a result of failures by KPMG Australia to take adequate steps both to educate its professional personnel and also to monitor compliance by such personnel with respect to the auditor independence requirements imposed by the Commission's rules and by U.S. GAAS or, with respect to the audit report on Company B's financial statements for its 2004 fiscal year, by PCAOB standards. As a result of these failures, on multiple occasions KPMG Australia failed to respond appropriately to problematic information concerning certain non-audit services to Company A and Company B that should have affected the independence determination.

Despite providing these prohibited services, KPMG Australia stated that it was "independent" in contemporaneous audit reports it issued on Company A's and Company B's financial statements, each of which was included, or incorporated by reference, in their respective public filings with the Commission throughout the relevant time period. By doing so, KPMG Australia violated Rule 2-02(b) of Commission Regulation S-X and caused its audit clients Company A and Company B to file periodic reports with the Commission that failed to include independently audited financial statements as required by Exchange Act Section 13(a), Exchange Act Rule 13a-1, and Regulation S-X.⁴

B. RESPONDENT

KPMG Australia is a partnership formed and existing under the laws of Australia which provides auditing and other professional services to a variety of companies, including companies whose securities were registered with the Commission and traded in U.S. markets. KPMG Australia is the Australian member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative.

C. RELEVANT ISSUERS

Company A is incorporated and headquartered in Australia. KPMG Australia served as the lead auditor of Company A's financial statements for its fiscal years 2001 through 2004. During this time period, Company A's American Depositary Shares and American Depositary Receipts were registered with the Commission pursuant to Exchange Act Section 12(b) and traded on the New York Stock Exchange. Company A, whose fiscal year ended September 30, filed annual reports on Form 20-F with the Commission pursuant to Exchange Act Section 13.

Company B is incorporated and headquartered in Australia. KPMG Australia served as the lead auditor of Company B's financial statements for its fiscal years 2001 through 2004. During this time period, Company B's Ordinary Shares and American Depositary Shares were registered with the Commission pursuant to Exchange Act Section 12(b) and traded on the New York Stock Exchange. Company B, whose fiscal year ended September 30, filed annual reports on Form 20-F with the Commission pursuant to Exchange Act Section 13.

⁴ This Order makes no finding with respect to Company A's or Company B's reported financial statements for any fiscal year in which the violations discussed herein occurred.

D. FACTS

1. Secondments

The term “secondment” is commonly used in Commonwealth countries and is analogous to the term “loaned staff engagements” used in the United States. KPMG Australia’s internal guidance explained that “[a] secondment is a temporary transfer of a KPMG employee (the secondee) to the business of a client,” to perform work under the supervision and direction of the client rather than of KPMG Australia. Beginning in early 2001, KPMG Australia implemented a business development drive that entailed the designation of personnel as “product champions” to promote secondments and other service products as a means of serving clients, including audit clients, and thereby generating revenue. Secondments also came to be viewed as a means of providing KPMG Australia staff with practical business experience and client exposure.

a. **KPMG Australia’s Deficient Auditor Independence Guidance On Secondments and Lack of Effective Compliance Monitoring**

KPMG Australia’s secondment practice during the relevant period was premised on the view, pervasive throughout the firm, that secondments to audit clients with a class of securities registered with the Commission (“Commission-registered audit client”) were permitted under the Commission’s auditor independence rules, provided that the secondee did not function as management by making decisions that would bind the audit client without further client oversight or ratification.

This understanding reflected domestic Australian independence standards at that time, which permitted secondments to audit clients provided the secondee would not be involved in “making management decisions”; “approving or signing agreements or other similar documents”; or “exercising discretionary authority to commit the [audit] client”; and provided the audit firm implemented safeguards by ensuring that the secondee was not given audit responsibility for any function or activity they performed during their secondment and obtaining an acknowledgment from the audit client of its responsibility for directing and supervising the activities of the secondee. Institute of Chartered Accountants in Australia, *Professional Statement F.1, Professional Independence* § 2.89.

