UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
February 16, 2006

ADMINISTRATIVE PROCEEDING
File No. 3-12208

In the Matter of **KEVIN HALL, CPA, and** **ROSEMARY MEYER, CPA** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Kevin Hall, CPA ("Hall") and Rosemary Meyer, CPA ("Meyer") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice to determine whether Hall and Meyer engaged in improper professional conduct.[1]

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[1] Rule 102(e)(1) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter:
>
> ... (ii) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct; ...
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> (iv) With respect to persons licensed to practice as accountants, "improper professional conduct' under §201.102(e)(1)(ii) means: (A) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standard; or (B) Either of the following two types of negligent conduct:
>
> (1) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted.
>
> (2) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

II.

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

A. SUMMARY

1. This matter concerns two KPMG auditors who engaged in improper professional conduct in the audit and review of the financial statements of U.S. Foodservice, Inc. ("USF"), a Columbia, Maryland based foodservice and distribution company. Respondents Hall and Meyer were the engagement partner and senior manager, respectively, for the audit and review work that KPMG performed for USF. The conduct at issue concerns KPMG's audit of USF for the 1999 fiscal year and interim review for the second quarter of 2000.

2. Beginning as early as 1998, USF engaged in a scheme to overstate the operating income reported in USF's financial statements, which were audited by KPMG and included in USF's Commission filings. A significant portion of USF's operating income was based on payments by its vendors, referred to as promotional allowances ("PAs"). USF artificially inflated its operating income by recording PAs that were not earned in the period recorded, and in many cases were entirely fictitious.

3. Hall and Meyer identified the valuation, existence and completeness of promotional income and receivables as a critical audit objective requiring heightened scrutiny. In the course of the 1999 year end audit, Hall and Meyer found numerous instances where USF recognized PA income when it should not have. Nevertheless, Hall and Meyer refused to act upon – or failed to recognize – these and other "red flags" they encountered.

4. In vouching vendor PA payments received by USF in the course of the 1999 audit, Hall and Meyer discovered that USF had recognized substantial unearned "prepayments" of PA income from its vendors. The working papers show that Hall and Meyer reviewed PA contracts that contained prepayment provisions. Other working papers prepared by Hall and Meyer identified – as "audit exceptions" – specific vendor prepayments and other instances where USF improperly recognized PA income. Notations in the working paper referencing these audit exceptions, however, were subsequently covered up by liquid white-out.

5. The existence of prepayments – while evidence of USF's fraud – directly and explicitly contradicted USF management's repeated representations that USF did not obtain vendor prepayments. Despite these apparent misrepresentations by USF management, Hall and Meyer did not take the necessary additional steps to either clarify these inconsistencies or bring the problems to the attention of USF's Audit Committee or others.

6. Hall and Meyer also failed to identify as exceptions numerous other inconsistencies that they encountered during their audit testing of vendor PA payments. Hall and Meyer obtained and reviewed audit evidence that directly contradicted USF's accounting for many of the payments that they tested.

7. Also during the 1999 audit, Hall and Meyer tested USF's PA receivables balances by confirming with third party vendors that they had received selected invoices and that the amounts of these invoices had been fully earned in USF's fiscal year 1999. However, Hall and Meyer allowed almost half of all the third party confirmations to go to – and be signed by – brokers who lacked any apparent connection with the vendor to whom the underlying invoice was addressed. Thus, Hall and Meyer had no adequate basis to conclude that the brokers in question were knowledgeable of the information contained in the confirmations.

8. Hall and Meyer also violated professional standards in connection with their examination of a supply contract during KPMG's fiscal year 2000 second quarter review. Having reviewed the accounting for the contract in detail, Hall and Meyer were aware that USF had to pay substantial penalties if minimum purchase requirements were not met. Hall and Meyer also knew that USF paid $15 million in penalties during the first two quarters of fiscal year 2000 and was likely to continue incurring penalties under the contract (because its purchases were increasingly lower than targeted amounts). Despite this knowledge, Hall and Meyer allowed USF to avoid expensing these payments and failed to require USF to assess its exposure to a contingent liability under the contract.

9. Although most of the red flags were simply ignored, when Hall and Meyer did ask questions or raise issues, they improperly and repeatedly relied on management representations to confirm previous management representations, even though these statements were contradicted by objective evidence such as executed contracts and information from third parties.

