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Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions

In the Matter of Scott Marcello, CPA,

Respondent.

PCAOB Release No. 105-2022-004

April 5, 2022

By this Order Instituting Disciplinary Proceedings, Making Findings, and Imposing Sanctions (“Order”), the Public Company Accounting Oversight Board (“Board” or PCAOB) is:

- (1) censuring Scott Marcello, CPA (“Marcello” or “Respondent”); and
- (2) imposing a civil money penalty of \$100,000 on Marcello.

The Board is imposing these sanctions on the basis of its finding that, pursuant to Section 105(c)(6) of the Sarbanes-Oxley Act of 2002, as amended (the “Act”), Marcello failed reasonably to supervise associated persons of KPMG LLP (“KPMG”) who illegally obtained and used confidential PCAOB information in violation of PCAOB rules and provisions of the securities laws related to the preparation and issuance of audit reports and the obligations and liabilities of accountants, including Securities and Exchange Commission (“Commission”) rules.

I.

The Board deems it necessary and appropriate, for the protection of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports, that disciplinary proceedings be, and hereby are, instituted pursuant to Section 105(c) of the Act and PCAOB Rule 5200(a)(2) against Respondent.

II.

In anticipation of institution of these proceedings, and pursuant to PCAOB Rule 5205, Respondent has submitted an Offer of Settlement (“Offer”) that the Board has determined to accept. Solely for purposes of these proceedings and any other proceedings brought by or on behalf of the Board, or to which the Board is a party, and without admitting or denying the findings herein, except as to the Board’s jurisdiction over Respondent and the subject matter of

these proceedings, which is admitted, Respondent consents to the entry of this Order as set forth below.¹

III.

On the basis of Respondent's Offer, the Board finds that:

A. Respondent

1. **Scott Marcello** is a certified public accountant licensed in the states of Florida (license no. AC17907 (active)), Connecticut (license no. CPAL.0010221(inactive)), and New York (license no. 087367 (inactive)). Marcello served as the Vice Chair of Audit for KPMG from July 2015 until April 2017 and, at all relevant times, was an associated person of a registered public accounting firm as that term is defined in Section 2(a)(9) of the Act and PCAOB Rule 1001(p)(i). Marcello was separated from KPMG in April 2017.

B. Summary

2. This matter concerns Marcello's failure reasonably to supervise senior members of KPMG's audit practice who unlawfully obtained and used confidential PCAOB information.² Under Marcello's supervision, several of his subordinates, including his direct report, KPMG's National Managing Partner for the Professional Practice Group, obtained confidential lists of the audits that the PCAOB would select for review during its 2016 and 2017 inspections of KPMG. Marcello's subordinates used the 2016 confidential information to enhance the audit documentation for the engagements on those lists in an attempt to improve KPMG's inspection results. The conduct of Marcello's subordinates violated PCAOB rules and securities laws related to the preparation and issuance of audit reports and the obligations and liabilities of accountants, including Commission rules.³

3. Pursuant to Section 105(c)(6) of the Act, Marcello, as a supervisory person of KPMG, failed to take sufficient and appropriate steps to reasonably supervise his subordinates with a view to preventing their misconduct.

¹ The findings herein are made pursuant to the Offer and are not binding on any other person or entity in this or any other proceeding.

² See *KPMG LLP*, SEC Exchange Act Rel. No. 86118 (June 17, 2019).

³ See, e.g., *David Britt, CPA*, SEC Exchange Act Rel. No. 92514 (July 28, 2021); *Thomas Whittle, CPA*, SEC Exchange Act Rel. No. 92513 (July 28, 2021); *David Middendorf, CPA*, SEC Exchange Act Rel. No. 87969 (Jan. 15, 2020); *Cynthia Holder, CPA*, SEC Exchange Act Rel. No. 87642 (Nov. 29, 2019); *Brian Sweet, CPA*, SEC Exchange Act Rel. No. 82557 (Jan. 22, 2018).