This understanding also was reinforced by two “Risk Alerts”⁵ issued internally by KPMG Australia in March and July 2001, following that firm’s receipt of guidance issued by the Department of Professional Practice (“DPP”) at KPMG LLP, the KPMG member firm in the United States (“KPMG U.S.”), directly to KPMG Australia and of “Professional Practice Letters” (“PPLs”) issued by DPP to professionals within KPMG U.S. and made available to

⁵ A Risk Alert was a bulletin containing written guidance issued periodically by the national risk management office at KPMG Australia and distributed to professionals within the firm. The guidance in such a Risk Alert was binding on all professionals within the firm.

KPMG Australia through the firms' mutual affiliation with KPMG International.⁶ The March 2001 Risk Alert advised that the Commission's independence rules did not "stop all secondments" but only precluded "act[ing] as a member of management while on secondment." The March 2001 Risk Alert also provided a sample engagement letter and sample terms and conditions for secondments, such as limits on secondees' use of audit clients' business cards, credit cards, and motor vehicles, as well as secondees committing audit clients to expenditures. In addition, in response to general concerns expressed by the Commission's Office of the Chief Accountant about the lack of quality controls on non-audit services rendered by non-U.S. accounting firms, the July 2001 Risk Alert introduced several new policies, including vesting responsibility in lead audit engagement partners for pre-approval and other quality controls with respect to non-audit services rendered to Australian Commission-registered audit clients.

In May 2002, KPMG U.S.'s DPP issued to its professionals in the United States a three-page PPL entitled "Loaned Staff Versus Advisory Services Engagements." This PPL stated in a "Background" section on its first page:

The SEC and [American Institute of Certified Public Accountants ("AICPA")] rules on auditor independence prohibit firm personnel from acting either permanently or temporarily as an employee of the audit client. Therefore, it is important to ensure that engagements resulting from requests from clients for staff assistance be structured to avoid the appearance that the firm's staff may be acting as an employee of the client.

The PPL advised that "every effort should be made to structure . . . engagement[s] under KPMG supervision, with a defined timeline and scope of work," but that "[i]f the engagement cannot be structured as a discrete engagement, then it is considered a loaned staff engagement and stringent requirements apply." With respect to Commission-registered audit clients, the PPL specified the following restrictions: (i) loaned staff engagements were permitted only with respect to staff level personnel and not with respect to managers and above; (ii) audit engagement partners were responsible for reviewing proposals for loaned staff engagements; and (iii) loaned staff engagements were limited to four weeks for public audit clients, unless otherwise approved by KPMG U.S.'s DPP. The PPL further specified that the following restrictions had to be "clearly defined in the engagement letter": (a) the KPMG staff member could not function in a management or employee role, could not make any management decisions, and could not sign reports or letters in KPMG's name; (b) the KPMG staff member could not be listed in client directories or publications and could not use the client's name on business cards; (c) a KPMG partner had to be responsible for oversight and verification of ongoing compliance with the terms of the engagement; and (d) the loaned KPMG staff had to prepare a memorandum summarizing the engagement activity for each payroll cycle. The PPL further dictated the use of standard engagement letters and terms and conditions, as well as the inclusion in the standard work papers of "the signed engagement letter(s); . . . copies of periodic status reports; and documentation of partner oversight of engagement letter compliance (e.g. review of status reports and memorandum to work papers)."

⁶ A PPL was a bulletin containing written guidance issued from time to time by KPMG U.S.'s DPP to professionals within that firm and, on occasion, to other KPMG member firms through their mutual affiliation with KPMG International.

The May 2002 PPL was received and reviewed by KPMG Australia's national risk management office. In June 2002 that office issued another two-page Risk Alert to all KPMG Australia professional personnel. That Risk Alert repeated guidance from the first half of the May 2002 PPL that every effort should be made to structure the temporary provision of staff as engagements under KPMG supervision and the general restrictions labeled (i) to (iii) above, including the prohibition on seconding managers or above. The June 2002 Risk Alert, however, failed to expressly reference the substantive guidance set forth in the entire second half of the May 2002 PPL, including items (a) through (d) above, which the PPL required be clearly defined in the engagement letter, as well as the work paper documentation requirements introduced by the PPL. The June 2002 Risk Alert cross-referenced the earlier March 2001 Risk Alert for further guidance, including on the use of engagement letters and the terms and conditions forming part of the engagement, but these cross-referenced materials likewise did not include all the prohibitions set forth in items (a) through (d) above or impose work paper documentation requirements.