10. As a result, Hall and Meyer failed to comply with Generally Accepted Auditing Standards ("GAAS") by unreasonably: (i) failing to exercise due professional care; (ii) failing to maintain an attitude of professional skepticism; (iii) failing to obtain sufficient competent evidential matter; (iv) substituting management representations for competent evidence; (v) failing to properly design and conduct audit confirmation procedures; and (vi) failing to require material adjustment to interim financial statements during their review engagement.

B. RESPONDENTS

11. Kevin M. Hall, age 51, was the KPMG engagement partner responsible for the USF audit and review engagements from at least June 1997 to April 2000. Hall became a CPA in 1977 and is licensed to practice in four states and the District of Columbia.

12. Rosemary K. Meyer, age 35, was the KPMG engagement senior manager responsible for the USF audit and review engagements from at least June 1997 to April 2000. Meyer was promoted to partner in October 2003. Meyer is a licensed CPA in Maryland.

C. RELATED PARTIES

13. KPMG LLP ("KPMG") is the U.S. member firm of KPMG International, a Swiss cooperative, and is headquartered in New York, New York. From late 1996 through April of 2000,

KPMG's Baltimore, Maryland office served as USF's independent auditors. As auditor, KPMG opined that the USF's financial statements for fiscal years 1997 through 1999 were prepared in conformity with Generally Accepted Accounting Principles ("GAAP") and that they had conducted their audits in accordance with GAAS.

14. U.S. Foodservice, Inc. is a broad-line distributor of foods headquartered in Columbia, Maryland. USF purchases goods from vendors and re-sells them to customers, such as restaurants, hotels, healthcare facilities, cafeterias, and schools. During the periods audited by KPMG, USF operated on a 52-53 week fiscal year ending on the Saturday closest to June 30. Accordingly, USF's fiscal quarters ended on the Saturday closest to the end of the calendar quarter.

15. Royal Ahold is an international food provider based in the Netherlands. Royal Ahold's American Depository Receipts ("ADRs") are traded on the New York Stock Exchange. In April 2000, Royal Ahold acquired USF, and Deloitte and Touche assumed KPMG's responsibilities as USF's independent auditor.

D. RESPONDENTS' IMPROPER PROFESSIONAL CONDUCT

Applicable Professional Standards

16. The "applicable professional standards" of care for accountants practicing before the Commission include GAAP and GAAS. GAAS consists of ten auditing standards, including three General Standards, three Standards of Fieldwork, and four Standards of Reporting. In addition to the auditing standards, GAAS prescribes various procedures used by auditors to comply with the auditing standards.

17. GAAS requires accountants to exercise reasonable diligence and due professional care while both planning and executing the audit of financial statements. In exercising professional skepticism, auditors are required to maintain a questioning mind when evaluating audit evidence. AICPA Codification of Statements on Auditing Standards, "Due Professional Care in the Performance of Work," AU § 230.07. Auditors are also not allowed to become satisfied with less than persuasive evidence because they believe that management is honest. AU § 230.09.

18. During fieldwork, an auditor must obtain sufficient competent evidential matter to provide a reasonable basis to render an audit opinion. AICPA Codification of Statements on Auditing Standards, "Evidential Matter," AU § 326. GAAS attaches significantly more value to evidence obtained from independent sources outside the entity being audited. AU § 326.21.

19. GAAS requires an auditor to obtain representations from management as part of an audit. AICPA Codification of Statements on Auditing Standards, "Management Representations," AU § 333. An auditor cannot substitute management representations for competent evidence: "During an audit, management makes many representations to the auditor, both oral and written, in response to specific inquiries or through the financial statements. Such representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333.02.

20. GAAS provides that confirmations are to be sent to people who are "knowledgeable about the information to be confirmed." AICPA Codification of Statements on Auditing Standards, "The Confirmation Process," AU § 330.26. When designing and conducting the confirmation process, "an appropriate level of professional skepticism" is required of auditors. AU § 330.15. For example: "Auditors need to consider the possibility that client personnel at various levels may participate in schemes that result in the overstatement of revenue. In some cases, customers and suppliers may be involved in such schemes as well." (AICPA Practice Alert 98-3, par. 3). The intended respondent of a confirmation request has a "direct effect on the reliability of the evidence obtained." AU § 330.16. Thus, the confirmation should be sent "to a respondent from whom the auditor can expect the response will provide meaningful and competent evidence." AU § 330.27.

