April 25, 2017

The Honorable James R. Doty
Chairman
Public Company Accounting Office Board
1666 K St. NW
Washington, DC 20006

Dear Mr. Doty:

We are writing to you to bring to your attention to questions raised by KPMG's role and findings as the independent auditor of Wells Fargo's financial statements from 2011-2015, years in which thousands of Wells Fargo staff engaged in fraudulent behavior affecting millions of accounts.

The Sarbanes-Oxley Act of 2002, passed in the wake of the Enron scandal, established the Public Company Accounting Office Board (PCAOB) "to oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports."[1] KPMG's failure to publicly identify the Wells Fargo scandal or its risk to investors raise significant questions about the conduct of both Wells Fargo and KPMG, and the PCAOB's role as overseer of public company auditors.

We wrote to KPMG on October 27, 2016, to ask for an explanation of how, in its role as independent auditor of Wells Fargo's financial statements from 2011-2015, KPMG failed to identify fraud and mismanagement that affected millions of customer accounts, cost the company billions of dollars in market capitalization, and resulted in the dismissal of over 5,000 Wells Fargo employees and the retirement of the Wells Fargo CEO.[2]

KPMG provided a response to our letter on November 28, 2016. This response explained that Wells Fargo's "misconduct ... did not implicate any key control over financial reporting and the amounts reportedly involved did not significantly impact the bank's financial statements. ... KPMG is confident that its audits and reviews of Wells Fargo's consolidated financial statements were appropriately planned and performed in accordance with applicable professional standards."[3]

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[1] Public Company Accounting Oversight Board, "About the PCAOB" (online at https://pcaobus.org/About/Pages/default.aspx).

[2] Letter to Lynn Doughtie, KPMG Chair and CEO, from Sens. Warren, Sanders, Hirono, and Markey (Oct. 27, 2016)

[3] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

This response provided us with three pieces of troubling new information regarding the Wells Fargo scandal and KPMG's role as auditor. This new information reveals that (1) KPMG, for several years prior to the CFPB and DOJ settlement, became aware of and analyzed in detail the illegal activity at Wells Fargo; (2) that the Wells Fargo Board had extensive knowledge of the wrongdoing, and that KPMG was aware that the Board had obtained this knowledge; and (3) despite the fact that a detailed investigation conducted by Wells Fargo's independent board members found that the problem was caused by the Bank's basic corporate structure and the top executives responsible for it[4], KPMG continues to stand by its conclusion that the "improper sales practices do not implicate the effectiveness of internal controls over financial reporting."

Findings and Concerns from the KPMG Response

The response indicated that KPMG, as part of its routine audit activities, became aware and analyzed in detail the illegal activity at Wells Fargo as early as 2013. According to KPMG, the auditor "interviewed the company's chief auditor ...the Corporate Investigations Unit, the company's controller's office, attorneys in the legal department, and ... outside counsel. KPMG also inspected regulatory reports, interviewed the banking regulators, and reviewed reports provided to executive management and board members."[5] The letter continues, noting that "as a result of these procedures, KPMG became aware of instances of unethical and illegal conduct by Wells Fargo employees, including incidents involving these improper sales practices."[6]

In fact, the KPMG letter indicates that the auditor scrutinized the misbehavior in detail, including reviewing the work of an additional outside consultant: "KPMG analyzed the potential impact on the financial statements of setting up unauthorized accounts...[and] concluded that the potential impact of any such errors would likely be insignificant. [KPMG's audit team] received additional support for this conclusion when an outside consultant calculated the potential financial impact of the improper sales practices."[7]

Second, the KPMG response also indicates that the Wells Fargo Board had extensive knowledge of the wrongdoing. According to KPMG, the auditor did not provide key information about the scandal to top executives at the bank because these individuals already had the information: "the bank's A&E Committee received reports describing ... the sales practices issues...the materials KPMG's auditors obtained were provided to executive management as well."[8]

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[4] Independent Directors of the Board of Wells Fargo & Company, *Sales Practices Investigation Report* (April 10, 2017) (online at https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf).

[5] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

[6] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

[7] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

[8] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

Third, the KPMG response indicates that the auditor still continues to believe that the illegal sales practices were irrelevant to their charge of identifying problems with financial reporting. According to the company, "from a financial reporting perspective, the improper sales practices did not involve key controls over financial reporting." In fact, in the conclusion to their response, KPMG stated that "the facts developed thus far with respect to the improper sales practices do not implicate the effectiveness of internal controls over financial reporting." [9]

This response from KPMG raises numerous questions. Principally, it is difficult to comprehend the KPMG conclusion that the scandal "did not involve key controls over financial reporting." In the month after the scandal broke, Wells Fargo's stock valuation declined by 12%;[10] in the first quarter after the news broke, "new credit card applications were down 43 percent in the fourth quarter of 2016 from a year ago, and ... new checking account openings fell 40 percent."[11] Wells Fargo's CEO retired shortly after news of the scandal broke, and four other senior executives at the bank were "terminated for cause."[12] And according to an independent consultant's review, "the bank stands to lose $99 billion in deposits, $4 billion in revenue and a customer base that could dwindle by up to 30 percent," because "[t]he breach of trust the scandal created has fundamentally changed the way that [Wells Fargo customers] think about ... the bank."[13]