C. **Marcello Failed Reasonably to Supervise KPMG Personnel Who Obtained and Used PCAOB Confidential Information**

i. **Applicable Law**

4. Section 105(c)(6) of the Act provides that the Board may impose sanctions on a supervisory person of a registered public accounting firm if the Board finds that an associated person of the firm commits certain violations (hereafter, “predicate violations”) and “the firm has failed reasonably to supervise [that] associated person, either as required by the rules of the Board relating to auditing or quality control standards, or otherwise, with a view to preventing” such violations.

5. As Vice Chair of Audit, Marcello was in charge of KPMG’s audit practice and he had responsibility for implementation and monitoring of KPMG’s audit-related quality control policies and procedures. As a result, Marcello was a “supervisory person” of KPMG, as that term is used in Section 105(c)(6) of the Act. As described below, Marcello failed reasonably to supervise several KPMG associated persons who committed predicate violations.

ii. **Background: PCAOB Inspection Process and KPMG’s Inspection Results**

6. The Act directs the Board to conduct a continuing program of inspections to assess registered public accounting firms’ compliance with applicable laws, rules and professional standards during the period covered by an inspection.⁴ Board inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts its issuer and broker-dealer audits. To achieve that goal, Board inspections include an evaluation of a firm’s performance in selected audit engagements, as well as an evaluation of the design and operating effectiveness of the firm’s quality control policies and procedures. Registered firms that issue audit reports for more than 100 issuers, including KPMG, are required to be inspected by the PCAOB annually.⁵

7. To ensure the integrity of the inspection process, the Board closely guards the confidentiality of its inspection selections. Typically, the Board’s Division of Registration and Inspections (“DRI”) does not reveal those selections to the firm under inspection until after the

⁴ See Act § 101(c)(3), 15 U.S.C. § 7211(c)(3); *id.* § 104(a)(1), 7214(a)(1).

⁵ See *id.* § 104(a)(1), § 7214(b)(1)(A).

“documentation completion dates” for the audits being reviewed and shortly before beginning its inspection field work procedures.⁶

8. Between 2010 and 2014, the rate of deficiencies that the Board identified in the KPMG audits that it reviewed increased each year. More specifically, the percentage of inspected audits in which the Board found that KPMG had failed to obtain sufficient evidence to support its audit opinions (or had failed to fulfill the objectives of its role when it was assigned work by another auditor) steadily increased, from 22 percent in the 2010 inspection to 54 percent in the 2014 inspection.

9. Many of the deficiencies the Board identified during its inspections concerned KPMG’s audits of banks and, in particular, the KPMG engagement teams’ evaluation of allowances, *i.e.*, reserves, that KPMG’s banking clients had recorded for potential losses in their loan portfolios.

10. In light of this inspection history, KPMG determined to take various steps to attempt to improve its results in future PCAOB inspections. One of those steps was to recruit to the Firm personnel from DRI, including individuals who had participated in inspections of KPMG and had identified deficiencies in certain of the Firm’s audit work. In May 2015, KPMG hired Brian Sweet as a partner. Immediately prior to joining KPMG, Sweet worked in DRI. While at the PCAOB, Sweet, who had experience auditing and inspecting the audits of banks, was part of the team that inspected KPMG.

iii. Predicate Violations by KPMG’s Associated Persons

11. In July 2015, two months after Sweet joined KPMG, the Firm appointed Marcello as Vice Chair of Audit. In his role as Vice Chair, Marcello supervised KPMG’s audit practice, which included the Department of Professional Practice (“DPP”), headed by David Middendorf.

12. DPP included an Inspections group responsible for overseeing KPMG’s participation in PCAOB inspections. Thomas Whittle, who reported to Middendorf, headed this Inspections group. David Britt, another partner in KPMG’s DPP and the co-leader of the Firm’s Banking and Capital Markets group, reported to KPMG’s Chief Auditor, who, in turn, reported to Middendorf.

⁶ Under PCAOB standards, a “complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (*documentation completion date*).” AS 1215.15, *Audit Documentation*.

13. When Sweet joined KPMG, he became part of DPP's Inspections group, reporting to Whittle. After several months at the Firm, Sweet recruited Cynthia Holder, a former colleague from the PCAOB, to join him in KPMG's Inspections group.