21. Under GAAS, the standard for interim reviews differs from those for year-end audits. AICPA Codification of Statements on Auditing Standards, "Interim Financial Information," AU § 722. The primary objective of an interim review "is to provide the accountant, based on applying his or her knowledge of financial reporting practices to significant accounting matters of which he or she becomes aware through inquiries and analytical procedures, with a basis for reporting whether material modifications should be made for such information to conform with generally accepted accounting principles." AU § 722.09. GAAS specifically mentions "the development of other contingencies" as a potential "significant change" relevant to a review that could affect interim financial reporting. AU § 722.16. When an auditor "becomes aware of information that leads him or her to question whether the interim financial information to be reported conforms with generally accepted accounting principles, the accountant should make additional inquiries or employ other procedures he or she considers appropriate to provide the limited assurance for a review engagement." AU § 722.18.

KPMG's Audit Program for PAs

22. In a typical PA agreement, USF committed to purchase a minimum volume from a vendor. The vendor in turn paid USF a per unit rebate of a portion of the original price it charged USF, according to an agreed-upon payment schedule. USF's PA agreements with vendors frequently required the vendor to pay large up-front payments – prepayments of PAs expected to be earned over the life of the contract – well into the millions of dollars.

23. Hall and Meyer previously identified USF's accounting for PAs as a high risk audit area. During the 1998 audit, Hall and Meyer opted to add an additional representation to the 1998

management representation letters stating that all PA amounts accrued and collected were earned in fiscal year 1998.

24. During their fiscal year 1999 audit, Hall and Meyer knew that USF's dependence on PAs was rapidly growing. They knew that PAs were critical to USF's financial results – without them, USF would have operated at a loss.

25. USF recorded PA income of approximately $350 million (as an offset to cost of sales), which significantly exceeded its operating earnings of approximately $212 million as reported in its Form 10-K for the year ended July 3, 1999.

26. Hall and Meyer also knew that USF had no comprehensive, automated system for tracking the amounts owed by vendors pursuant to the PA agreements. Instead, USF appeared to employ a significant amount of manual effort and management judgment in estimating and recording PA income. USF also purportedly relied heavily on its vendors to provide it with actual purchasing information upon which USF purportedly based its PA estimates. Hall and Meyer recognized that this subjective process exposed USF to potentially material errors in income recognition and financial reporting.

27. Based on their understanding of USF's business risks and weak control environment, Hall and Meyer identified the valuation, existence and completeness of promotional income and receivables as a "critical audit objective." Hall and Meyer also recognized that PAs were "critical to the fair presentation of the Company's financial statements."

28. Hall and Meyer acknowledged that testing of PAs would require special scrutiny and, therefore, planned to perform significant testing on PA income and receivables. Hall and Meyer assumed responsibility for the detail testing themselves rather than delegating the work to more junior audit staff.

29. For KPMG's audit for fiscal year 1999, Hall and Meyer designed an audit program related to PAs that included: (1) testing vendor PA payments received in fiscal 1999 and applied to reduce fiscal 1998 and 1999 receivables; (2) testing subsequent PA payments received during early fiscal 2000 and applied to fiscal 1999 receivables; (3) recalculating selected PA income balances recorded by USF through examination of PA contracts and vendor correspondence; and (4) seeking third party confirmation from vendors of outstanding PA balances.

30. Hall and Meyer failed to exercise due professional care and violated other applicable professional standards in executing these planned audit steps.

Deficient Cash Receipts Testing of PAs

31. To evaluate the collectibility and validity of PA receivables, KPMG sought to perform extensive vouching of vendor PA payments received by USF. Vouching of cash receipts allowed KPMG to test the legitimacy of USF's purported policy of applying cash receipts to the oldest vendor invoice if the payment purpose was not specifically identified by the vendor. Finally,

vouching vendor payments allowed KPMG to determine whether vendor prepayments existed and, if so, whether they were properly deferred.

32. While vendor prepayments of anticipated PA earnings are a common practice in the foodservice industry, USF management represented to KPMG (both orally and in writing) that USF did not receive prepayments from vendors and, therefore, applied all vendor collections as immediate reductions of receivables. The representation was important because GAAP did not allow USF to apply prepayments as immediate reductions of PA receivables. Instead, GAAP required USF to record a deferred liability for the amount of the prepayment until those monies were earned.