In July 2002, following issuance of the June 2002 Risk Alert, KPMG Australia held a training program for its personnel which included instruction on the Commission's independence rules. The training instruction cautioned that the "Perception/appearance" of independence was a "huge" issue in the United States, and that even arrangements, such as "secondments," which would not pose a problem under Australian GAAS, would "most likely be an issue for US GAAS." This training instruction did not repeat the substantive guidance and the documentation requirements from the May 2002 PPL that had been omitted from the June 2002 Risk Alert.

The truncated guidance was compounded by KPMG Australia's failure to adopt contemporaneous quality controls adequate to monitor independence compliance with respect to both firm guidance and the Commission's independence rules, particularly by divisions of the firm such as its Corporate Recovery Department⁷ that were not under the direct supervision of the lead audit engagement partners. As a result, KPMG Australia's partners, particularly those in such divisions, continued to arrange and extend secondments of the firm's professional personnel to Company B into 2003, although on a limited basis. More than five secondments rendered at various times from mid-2002 into 2003 violated not only the Commission's substantive independence rules but also internal firm guidance and procedures with respect to the pre-approval and duration of secondments.

b. Violative Secondments Rendered to Company A

During 2001 and the first half of 2002, KPMG Australia rendered secondments to Company A, and at least one other KPMG member firm rendered secondments to Company A's foreign operations in another country. At least 30 secondments rendered during that period violated U.S. GAAS and the Commission's auditor independence rules.

Examples of secondees seconded to act in a managerial capacity with financial reporting responsibilities, in violation of the auditor independence rules, include the following. Between November 2000 and June 2001, an assistant manager was seconded to Company A to fill in for a "Market Operations Support and Control Manager" who was out of the office on maternity

⁷ The Corporate Recovery Department separated from KPMG Australia in 2004.

leave, and in that role he managed a team of 20 to 25 Company A employees who reconciled trading information, cleared account items, and prepared monthly reports. Likewise, between May and August 2001, an accountant was seconded by another KPMG member firm to an overseas subsidiary of Company A in the role of “Acting Senior Financial Controller, Personal Financial Services,” in which capacity he hired and supervised staff, provided overall financial control for the unit, and oversaw the preparation of monthly financial reports. From March to July 2002, a KPMG Australia manager was seconded to manage the life insurance accounting team at a division of Company A where he functioned essentially as a controller of the team, including giving guidance on accounting questions to the accountants working under him who were preparing the life insurance accounts. From September 2001 to August 2002, another KPMG Australia manager was seconded to the life insurance accounting team, in which role he supervised Company A personnel and also reported to the other KPMG Australia secondee.

In March 2001, a KPMG Australia senior manager was seconded to a funds management subsidiary of Company A, in which role he was assigned the title “Acting CFO.”

In addition to the foregoing, secondments included implementing a general ledger system for Company A in 2001 and conducting loan file reviews as part of internal audit procedures that were then relied on as part of the external audit in both 2001 and 2002. Another secondment entailed preparing the financial statements for one of Company A’s foreign subsidiaries.

These and other violative secondments occurred because the Company A audit engagement team instituted inadequate safeguards and controls prior to 2002 for purposes of monitoring ongoing compliance with auditor independence rules governing the provision of non-audit services. Further, internal communications in March and April 2001 within the audit engagement team for Company A included information about the “Acting CFO” secondment noted above which, had it been properly focused on, should have caused KPMG Australia to stop that secondment from being arranged or continuing in order to avoid an impairment in appearance of the firm’s auditor independence, as required by the Commission’s rules and U.S. GAAS.

c. Violative Secondments Rendered to Company B

During the period November 2000 through October 2003, KPMG Australia rendered secondments to Company B. At least 20 secondments rendered during that period violated U.S. GAAS, and the Commission’s auditor independence rules.