14. Between 2015 and February 2017 (both before and after Marcello became Vice Chair of Audit), Middendorf, Whittle, Britt, Sweet, and Holder obtained and used confidential PCAOB inspection information to improve KPMG's inspection results, including for banking clients. The scheme included using an employee at the PCAOB to provide confidential lists of PCAOB inspection selections and inspection focus areas so that KPMG could target resources to those audits in advance of PCAOB inspections.

15. In March 2016, Holder obtained from a PCAOB inspector, Jeffrey Wada, a list of several KPMG issuer clients, mostly banks, whose audits the PCAOB intended to review as part of its 2016 inspection of the Firm (the "2016 Inspections List"). Holder shared the 2016 Inspection List with Sweet, who, in turn, informed Middendorf, Whittle, and Britt of it.

16. Upon receiving that confidential information, Middendorf, Whittle, and Britt instructed Sweet and others to perform examinations of the audit work papers for seven banking clients on the 2016 Inspections List outside of KPMG's normal processes. The reviews consisted of partners outside of the engagement teams re-reviewing the audit work papers of the seven banking clients after KPMG's audit reports had been issued for those clients, but before the respective documentation completion dates for the audits. The re-reviews uncovered problems with audit documentation as well as concerns about substantive audit issues, which Middendorf, Whittle, and the others attempted to have addressed in hopes of improving KPMG's inspection results.

17. In early February 2017, Holder again received from Wada a confidential list, this time the entire list, of the KPMG audits that the PCAOB intended to review as part of its 2017 inspection of the Firm (the "2017 Inspections List"). Holder shared the 2017 Inspections List with Sweet, who promptly informed Middendorf, Whittle, and Britt of it.

18. Before the confidential information from the 2017 Inspections List could be used, one of the engagement partners, who had been informed by Sweet that the PCAOB was planning to review her audit, recognized that prior knowledge that the PCAOB would inspect the audit was confidential information that KPMG should not have. The partner then contacted a supervisor, who in turn escalated the matter. Ultimately, KPMG's Office of General Counsel was informed and began an internal investigation.

19. As a result of the scheme to obtain and use confidential information for KPMG's benefit, Middendorf, Whittle, Britt, Sweet, and Holder, all violated, among other provisions, PCAOB Rule 3500T, *Interim Ethics and Independence Standards*.⁷

20. KPMG failed to adequately supervise Middendorf, Whittle, Britt, Sweet, and Holder as required by PCAOB quality control standards. Indeed, KPMG failed to implement and monitor sufficient policies and procedures to provide "reasonable assurance that . . . personnel . . . perform all professional responsibilities with integrity."⁸

iv. Marcello Failed to Reasonably Supervise

21. In his role as a supervisory person of KPMG, Marcello failed reasonably to supervise Middendorf and other subordinates with a view to preventing the predicate violations described above. Specifically, Marcello failed to take appropriate and immediate steps when he learned that KPMG had received confidential PCAOB inspection information in both 2016 and 2017. As a result, Marcello failed reasonably to supervise associated persons of KPMG under Section 105(c)(6) of the Act.

a. KPMG's Focus on Inspection Results

22. KPMG promoted Marcello to Vice Chair of Audit, in part, to improve its relationship with the PCAOB, including by reversing the trend of poor inspection results. After being appointed Vice Chair of Audit, Marcello met with the SEC and the PCAOB, both of which expressed disappointment with KPMG's inspection performance, specifically with respect to its audits of banks. Thereafter, Marcello's actions contributed to a culture in which KPMG personnel, including Marcello's subordinates, perceived that improving the Firm's inspection results took priority over improvements in overall audit quality.

b. 2016 Confidential Information

23. In March 2016, Marcello learned from Middendorf that KPMG had obtained advance information about certain PCAOB inspection selections of KPMG audits. Specifically,

⁷ See, e.g., *David Britt, CPA*, SEC Exchange Act Rel. No. 92514 (July 28, 2021) (consenting to entry of an order denying him the privilege of appearing or practicing before the Commission as an accountant); *Thomas Whittle, CPA*, SEC Exchange Act Rel. No. 92513 (July 28, 2021) (same); *David Middendorf, CPA*, SEC Rel. No. 87969 (Jan. 15, 2020) (order suspending him from appearing or practicing before the Commission); *Cynthia Holder, CPA*, SEC Exchange Act Rel. No. 87642 (Nov. 29, 2019) (consenting to entry of an order denying her the privilege of appearing or practicing before the Commission as an accountant); *Brian Sweet, CPA*, SEC Exchange Act Rel. No. 82557 (Jan. 22, 2018) (same).