33. As part of their testing of 1999 cash receipts, Hall and Meyer sought evidence that vendor payments received in fiscal 1999 were applied by USF against the proper 1998 or 1999 vendor receivable balances. To perform these tests, Hall and Meyer selected 50 vendor payments and reviewed copies of the vendor remittances and checks. The audit working paper evidencing the cash receipts testing performed by Hall and Meyer bears the identifier "D-31." That working paper has the explanatory note: "KPMG obtained copies of vendor remittances and check copies and vouched cash received during fiscal 1999, on a test basis. See tick mark definitions."

34. Of the 50 payments selected for testing by Hall and Meyer, the majority showed that the payments were improperly applied by USF as reductions to vendor receivable balances for the wrong fiscal year.

35. Hall and Meyer noted six audit exceptions where USF's payment allocation did not match the purpose of the payments as reflected in vendor remittance advices. The KPMG working papers highlight significant audit deficiencies with respect to the six audit exceptions identified by Hall and Meyer. A footnote contained on working paper D-31 states "[i]n certain instances, KPMG noted that vendor remittances and PGM [Product Group Manager] notes differed with respect to application. Those items are denoted by [a] **bold ***." (*emphasis in original*). As it was originally produced to the SEC, the copy of the cash receipts testing working paper D-31 does not contain any asterisks identifying the audit exceptions discovered by Hall and Meyer.

36. Obscured underneath liquid white-out, the original working paper D-31 reveals six handwritten black asterisks denoting six audit exceptions identified by Hall and Meyer. The six audit exceptions involved the following vendor payments: (1.) Sara Lee/Superior Coffee - $4,000,000; (2.) Nabisco - $1,796,203; (3.) Tyson Foods - $2,266,882; (4.) Dakota Growers Pasta - $240,000; (5.) Dakota Growers Pasta - $123,868; and (6.) CSC - $450,000.

37. Four of the six exceptions identified by Hall and Meyer (Sara Lee, Tyson Foods, Nabisco and Dakota Growers (the $240,000 payment)) were prepayments that would not be earned, in whole or in part, until fiscal year 2000 or later. Rather than recording the unearned portions of these payments as deferred liabilities, USF improperly recorded them as reductions to accounts receivable thereby falsely asserting that these payments were earned as of July 3, 1999.

38. KPMG's own working papers identify the Tyson Foods and Nabisco cash receipts as prepayments, which Hall and Meyer had been repeatedly told by USF management did not exist. Working paper D-31 documents the Tyson Foods cash receipt as "99 m/a prepay" [m/a means 'merchandizing allowance'], which is the same as the note – "99 m/a prepay" – on the remittance that was attached to the check. Likewise, the reference in working paper D-31 to the Nabisco cash receipt contains a notation, obscured by liquid white-out, "advance on USF baked good agreement." In fact, the remittance advice that accompanied the wire transfer from Nabisco states "REF: ADVANCE ON US FOODSERVICE BAKED GOOD AGREEMENT $1,196,202.71 AND CONVERSION ALLOWNCE (sic) OF $600,000." In addition, the Nabisco PA contract in effect at the time, which Hall and Meyer obtained and reviewed, contained prepayment provisions requiring Nabisco to make an advance payment to USF that was not earned until USF had satisfied certain purchase volume requirements in fiscal year 2000.

39. Upon discovering these audit exceptions, Hall and Meyer faced a potential management integrity issue given the repeated, specific and explicit representations made to KPMG that USF did not obtain prepayments from vendors. Additionally, the apparent misapplication of cash and improper reduction of old receivables brought into question the collectibility and legitimacy of previously recorded PA income.

40. With regard to the Nabisco audit exception, per Hall's and Meyer's request, USF provided them with a letter from Nabisco marked as working paper "D-31a." However, that letter should have raised even more questions. First, the amount referenced on D-31a was not the full amount that Hall and Meyer had selected for detailed testing. Second, D-31a suggested that at least some portion of the payment was on its face applicable to USF's fiscal years 1998 and 1999, yet USF improperly applied the entire payment to fiscal year 1999. Despite these obvious discrepancies, Hall and Meyer accepted D-31a as though it adequately supported USF's accounting.