During that three-year period, KPMG Australia seconded four managers and a director (a level above manager but below partner) from the firm’s Corporate Recovery Department for periods lasting from five weeks to fifteen months to perform loan file portfolio functions at Company B’s Credit Restructuring Unit (“CRU”). Each of the five secondees managed a portfolio of problematic “retention” loan files on behalf of Company B with the goal of continuing payments on the loans. If this proved impossible, the files were redesignated as “exit” files and referred to another division of the CRU. In this role, the secondees reviewed loan files; met personally with customers of Company B; appointed third-party advisers; developed and implemented strategies for recovery on the loans; and were assisted in the

foregoing by CRU analysts whose work they supervised from time to time. The secondees were given delegated credit authority, which enabled them to implement recovery strategies for loan files below a set dollar amount without obtaining prior approval from their CRU supervisors, although these decisions were subject to subsequent overview by their CRU supervisors. For purposes of communicating with customers and other third parties, the secondees used Company B titles, business cards and letterhead. In two instances loan files assigned to and worked on by these corporate recovery secondees in their capacity as “account managers” were selected for audit procedures by the KPMG Australia audit engagement team, and in one instance the provisioning for a loan file was adjusted as a result of those audit procedures.

Moreover, two of the corporate recovery secondees held supervisory positions in Company B’s CRU. In one such secondment, the secondee from KPMG Australia served with the client title “Executive, Credit Restructuring Retention” in the CRU office in Melbourne during August and September 2002, with responsibility for supervising the CRU managers who handled retention loan files. In that capacity, the secondee regularly made decisions, without regard to oversight, concerning recovery strategies for loan files that exceeded the CRU managers’ delegated credit authority.

KPMG Australia also seconded personnel from other practice areas to work for divisions and subsidiaries of Company B that were consolidated into Company B’s financial statements. For example, a KPMG Australia partner was seconded to serve as “Acting Global IT Audit Manager” at Company B between late 2000 and August 2001, and later in the same reporting period, while serving on the external audit engagement team at KPMG Australia, he reviewed internal audit documentation he himself had prepared for the purpose of scoping the substantive testing of Company B’s information technology. Between January and March 2002, a KPMG Australia senior manager was seconded to Company B to calculate an adjustment with respect to the purchase price for the sale of a unit of the financial institution.

KPMG Australia also seconded personnel from other practice areas to work on assignments for trusts and funds managed by Company B or its subsidiaries, but which were not consolidated into Company B’s financial statements. For example, between late 2000 and mid-2001, three KPMG Australia employees were seconded to a subsidiary of Company B for several months to serve as “managers” with responsibility for reviewing and approving daily pricing activities involving trusts managed by the subsidiary. Among this group, one secondee supervised a team of nine employees and another secondee was seconded specifically to fill in for employees who had resigned. Additionally, two secondees worked for a Company B subsidiary preparing *pro forma* financial statements for managed investment funds, and two secondees prepared or amended *pro forma* trust financial statements. And from late 2002 through early 2003, a manager was seconded to serve as a liaison and coordinate the flow of information and meetings between the external audit engagement team at KPMG Australia and a subsidiary of Company B in respect of KPMG Australia’s audit of trusts for which the subsidiary was the responsible entity, the accounts of which were not consolidated into Company B’s financial statements.

By late 2002 KPMG Australia had sufficient collective knowledge to be on notice of secondments to Company B that violated the Commission’s independence rules. In November

2002, there were internal communications within the firm about bringing to an end one secondment that had been ongoing since January 2002 in violation of the policies contained in the July 2002 Risk Alert. There was also information about a later secondment which, had it been properly communicated and focused on, should have caused the firm to stop that secondment from being arranged or continuing.

d. KPMG Australia's Termination of Non-Tax Secondments

On March 4, 2004, after the Commission's commencement of a formal investigation of this matter, KPMG U.S.'s DPP issued to professionals in that firm a PPL revising that firm's policy to prohibit the provision of loaned staff services to Commission-registered audit clients not involving the provision of tax services. This PPL was received and reviewed by KPMG Australia's national risk management office. On April 1, 2004, that office issued a bulletin to all KPMG Australia professional personnel prohibiting all non-tax secondments to Commission-registered audit clients.