Moreover, KPMG's conclusions about the integrity of financial reporting appear to conflict with the conclusion of a review conducted by Wells Fargo's independent board members. This review, which was released in April 2017, found that one root cause of the scandal was the Bank's basic corporate structure and the top executives responsible for it. A summary of the report noted that "the Bank's decentralized corporate structure gave too much authority and autonomy to the Community Bank's senior leadership ... Community Bank leadership resisted and impeded outside scrutiny or oversight, and when forced to report, minimized the scale and nature of the problem."[14] The review also found that "[c]orporate control functions were constrained by the decentralized organizational structure and a culture of substantial deference to the business units."[15] This was the same corporate structure that was

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[9] Letter from Lynn Doughtie, KPMG Chair and CEO, to Sens. Warren, Sanders, Hirono, and Markey (Nov. 28, 2016)

[10] Joseph N. DiStefano, "Wells Fargo, worst 2016 bank stock, 'will continue' to lose value: report," *Philadelphia Inquirer* (October 7, 2016) (online at http://www.philly.com/philly/blogs/inq-phillydeals/Wells-Fargo-worst.html); "Wells Fargo & Company Common Stock Historical Stock Prices," *NASDAQ* (April 24, 2017) (online at http://www.nasdaq.com/symbol/wfc/historical).

[11] Michael Corkery, "Wells Fargo Struggling in Aftermath of Fraud Scandal," *New York Times* (January 13, 2017) (online at https://www.nytimes.com/2017/01/13/business/dealbook/wells-fargo-earnings-report.html?_r=2).

[12] Paul Blake, "Wells Fargo publishes sales scandal findings, seizing $75 million in compensation from 2 former executives," *ABCNews* (April 10, 2017) (online at http://abcnews.go.com/Business/wells-fargo-publishes-sales-scandal-findings-seizing-75/story?id=46703038).

[13] Jeff Cox, "Wells Fargo fallout could tally $4 billion in revenue, up to 30% customer drop, study says," *CNBC* (October 24, 2016) (online at http://www.cnbc.com/2016/10/24/wells-fargo-fallout-could-tally-4-billion-dollars-in-revenue-up-to-30-percent-customer-drop-study-says.html).

[14] Independent Directors of the Board of Wells Fargo & Company, *Sales Practices Investigation Report* (April 10, 2017) (online at https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/presentations/2017/board-report.pdf).

[15] *Id.*

deemed by KPMG to have "maintained ... effective internal control over financial reporting"[16] in every year between 2011 and 2015.

We have attached a copy of the KPMG letter for your review.

Questions

KPMG, in its role as Wells Fargo's independent auditor, failed to prevent or even publicly disclose the fraud that affected hundreds of thousands of customers, and cost the company CEO his job. In response to questions about this failure, KPMG denied any wrongdoing, standing by their conclusion that Wells Fargo – during the entire time the scandal was ongoing – "maintained effective internal control over financial reporting."

The PCAOB's role is to oversee and establish rules for independent auditors like KPMG. But the Wells Fargo incident raises significant questions about whether PCAOB is doing its job effectively. Given these concerns, we ask that you provide us with the following information:

1. Has the PCAOB conducted any review of KPMG's conclusions with regard to its conclusions about Wells Fargo's financial reporting from 2011-2015? If so, what were the findings of these reviews?

2. In response to the Wells Fargo crisis, has the PCAOB established any updated rules or guidance to help auditors determine whether actions undertaken by employees of public companies result in incorrect financial reporting or undermine the integrity of financial reporting?

3. In the case of Wells Fargo, KPMG indicated that the size of the fraudulent accounts or the fines imposed by the CFPB and other regulators for the fraudulent accounts was the sole factor affecting the integrity of financial reporting. KPMG ignored factors such as the impact of the fraud on the company's stock price, the reputational harm to the firm, and the flawed corporate structure that the independent board members identified as a root cause of the scandal. Were these decisions by KPMG appropriate and consistent with PCAOB rules and guidance?

4. KPMG did not publicly report the widespread fraud, despite now acknowledging that its auditors were aware of it prior to the 2016 settlement. Do PCAOB rules or guidance indicate whether auditors have a responsibility to publicly report or otherwise act on their knowledge of illegal or inappropriate activity by their clients?

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[16] *See* the following set of sample audits for Wells Fargo from 2011-2015: 1) https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/sec-filings/2015/exhibit-13.pdf (p. 132, 263); 2) https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2014-annual-report.pdf (p. 130, 259); 3) https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2013-annual-report.pdf (p. 132, 263); 4) https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2012-annual-report.pdf (p. 120, 243); 5) https://www08.wellsfargomedia.com/assets/pdf/about/investor-relations/annual-reports/2011-annual-report.pdf (pp. 113, 231).

We ask that you provide us with written answers to these questions no later than May 15, 2017. We also ask that you or your staff provide us with a briefing on this matter and our questions relating to it no later than May 26, 2017.

Sincerely,

Elizabeth Warren
United States Senator

Edward J. Markey
United States Senator