41. With regard to the five other audit exceptions, Hall and Meyer discussed with USF management the "99 m/a prepay" reference and the overall discrepancy between USF's accounting treatment of the exceptions and the underlying vendor remittances. Hall and Meyer documented on working paper "D-25a" that a member of USF management had obtained oral confirmation from these vendors that the receipts were properly allocated by USF and none of them constituted prepayments for 1999. USF management thus told Hall and Meyer that the vendors' remittance advices were wrong.

42. Working paper D-25a also suggested the remaining five exceptions noted on D-31 were cleared by additional work shown at working paper "D-32."

43. D-32 has not been produced to the SEC despite being requested and subject to administrative subpoena. Hall and Meyer cannot now establish whether the document ever existed. During the investigation SEC staff requested that KPMG set forth its conclusion relating to the existence of, and reference to, the D-32 workpaper. After consultation with Hall, Meyer and others who worked on the 1999 audit, counsel for KPMG, Hall and Meyer responded in a letter to

the SEC staff that "the reference to a D-32 workpaper was errant – that is, that there was no D-32 workpaper."

44. To clear the remaining five exceptions from D-31, Hall and Meyer simply accepted USF management's explanation that the receipts were properly allocated to fiscal year 1998 or 1999 receivables and did not constitute prepayments.

45. This was not the first audit in which Hall and Meyer had discovered vendor prepayments and accepted management's explanations without any further corroboration or audit evidence. During their audit of USF's fiscal year 1998 financial statements, KPMG reviewed vendor correspondence referencing a prepayment from Sara Lee/Superior Coffee made to USF within the last week of the fiscal year. Hall and Meyer accepted USF management's explanation that the prepayment was earned in fiscal year 1998 and, therefore, no longer considered this as an audit exception. KPMG did not perform any additional audit procedures to independently determine whether the payment in fact related to fiscal year 1998 or was a prepayment for subsequent periods.

46. In addition to failing to properly resolve the exceptions and inconsistencies they did find during the 1999 audit, Hall and Meyer failed to identify, and seek resolution of, additional glaring audit exceptions that were apparent during their PA cash receipts testing.

47. Hall and Meyer relied almost exclusively on USF's purchasing managers, who supposedly had researched and identified the purpose of the payments and documented the proper application on the remittance advices. The related remittances reveal that USF personnel simply handwrote that such payments were applicable towards fiscal 1998 or 1999 invoices/receivables.

48. Hall and Meyer accepted these internal handwritten designations despite seeing vendor remittances showing that the payments related to receivable balances for a different period than allocated by USF. For example, the vendor remittance for a Basic American payment indicated that the payment was for PAs earned in fiscal year 1999 but USF applied the payment against Basic American's fiscal year 1998 receivable balance.

49. The audit failures in this area had serious adverse consequences. Given that vendors were making timely payments for fiscal 1999 PA monies, but not making payments toward older receivable balances on USF's books, Hall and Meyer should have recognized the possibility (and – as it turned out – the reality) that this and other 1998 PA receivable and income balances were inflated and not earned as recorded by USF.

50. Many other payments likewise provided inadequate information as to allocation and were payments for an altogether different purpose. In certain instances, handwritten notes by USF personnel on the check remittance show that payments from one vendor were allocated to multiple unrelated A/R balances.

51. In these and many other cases, Hall and Meyer did not denote the inconsistencies as audit exceptions warranting further follow up procedures. In all these instances, Hall and Meyer

performed procedures to test management representations; obtained evidence that management's representations were wrong; and then simply relied on additional management representations to accept the representation they were trying to test.

Inadequate Testing of Subsequent Receipts

52. In their fiscal year 1999 audit, Hall and Meyer performed "subsequent receipts testing." Hall and Meyer examined five payments received in the beginning of fiscal year 2000 to determine whether USF properly used those payments to pay down accounts receivable balances that had been recorded at the end of fiscal year 1999. The testing design was to make sure the fiscal year 2000 payments received in fact related to the fiscal year 1999 receivable balance against which those payments were applied.

53. Most of the checks that Hall and Meyer reviewed were sent from third-party purchasing agents purportedly representing multiple USF vendors and the checks did not designate the purpose of the payments or the vendors to which the payments should be applied.