2. Other Violative Services Rendered to Company B

a. Commission Payments

Between July 2000 and November 2005, KPMG Australia received trailing commissions from an affiliate of Company B, in return for having previously recommended the affiliate's products to its clients, prior to the affiliate's acquisition by Company B in 2000. Between 1996 and 2000, KPMG Australia had recommended the products to its clients in exchange for receiving both initial commissions and subsequently, if the product was retained by the client, trailing commissions as well. Between 2000 and 2005, KPMG Australia received over 67,000 AUD in commissions for products sold before 2000 but which continued to be held by 29 individuals and one corporate entity. In response to an anonymous inquiry received in 2005 relating to whether the payments impaired KPMG Australia's independence in relation to Company B, KPMG Australia terminated the relationship in November 2005 and returned to the Company B affiliate the total amount of commission payments received from 2000 to 2005.

b. Advocacy Services

Between March 2002 and March 2004, a legal practice that at the time was associated with a KPMG member firm other than KPMG Australia rendered litigation services to overseas subsidiaries of Company B. These legal services included representing the subsidiaries at "employment tribunals" on claims of illness, injury, stress, discrimination, and unfair or wrongful dismissal as well as representation of the subsidiaries in litigation on diverse subjects including a bounced check, the liquidation of a customer corporation, a life insurance dispute, a personal injury claim, and an unfair dismissal claim. Most of these legal services were terminated shortly after the Company B audit committee adopted, in November 2002, a policy prohibiting legal services being provided by the auditor, but the representation in both a personal injury and an unfair dismissal litigation continued up until April 1, 2004. The KPMG Australia audit engagement team noted the foregoing services and associated fees in a chart of non-audit

services and fees prepared monthly during the relevant period. The legal practice separated from the KPMG member firm on April 1, 2004.

E. LEGAL ANALYSIS

1. Independence Principles

a. Secondments

Since February 2001, Rule 2-01 of the Commission's Regulation S-X has contained three provisions relevant to KPMG Australia's secondment practice. First, Rule 2-01(b) sets forth a general standard that deems independence to be impaired whenever "a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement." Second, Preliminary Note 2 to Rule 2-01 articulates four preliminary factors to be considered "in the first instance" under the general standard, including consideration of whether "the provision of a service . . . results in the accountant acting as management or an employee of the audit client." And third, the Rule sets forth "a non-exclusive specification of circumstances inconsistent with" the general standard, including a specification under the heading "Management functions," which prohibits an accountant from "[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client." Rule 2-01(c), (c)(4)(vi). Thus, acting either as a manager or employee of an audit client is inconsistent with independence under Rule 2-01. This principle is consistent with prior enforcement proceedings, *see In the Matter of Moret Ernst & Young Accountants, n/k/a Ernst & Young Accountants*, Exch. Act Rel. No. 46130 (June 27, 2002); *In the Matter of Bernard Tarnowsky*, Exch. Act Rel. No. 34-32635 (July 15, 1993). *See also Codification of Financial Reporting Policies* § 602.02.d. As described above, KPMG Australia and another KPMG member firm rendered at least 30 secondments to Company A, and KPMG Australia rendered at least another 20 secondments to Company B, which violated this principle.⁸

b. Direct Business Relationship

At the same time, Rule 2-01 has also prohibited, as inconsistent with the general standard of independence, "any direct or material indirect business relationship with" the audit client, excepting the relationship of "a consumer in the ordinary course of business." Rule 2-01(c)(3). *See also Codification of Financial Reporting Policies* § 602.02.g; *Commission Letter dated 2/14/89, responding to 3/29/88 Petition by Arthur Andersen & Co. and Others* (available at:

⁸ As noted above, certain secondments were to Company B units whose operations were not included in Company B's consolidated financial statements and may not have been subject to audit procedures during an audit of the company's financial statements. However, Rule 2-01(c)(4)(vi) has never contained a qualification that would permit secondments of this type, even though qualifications for services where it is reasonable to conclude that the results of the services will not be subject to audit procedures during an audit of the financial statements were added to other subparagraphs of Rule 2-01(c)(4) in the amendments that took effect on May 6, 2003.