⁸ See *KPMG LLP*, SEC Exchange Act Rel. No. 86118, at 13-14 (June 17, 2019) (finding that KPMG violated QC § 20.09, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice*).

Marcello understood that KPMG had obtained information about PCAOB inspection selections or potential selections through Sweet's contacts at the PCAOB, which Marcello should have recognized was inappropriate. At the time, Marcello also understood that for all of the selections, which included the Firm's audits of several banks, the documentation completion date for the final assembly of work papers had not passed.⁹ Marcello further understood that KPMG personnel intended to review the work papers for those audits and could enhance the documentation in an effort to improve inspection results.

24. Despite knowing that Middendorf and others had received advance notice of certain inspection selections and intended to review and could enhance work papers for those audits, Marcello failed to take appropriate action in response. Marcello did not report or escalate the matter, or instruct Middendorf and other subordinates to refrain from using the PCAOB's confidential information. In failing to take action in response to learning about the receipt and intended use of confidential information in 2016, Marcello missed an opportunity to change the tone at the top of the Firm, which could have helped prevent further violations.

c. 2017 Confidential Information

25. On February 7, 2017, Middendorf reported to Marcello that Sweet had obtained a list of 2017 PCAOB inspection selections. Marcello understood that the list had come from someone inside the PCAOB. Marcello, however, again failed to respond appropriately, including by failing to promptly report the receipt of that highly confidential information to anyone at KPMG or the PCAOB. Instead, over the course of a week, he and Middendorf had several conversations about the list and what to do with the information, though they agreed that no one should use the information while they decided what to do with it.

26. Marcello ultimately reported the receipt of the confidential information, but only after he learned of others' negative reaction to KPMG having the information. First, Marcello learned from Middendorf that KPMG's Chief Auditor had a very negative reaction to learning that Sweet had obtained the confidential inspection information. Second, Marcello also learned from Middendorf that a professional practice partner likewise had a very negative reaction to learning that KPMG had obtained confidential PCAOB inspection information. Finally, two partners who had learned of the issue from the professional practice partner informed Marcello of additional details concerning the situation and that they were troubled by KPMG having the list and would report the issue themselves if Marcello did not. After that meeting Marcello escalated the issue, reporting it to KPMG's in-house counsel on February 14, 2017, a week after learning of KPMG's receipt of the confidential 2017 Inspections List.

* * *

⁹ See AS 1215.15.

27. As a result of the actions and omissions described above, pursuant to Section 105(c)(6) of the Act, Marcello failed reasonably to supervise Middendorf and other subordinates, with a view to preventing the predicate violations that they committed.

IV.

In view of the foregoing, and to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports, the Board determines it appropriate to impose the sanctions agreed to in Respondent's Offer. Accordingly, it is hereby ORDERED that:

- A. Pursuant to Sections 105(c)(4)(E) and 105(c)(6) of the Act and PCAOB Rule 5300(a)(5), Marcello is censured; and
- B. Pursuant to Sections 105(c)(4)(D) and 105(c)(6) of the Act and PCAOB Rule 5300(a)(4), a civil money penalty in the amount of \$100,000 is imposed upon Marcello. All funds collected by the Board as a result of the assessment of this civil money penalty will be used in accordance with Section 109(c)(2) of the Act. Marcello shall pay the civil money penalty within 10 days of the issuance of this Order by (1) wire transfer in accordance with instructions furnished by Board staff; or (2) United States Postal Service money order, certified check, bank cashier's check, or bank money order (a) made payable to the Public Company Accounting Oversight Board; (b) delivered to the Office of Finance, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006; and (c) submitted under a cover letter which identifies Scott Marcello as the respondent in these proceedings, sets forth the title and PCAOB release number of these proceedings, and states that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to the Office of the Secretary, Attention: Phoebe W. Brown, Secretary, Public Company Accounting Oversight Board, 1666 K Street, N.W., Washington D.C. 20006.

ISSUED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

April 5, 2022