54. In other instances, the checks that Hall and Meyer used to verify proper cash application did not match up, i.e., the check was from another entity or the amount differed from the amount selected for testing, yet Hall and Meyer failed to follow up.

55. Some of the checks reviewed by KPMG were for amounts significantly larger than the amount that KPMG selected for testing.

56. For example, Hall and Meyer tested a payment of $300,000 applied to a vendor named Crystal Cove. As support for the payment, USF provided KPMG with a check in the amount of $1,059,263 from Commodity Management Systems ("CMS"), a purchasing agent. Despite the absence of a remittance advice or any indication on CMS's check as to the purpose of the monies or how these monies should be applied, USF applied these monies, in part, as payment on Crystal Cove's account.

57. Internal USF notations indicate that USF broke up and applied the CMS check to three different vendor receivable accounts.

58. Hall and Meyer did not perform any additional steps to ensure that these checks had anything to do with the vendors to whose accounts they were applied, nor did they obtain any evidence demonstrating that the payments related to fiscal year 1999 activity.

59. Hall's and Meyer's testing of USF's subsequent cash receipts effectively constituted nothing more than obtaining company representations without obtaining any persuasive evidence indicating that USF properly applied these payments.

Examination of PA Contracts Containing Unearned Prepayments

60. KPMG's PA testing also involved recalculating PA income purportedly earned and recorded by USF for fiscal year 1999.

61. Hall and Meyer selected individual PA income balances for 21 vendors and sought supporting documentation for the two key components of the balances necessary to perform a recalculation: (1) the agreed-upon PA rates in effect during fiscal year 1999 and (2) the purchase volume made by USF from the respective vendor.

62. KPMG's working papers indicate that the supporting documentation obtained by Hall and Meyer for the PA rates was primarily executed PA contracts and/or vendor correspondence between USF and the respective vendor.

63. Of the 21 balances selected, Hall and Meyer documented having reviewed PA contracts for the following five vendors during this testing: (1) Nabisco; (2) Fort James/Commercial; (3) Tyson Foods; (4) Smithfield; and (5) Rich Products. Several of these contracts contained prepayment provisions, which USF had repeatedly represented to KPMG did not exist. In particular, Hall and Meyer reviewed PA contracts with Nabisco, Rich Products, and Smithfield Foods that contain specific prepayment provisions requiring the vendors to make large up-front payments of PAs expected to be earned over the life of the contract – well into the millions of dollars.

64. The Nabisco contract provided for revocable "signing bonuses" that were contingent upon USF meeting volume hurdles.

65. The Rich Products contract called for advance payments for expected volume growth that were revocable if the contracted volume growth was not achieved.

66. The Smithfield Foods contract contained a schedule of up-front payments that Smithfield was obligated to make in exchange for USF committing to purchase 200 million pounds of products over the five-year contract term. The Smithfield contract also contained a clawback provision that required USF to refund any pro-rata portion of the prepayments to the extent that the 200 million volume commitment was not achieved.

67. Not only did Hall and Meyer review the prepayment provision in the Nabisco PA contract, but in connection with their cash receipts testing, Hall and Meyer reviewed the underlying wire remittance for a prepayment made under the contract. Working paper D-31 has an explicit reference to the Nabisco prepayment with the notation, obscured by liquid white-out, "advance on USF baked good agreement."

68. Notwithstanding the clear evidence of prepayment provisions in the contracts they reviewed, Hall and Meyer documented that "no significant problems were noted" as a result of this testing.

Improperly Designing PA Accounts Receivable Confirmations

69. As part of its testing of USF's PA receivable balances, KPMG sought third-party confirmation of 35 individual PA balances (including the 30 highest dollar value items) outstanding as of July 3, 1999. KPMG's confirmation letters to vendors contained requests to confirm that individual invoices had been received by the vendor and that the amounts of these invoices had been fully earned in USF's fiscal year 1999.

70. Specifically, the confirmation letters stated: "The invoice amount(s) is(are) due to U.S. Foodservice as of July 3, 1999 for rebates and/or promotional income earned on products purchased and delivered to U.S. Foodservice prior to July 3, 1999."

71. Hall and Meyer approved sending certain confirmations to third-party purchasing agents/brokers – even when those agents/brokers were not the recipients of the selected invoices.