<http://www.sec.gov/info/accountants/naction/aartan1.htm>) (the “1989 Response”). This guidance prohibits any business relationship in which an auditor and an audit client: (i) “have joined together in a profit-seeking venture,” thereby creating a “unity of interest”; (ii) have, to some extent, rendered “the auditor’s interest . . . wedded to that of its client” thereby creating a situation of “interdependence”; and (iii) are working together as “coventurers” to generate “interdependent” revenues from a third party. *1989 Response*, at 4. Such relationships create an impermissible “mutuality or identity of interest” between the auditor and the audit client since “the advancement of the auditor’s interest would, to some extent, be dependent upon the client,” thereby rendering such relationships inconsistent with the essential requirement that the appearance of independence be maintained. *Id.* at 7. The Commission also has brought numerous proceedings to enforce this prohibition. *In the Matter of Ernst & Young*, Initial Decision Rel. No. 249, Admin. Proc. File No. 3-10933 (Apr. 16, 2004), *finality order*, Rel. No. 33-8413 (Apr. 26, 2004); *In the Matter of Ernst & Young LLP, et al.*, Securities Exchange Act Release No. 58309, AAER No. 2858, Admin. Proc. File No. 3-13114 (Aug. 5, 2008). Applying these principles, the trailing commission payments described above constituted a direct business relationship between KPMG Australia and its audit client Company B.

c. Acting as an Advocate

Finally, Rule 2-01 has also included among its four preliminary factors a prohibition on those services that “place[] the accountant in a position of being an advocate for the audit client.” Preliminary Note 2 to Rule 2-01. And Rule 2-01 has also prohibited legal services to the audit client, subject to certain qualifications, as inconsistent with the general standard of independence. Rule 2-01(c)(4)(ix). *See also Codification of Financial Reporting Policies* § 602.02.e.ii. As described above, the litigation services put the associated legal practice in the position of acting as an advocate of KPMG Australia’s audit client Company B.

As a result of these non-audit services, KPMG Australia violated Rule 2-01 of Regulation S-X and therefore did not maintain independence in appearance from its audit clients Company A and Company B.

2. Violation of Rule 2-02(b) of Reg. S-X and of Issuer Reporting Provisions

Because these non-audit services impaired KPMG Australia’s independence as defined by Rule 2-01 of Regulation S-X, they both constituted and caused certain statutory and regulatory violations.

Each time KPMG Australia signed an audit report for Company A or Company B where either the period covered by the audit, or the period of the audit work, or both, overlapped with the non-audit services recited above, KPMG Australia directly violated 2-02(b) of Regulation S-X. *See* Rule 2-02(b) (requiring accountant’s report to “state whether the audit was made in accordance with generally accepted auditing standards”).⁹ Issuing an audit report incorrectly

⁹ Pursuant to Commission Release 33-8422, GAAS, as used in Regulation S-X, means the standards of the PCAOB and any applicable Commission rules. Audit reports dated on or after May 24, 2004 – the effective date of PCAOB Auditing Standard 1 – were required to state they were performed in accordance with PCAOB standards; reports dated prior to May 24, 2004 were required to state that they were performed in accordance with the standards

stating that the audit was performed in accordance with U.S. GAAS or PCAOB standards, which include independence requirements, violates Rule 2-02(b). The KPMG Australia audit reports on financial statements for Company A's 2001 and 2002 fiscal years and for Company B's 2001 through 2003 fiscal years improperly stated that the audits had been performed in accordance with U.S. GAAS. The KPMG Australia audit report on Company B's financial statements for the 2004 fiscal year improperly stated that the audit had been performed in accordance with PCAOB standards.

Likewise, each time non-independent audit reports were filed with Company A's or Company B's annual reports on Form 20-F, the issuer violated federal securities statutes and rules requiring that those Commission filings include financial statements that were audited by independent accountants. *See* Exchange Act § 13(a) and Exchange Act Rule 13a-1 thereunder (requiring annual reports to include independently audited financials).¹⁰ By issuing consents for inclusion of these audit reports in Commission filings, KPMG Australia bears responsibility for causing all of these reporting violations, since it should have known that the non-audit services would cause Company A and Company B to lack independent audits and thus to violate the reporting provisions listed above.

3. Firm Responsibility

KPMG Australia as a firm bears responsibility for these violations for the additional reason that it failed to adopt adequate quality controls to educate and to monitor its personnel during the relevant period with respect to the independence requirements of U.S. GAAS or PCAOB standards and applicable Commission rules. During the relevant period, audit firms were required to educate firm personnel assigned to engagements for Commission-registered audit clients about these independence requirements. *See, e.g.,* American Institute of Certified Public Accountants, QC Section 20.09 ("Policies and procedures should be established to provide the firm with reasonable assurance that personnel maintain independence (in fact and appearance) in all required circumstances."). These same firms were required to monitor on an ongoing basis whether personnel were complying with these independence requirements. *See id.* QC Section 20.08 ("[P]olicies and procedures for the quality control element of Monitoring are established to provide the firm with reasonable assurance that the policies and procedures related to each of the other elements are suitably designed and are being effectively applied."). In this context:

Monitoring involves an ongoing consideration and evaluation of the: (a) relevance and adequacy of the firm's policies and procedures; (b) appropriateness of the firm's guidance materials and any practice aids; (c) effectiveness of professional development

of GAAS. PCAOB independence standards under Rule 3600T require auditors to be independent from their audit clients.

¹⁰ *See also* Form 20-F, Part I, Item 8.A.1 (requiring that the filing contain consolidated financial statements audited by an independent auditor and accompanied by an audit report); *id.* Part 1, Item 8.A.2. (requiring that financial statements be audited in accordance with GAAS and with Commission standards for auditor independence).

activities; and (d) compliance with the firm's policies and procedures. When monitoring, the effects of the firm's management philosophy and the environment in which the firm practices and its clients operate should be considered.

American Institute of Certified Public Accountants, QC Section 20.20.

As discussed above, KPMG Australia's national risk management office failed to provide its personnel with fulsome independence guidance with respect to secondments and also failed to adopt quality controls adequate to monitor compliance by the firm's personnel with respect to both firm guidance and the Commission's independence rules. In addition, KPMG Australia failed to adopt quality controls adequate to monitor the full range of non-audit services provided to Commission-registered audit clients not only by the firm's personnel but also by personnel at associated KPMG member firms in other countries.¹¹ As a result of these failures, on multiple occasions KPMG Australia's personnel failed to inform themselves adequately or respond appropriately to problematic information concerning non-audit services to Company A and Company B that should have affected the independence determination. *See In the Matter of KPMG Peat Marwick LLP*, Rel. No. 34-43862, 2001 SEC LEXIS 98, at *97 (Jan. 19, 2001), *reconsideration denied*, Rel. Nos. 34-44050 and AAER-1374 (Mar. 8, 2001), *petition for review denied*, 289 F.3d 109 (D.C. Cir. 2002) (firm's failure, at high levels, to inform itself about facts material to independence determination constitutes negligence).

4. Improper Professional Conduct

Rule 102(e) of the Commission's Rules of Practice and Exchange Act Section 4C both define "improper professional conduct" to include: (i) "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards" in circumstances in which the "accountant," in the case of Rule 102(e), or "registered public accounting firm or associated person," in the case of Section 4C, "knows, or should know, that heightened scrutiny is warranted"; or (ii) "[r]epeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission." The Commission has made clear that auditor independence is *always* an area requiring heightened scrutiny. *See* Adopting Release for Rule 102(e), Rel. Nos. 33-7593, 34-40567, 1998 SEC LEXIS 2256 (Oct. 19, 1998) ("Because of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny."). Here, KPMG Australia's conduct with respect to the non-audit services

¹¹ As the firm that signed the audit reports on the financial statements of Company A and Company B, KPMG Australia bore ultimate responsibility for the independence of the audit engagement. Under the Commission's Rule 2-01, the independence of the audit engagement may be compromised when non-audit services are rendered not just by the firm that leads the audit engagement but also by any associated entities in other countries. *See* Rule 2-01(f)(2) ("Accounting firm means an organization . . . that is engaged in the practice of public accounting . . . and all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States."). Moreover, Rule 2-01(c)(7) requires, effective May 6, 2003, that all non-audit services receive pre-approval from the client's audit committee, and as a matter of practice any communications between the auditor and the audit committee are typically coordinated through the firm that leads the audit engagement. Thus, Rule 2-01 implicitly contemplates that any associated entities will typically apprise the firm that leads the audit engagement of any non-audit services prior to rendering such services to the client.

rendered to Company A and Company B constituted improper professional conduct under both prongs of this definition.

IV.