72. In many cases, USF and USF's vendors retained third-party brokers to assist them in negotiating product pricing with vendors, facilitating product ordering by USF and also performing the invoicing of USF for product purchases. These brokers were typically not involved in negotiating the PA contracts between USF and the vendors, nor did they typically track PA amounts earned by or owed to USF. Hence, PAs were outside of the brokers' purview as PA activity was conducted directly between USF and its vendors.

73. Of those 35 separate confirmation requests, 16 – almost half – went to three individual brokers who were retained and compensated by various vendors. Two vendors received four confirmations each, while the third received six, including one for Pillsbury Bakeries. The working paper lead sheet, which was initialed by both Hall and Meyer, shows which confirmations were signed by an entity other than the addressee (i.e., the party named on the invoice to be tested).

74. Hall and Meyer did not design or perform any substantive procedures to verify that vendor sales brokers were authorized to sign on behalf of vendors.

75. The sales brokers were not employees of USF's vendors and, therefore, may not have been knowledgeable about the information being confirmed and/or authorized to sign on behalf of vendors.

76. Hall and Meyer accepted USF's management's suggestion that KPMG confirm invoices with brokers without assessing the objectivity or knowledge of those third-party brokers to determine whether their responses would serve as meaningful and competent audit evidence. Hall and Meyer did not independently determine to whom the invoices were addressed or who paid them.

77. Hall and Meyer did not look at the actual invoices to ascertain whether the audit process was confirming the information with the party who received and paid the invoices. In fact, all of the underlying invoices were addressed to the vendors' finance or accounts payable department and not to sales personnel or third-party brokers.

78. Instead of analyzing whether confirms with these brokers satisfied the requirements of GAAS, Hall and Meyer relied upon management's representations from the prior year's audit that the signers of the confirmations were "knowledgeable." The reasons provided by USF management were that these brokers were deemed to be "reputable representatives of the related vendors" and that USF's relationship with them is at "arms-length". USF management also requested that "KPMG 'tactfully' discuss [its] concerns and findings with the Audit Committee of the Board of Directors."

79. Despite this request by USF management, Hall and Meyer did not raise this concern to a higher level and instead sent audit confirmations to these brokers without further inquiry.

80. Hall and Meyer identified the red flag and the potential adverse impact on their confirmation process. However, they relied solely on USF's representations to satisfy their concerns.

Failures Surrounding Second Quarter 2000 Review of Supply Contract

81. In approximately August 1998, USF sold various manufacturing assets to United Signature Food ("Signature") that USF had obtained from a prior acquisition. USF received consideration of approximately $101 million (cash of $85 million and a note of $16 million) from Signature in exchange for the assets. Since the assets had a book value of approximately $19 million, USF had a significant gain on the sale of the assets.

82. In connection with the sale, USF also entered into a long-term supply agreement with Signature that required USF to meet minimum, yet aggressive, purchase obligations each month. The agreement provided that substantial penalties would be incurred if these thresholds were not achieved. The contract also provided that USF could only terminate the agreement by paying significant fees to Signature.

83. During its audit for the year ended July 3, 1999, Hall and Meyer prepared an exhaustive summary of the key terms of the supply agreement, including those set forth above. Hall and Meyer also expressed their concurrence with USF's deferral of the entire gain arising from the asset sale.

84. Hall and Meyer stated in the summary memo that "[t]o the extent that payments are made in any year for failure to meet the minimum purchase targets they will be recorded as incurred." However, Hall and Meyer were aware of facts that clearly indicated that USF was not properly accounting for penalties that it had paid and would likely owe in the future.

85. As part of KPMG's quarterly review for USF's fiscal second quarter ended January 1, 2000, Hall and Meyer sought to reconcile the decrease in the balance of the deferred gain since July 3, 1999. Of the $23 million decrease during this six-month period, $15 million related to "cash payments to United Signature Foods" and that "[the] Company did not recognize income during the 2nd Qtr because of their downturn in purchasing from United Signature."

86. Hall and Meyer documented that USF's payments to Signature were due to USF "not meeting purchasing requirements" as required under the contract. Hall and Meyer were fully aware that USF was not meeting its purchase obligations under the supply agreement and that USF was contractually obligated to pay penalties to Signature if this occurred.