Based on the foregoing, the Commission finds that Respondent KPMG Australia: (a) engaged in improper professional conduct pursuant to Exchange Act Section 4C and Rule 102(e)(1)(ii) of the Commission's Rules of Practice; (b) violated Rule 2-02(b) of Regulation S-X; and (c) caused Company A and Company B to violate Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 thereunder.

V.

Respondent has undertaken to:

1. Retain, within sixty (60) days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the staff of the Commission, to review and evaluate whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards and applicable Commission rules both to educate and to monitor its personnel with respect to the independence requirements concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. KPMG Australia shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to its own files, books, records, and personnel as reasonably requested for the review;

2. Require that the Independent Consultant issue a report, within six (6) months of being retained, summarizing the review and recommending policies and procedures reasonably designed to ensure compliance with the education and monitoring of firm personnel with respect to the independence requirements, under PCAOB standards and applicable Commission rules, concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. Simultaneously with providing that report to KPMG Australia, KPMG Australia shall require that the Independent Consultant contemporaneously transmit a copy to Nina B. Finston, Assistant Director, Division of Enforcement, U.S. Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-5631;

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

KPMG Australia and the Independent Consultant are unable to agree on an alternative proposal, KPMG Australia will abide by the determinations of the Independent Consultant;

4. Require the Independent Consultant to review and evaluate whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards both: (i) to educate its personnel, and (ii) to monitor compliance by its personnel, with respect to the independence requirements, under PCAOB standards and applicable Commission rules, concerning non-audit services to, advocacy on behalf of, and business relationships with Commission-registered audit clients. This review shall encompass whether KPMG Australia's quality controls are designed and implemented in a manner reasonably sufficient under PCAOB standards to monitor for prohibited non-audit services, advocacy, and business relationships as between KPMG member firms in other countries and Commission-registered audit clients for which KPMG Australia signs audit reports under Rule 2-02(b) of Regulation S-X. The Independent Consultant shall disclose to the staff of the Commission in the event that KPMG Australia or any of its employees, agents, consultants, joint venturers, contractors, or subcontractors, refuse to provide information necessary for the performance of the Independent Consultant's responsibilities. KPMG Australia agrees that it will not take any action to retaliate against the Independent Consultant for such disclosures;

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

6. Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Nina B. Finston, Assistant Director, Division of Enforcement at the address given above with a copy to the Office of Chief Counsel of the Enforcement Division at the same address as above but using zip code 20549-6553 no later than sixty (60) days from the date of the completion of the undertakings;

7. These undertakings shall be binding upon any acquirer or successor in interest to KPMG Australia's or substantially all of KPMG Australia's audit practice for Commission-registered audit clients; and

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

VI.

In determining to accept the Offer, the Commission considered the remedial steps taken by KPMG Australia since the time of the conduct described above, such as additional national risk management staff and resources, increased training, revised policies, and strengthened controls, as well as the cooperation by KPMG Australia and its personnel during the investigation of this matter.

VII.

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

Accordingly, it is hereby ORDERED, effective immediately, that Respondent KPMG Australia be, and hereby is, censured.

IT IS FURTHER ORDERED, effective immediately, that Respondent KPMG Australia shall cease and desist from committing any violations and any future violations of Rule 2-02 of Regulation S-X, and from causing any violations and any future violations of Section 13(a) of the Exchange Act and Exchange Act Rule 13a-1 thereunder.

IT IS FURTHER ORDERED that Respondent KPMG Australia shall, within ten (10) days of the entry of this Order, pay disgorgement of \$1,982,000 and prejudgment interest of \$760,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies KPMG Australia as a Respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Nina B. Finston, Assistant Director, Division of Enforcement, at the address given above.

IT IS FURTHER ORDERED that Respondent KPMG Australia shall comply with its undertakings enumerated in Section V above.

By the Commission.

Elizabeth M. Murphy
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), on the Respondent and its legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray
Chief Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Nina B. Finston, Esq.
Division of Enforcement
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-5631

KPMG Australia
c/o Michael P. Carroll, Esq.
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, NY 10017

Michael P. Carroll, Esq.
Davis Polk & Wardwell LLP
450 Lexington Avenue
New York, NY 10017
(Counsel for KPMG Australia)