87. The $15 million in payments represented penalty payments. Rather than expensing the penalty payments through the income statement, USF improperly accounted for the penalty payments as reductions of the deferred gain on the sale. Although Hall and Meyer were aware of this accounting treatment, they did not assess whether it comported with GAAP.

88. USF's recording of these payments as offsets to the deferred gain violated GAAP, as basic accrual-basis accounting requires that expenses are recorded to the income statement as they are incurred. "Expenses represent actual or expected cash outflows (or the equivalent) that have occurred or will eventuate as a result of the entity's ongoing major or central operations." FASB Concepts Statement No. 6 "Elements of Financial Statements (A Replacement of FASB Concepts Statement No. 3 –Incorporating an Amendment of FASB Concepts Statement No. 2)," par. 81.

89. Additionally, accounting standards governing sale-leaseback accounting for operating leases, to which USF analogized with respect to its recognition of the deferred gain, require that a seller-lessee recognize rent payments made to a buyer-lessor as expenses. Therefore by analogy, USF (as the seller-lessee) was required to recognize penalty payments made to Signature (as the buyer-lessor) as expenses.

90. By not requiring USF to expense these payments, Hall and Meyer not only permitted non-GAAP accounting, but they also failed to employ their own previously prescribed treatment in the event that such payments were made. In the summary memo prepared in conjunction with the 1999 audit, Hall and Meyer stated that if penalties arose they would be recorded as incurred. This statement indicates that USF intended to conform to GAAP by expensing penalty payments through the income statement when incurred. As USF's purchases from Signature fell far below the minimum contractual requirements beginning in approximately July 1999, USF incurred and paid significant monthly penalties.

91. USF should have reflected these penalties as expenses on its monthly income statements and not offset them against a balance sheet liability account. Of the $15 million of penalty payments referred to in KPMG's working papers, approximately $11 million was incurred in the second quarter of USF's fiscal year 2000.

92. By improperly recording the $11 million of penalty payments as a reduction of the deferred gain recorded from the assets sale, USF overstated its pre-tax earnings by approximately 25% as reported in USF's Form 10-Q and Form 10-Q/A for the second quarter of fiscal year 2000.

93. Improperly accounting for the entire $15 million of penalty payments resulted in USF overstating its reported pre-tax earnings by approximately 18% for the six months ended January 1, 2000.

94. Despite being aware of the penalties and overall downward trend in USF's purchasing levels from Signature, Hall and Meyer also did not perform sufficient procedures to address the likelihood of USF continuing to incur shortfall penalties beyond January 1, 2000 under this obviously unfavorable contract. GAAP, specifically "*Statement of Financial Accounting Standards No. 5: Accounting for Contingencies*" ("SFAS 5"), requires the accrual of a contingent liability when a loss is probable (the future event is likely to occur) and estimable and also requires disclosure if the loss is at least reasonably possible.

95. Hall and Meyer had every indication that USF would continue to incur penalties beyond the second quarter given that: (1) USF had incurred monthly penalties during the first two quarters and (2) USF's purchases continued to fall further and further short of the contracted levels.

96. In fact, USF did continue to incur monthly penalties of approximately $2 million from January 2000 until the agreement was ultimately terminated in early 2001.

97. Given the numerous red flags that were known by Hall and Meyer during their second quarter review, they should have, at a minimum, required USF management to assess its continued exposure under this contract and determine whether a contingent liability and/or financial statement disclosure was necessary.

E. VIOLATIONS

As a result of the conduct described above, Hall and Meyer engaged in improper professional conduct as defined in Rule 102(e)(1)(ii) in that their conduct (A) constituted intentional or knowing conduct, including reckless conduct, that resulted in violation of applicable professional standards, or in the alternative, (B) constituted negligent conduct, consisting of (1) a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which Hall and Meyer knew, or should have known, that heightened scrutiny was warranted, or (2) repeated instances of unreasonable conduct by Hall and Meyer, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

III.

In view of the allegations made by the Division of Enforcement and the Office of the Chief Accountant, the Commission deems it appropriate that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations; and

B. Whether Respondents should be censured by the Commission or temporarily or permanently denied the privilege of appearing or practicing before the Commission.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served upon Respondents in accordance with the provisions of Rule 141 of the Commission's Rules of Practice, 17. C.F.R. § 201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Nancy M. Morris
Secretary